COMMONWEALTH OF PENNSYLVANIA

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October 7, 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 Reply 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,

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Attachment
cc: Honorable Dennis J. Buckley
Certificate of Service
175388.DOC

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY BRIEF OF THE OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this Reply Brief in response to the Main Brief (M.B.) of Columbia Water Company (Columbia, CWC or the Company). The OCA's Main Brief contained a comprehensive discussion of the evidence and its position on all issues, thus OCA will respond only to those matters raised by Columbia that were not previously addressed or that require clarification. Nevertheless, the OCA does not waive its opposition on contested issues because it does not repeat arguments here. Accordingly, the OCA incorporates the arguments and analysis contained in its Main Brief herein by reference.

In the Conclusion of its Main Brief, Columbia states that it has justified an increase in base revenues of $949,426. CWC M.B. at 62. It is important to clarify that the Company claimed only $773,210 in its initial filing. GDS Exh. 1 at 1-1. The Company has stated that it is not seeking revenues above the filed-for amount. CWC St. 2R at 21. The Company does reference the $773,210 figure in other places in its brief. CWC M.B. at 1, 3, App. B at 3.

Regarding the Company's rate base, Columbia has not justified recovering its PennVest-financed investment through a surcharge over the term of the loan and again in rate base for the remaining life of the plant. Regarding the Company's revenue calculation, Columbia fails to show why the income generated by costs included as operating expenses – for assisting the Borough with turn offs and turn ons, and bulk water sales – should not be included as utility income for purposes of determining revenue requirement. Regarding the Company's expense claims, Columbia also fails to demonstrate why the Public Utility Commission (PUC or Commission) should abandon case precedent when the OCA's adjustments are more appropriate under the law. Regarding rate of return, Columbia fails to show why its proposed capital structure should not reflect all of the Company's long-term debt. Further, the Company failed to show how its requested upward adjustments to its proposed cost of common equity and excessive reliance on non-DCF (Discounted Cash Flow) costing analyses is justified under the facts or law. Columbia's arguments on contested issues in its Main Brief are not persuasive. As the party with the burden of proof, Columbia must conclusively demonstrate how its claims are justified under the facts and the law.

As explained in Section IV.E.1, *infra*, in response to the Company's Main Brief, the OCA made a correction to its Salaries & Wages adjustment related to the Fire Hydrant Painter. The correction affected other schedules. Accordingly, the OCA has updated Tables I and II and Schedules 1S to 8S attached to this brief.

The OCA's final recommendation is that Columbia's existing annual revenues be decreased by $319,728. <u>See</u> OCA Tables I and II (updated).

II. RATE BASE

A. Cash Working Capital

As discussed at page 9 of the OCA's Main Brief, the Company's cash working capital claim is based on one-eighth (12.5%) of its operating and maintenance expenses (O&M). The Commission should ultimately modify the adjustment to cash working capital in accord with the total operations and maintenance adjustments adopted in this proceeding. See OCA Table II, line 17. The Company did not address this issue in its Main Brief except to revise its own cash working capital adjustment based on its revised O&M expense claim. CWC M.B. at 9.

B. PennVest Book Depreciation Reserve

In an Errata Sheet filed August 27, 2013, the Company stated that it was making a correction to its claim based on the fact that it based the PennVest surcharge on the 4% Compound Interest Depreciation Method, and book depreciation reflects this rather than straight-line depreciation. CWC St. 2R at 19-21. As discussed in the OCA's Main Brief and below, the PennVest-funded plant is not recoverable in rate base and, thus, no associated depreciation expense should be allowed. OCA M.B. at 10-21; OCA St. 1S at 42-43. For the same reason, no associated depreciation reserve should be reflected and the Company's adjustment is superfluous.

The OCA points out that if Columbia had been recovering the PennVest plant in rate base, changes in depreciation expense, accumulated depreciation and rate of return would have been recognized – including the change from compound interest to straight line depreciation methodology – in each base rate case since the PennVest plant was placed into service. OCA St. 1S at 41-43. These changes were never reflected, however. Moreover, the Company's need to make an after-the-fact correction now is further evidence showing the PennVest plant was not and should not be recognized in rate base. Tr. 142 ("That depreciation methodology change was never flowed back and reflected in the unbundled PennVest rate.")

C. PennVest Plant

The OCA's Main Brief, pages 9 to 21, contains a detailed discussion of the factual, legal, and policy reasons why the Company cannot recover its PennVest principle and interest payments through a reconcilable surcharge until the loan is retired and then recover depreciation and return over the remaining life of the plant. The OCA incorporates that discussion here and limits the following discussion to its response to certain arguments raised in the Company's Main Brief. CWC M.B. at 9-16.

Initially, the OCA corrects several confusing statements by the Company. First, no party has argued that the plant is not used and useful. CWC M.B. at 9; Tr. 177, 187. Instead, the central determination in this proceeding is whether plant can or cannot be recovered in rate base after being recovered through a reconcilable surcharge from at least 1997 to 2011. Second, the OCA agrees that the volumetric rate that was initiated in 1993 was a rate base/rate of return developed charge.[1] CWC M.B. at 9, 11; OCA St. 1S at 39-40. As stated by OCA witness Everette:

> [T]he OCA underscores that the Joint Stipulation, signed by the Company and OCA, states that the Company agrees to rate base/rate of return treatment, rather than applying a surcharge equal to the debt service on the loan. It goes on to state that the plant additions would be included in rate base, along with a return and depreciation expense and reflection of increased deferred income taxes.

OCA St. 1S at 39 (citing page 3 of the 1993 Settlement stipulation). Columbia *proposed* a principle/interest surcharge in that proceeding. Pa. P.U.C. v. Columbia Water Co., R-00932594, Corrected Order (Apr. 30, 1993) (1993 Order) (copy provided in GDS Rebuttal Exh. 1). The

[1] The Company also says this conversely, "it is hard to imagine the OCA... arguing that the PennVest rate set in 1993 was a debt-service only surcharge." CWC M.B. at 11. The OCA is not making this argument, so the Company's statement serves no purpose.

OCA opposed principle/interest surcharge recovery for Columbia and the OCA's position was adopted by the settlement. 1993 Order, App. C to Settlement at 1-2. As evidenced by the plain language of that settlement and the Company and OCA Statements in Support, the OCA and Company agreed upon rate base treatment in lieu of a principle/interest surcharge. Id., Settlement at 3, App. B at 2, App. C at 2. Significantly, there is no mention in any of these documents regarding a rate base/rate of return surcharge. Only two options were discussed: rate base/rate of return treatment or a debt-service (principle/interest) surcharge.

> 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.

Id., App. B (CWC Statement in Support).

> This lesser amount is the result of permitting the Company to recover the costs of its PennVest-financed plant additions through rate base (including the provision of a reasonable rate of return and an allowance for depreciation expense), rather than through the imposition of a debt-service based surcharge. The OCA submits that, given 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. See Pa. PUC v. Lemont Water Co., Docket No. R-912114 (June 24, 1992).

Id., App. C (OCA Statement in Support).

> 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.

1993 Order, Settlement at 3. Because the 1993 case was an abbreviated, single-issue proceeding ("the proposed increase results solely from the proposed implementation of a surcharge to recover the debt service on a loan [from PennVest]"), rate base treatment was effectuated through a volumetric charge. 1993 Order, App. C at 1-2.

The disagreement in this proceeding is what happened *after* the 1993 case. If rate base/rate of return treatment had continued, certain things should have happened in Columbia's next rate case. OCA St. 1S at 41-42. OCA witness Everette walked through the steps a utility takes to reflect recovery of PennVest-financed plant in rate base:

> [T]he 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. The evidence shows that these steps were not taken in the Company's next base rate case in 1997, or in any rate case through 2011. See OCA M.B. at 13-17. Instead, beginning in 1997, Columbia effectively began recovering the PennVest-financed plant as a principle/interest surcharge. Id.; OCA St. 1S at 39. This is demonstrated by a review of the primary features of rate base treatment compared to principle/interest surcharge recovery:

	Rate Base/Rate of Return Treatment	Typical Principle/Interest Surcharge	Columbia's Surcharge
Plant	Included in rate base	Recovered through a surcharge, excluded from rate base	According to Company filings: plant was excluded from rate base. According to CWC: plant kept in a separate, "second" rate base[2] Tr. 152-53, 163.
Recovery	Through rate base; treated the same as other plant-in-service and the recovery target takes the form of a granted rate of return	Through a surcharge on either the customer charge or volumetric rate	Through a surcharge on the volumetric rate
Basis for Annual Recovery Target	Depreciation expense and allowed return on the investment; calculated in each case as part of overall base rates	Annual principle and interest payments to PennVest	According to Commission Orders: annual principle and interest payments to PennVest. According to CWC: revenue requirement established in 1993 for PennVest plant.
Adjustments to Annual Recovery Target	Made in every base rate case to account for updates to depreciation reserve, depreciation methods, ADIT and granted rate of return	Made only if the annual principle and interest payments to PennVest are altered	Not adjusted in any case after 1993 to account for updates to depreciation reserve, depreciation methods, ADIT or granted rate of return
Reconciliations	Never reconciled, the Company is given the opportunity to earn the granted rate of return and may file for base rate increases if warranted	Reconciled when necessary to match revenues collected to PennVest obligation (principle and interest)	According to Commission orders: reconciled periodically to match revenues collected to the Company's PennVest obligation (principle and interest). According to CWC: reconciled periodically to match the 1993 revenue requirement for PennVest plant
Discontinuance of Recovery Method	When plant is fully depreciated, rates no longer reflect depreciation expense and return on that portion of rate base, just like any other plant in service	Surcharge is discontinued when PennVest loan is retired	Surcharge was discontinued when PennVest loan was retired

[2] In its rebuttal testimony, the Company stated that "the rate charge here is a rate of return, rate base, and depreciation rate as part of the Company's overall cost of service." CWC St. 2R at 8. After the OCA and I&E pointed out that the PennVest-financed plant was not included in the Company's rate base claim in filings after 1997 (OCA St. 1S at 40; I&E St. 3-SR at 3), the Company – for the first time – contended that the plant was in a separate rate base earning a different rate of return than the rest of the Company's rate base. Tr. 152-53, 163.

OCA M.B. at 10-17; Pa. P.U.C. v. Shickshinny Water Co., 67 PaPUC 3, 6, 12-13 (1988) (Shickshinny); Pa. P.U.C. v. Lemont Water Co., R-00912114, RD at 32-34, 42-43 (May 15, 1992); 52 Pa. Code § 69.363.

Thus, while the Company had Commission approval for rate base treatment in 1993, in 1997, the Company switched from rate base treatment and was benefiting from the reduced risk inherent to a reconcilable surcharge. OCA M.B. at 13-17. 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.[3] Id. at 40, 44 and App. A. Columbia's surcharge was not rate base treatment and was serving as a principle/interest surcharge.

Further, whatever the Company's belief or intent, the evidence shows the *Commission* was reconciling a principle/interest surcharge rather than approving rate base treatment. As discussed on pages 14 to 16 of the OCA's Main Brief, the Commission-approved settlement of the 1997 case tied the surcharge increase to PennVest payments, stating that the Company was "significantly under-recovering adequate revenues to repay the PennVest loan."[4] Pa. P.U.C. v. Columbia Water Co., R-00974007, RD, Joint Petition at 5 (Nov. 20, 1997) (1997 RD). In subsequent cases in 2001, 2003, 2005 and 2007, the Commission stated explicitly that surcharge

[3] The Company states that it only reconciled the surcharge because the Commission requested it, as though that lack of intent would somehow negate the fact that the surcharge was reconciled and convert its recovery to base rate treatment. CWC M.B. at 12. Even this dubious argument fails, however, because in settlement of the 1997 case, the Company committed to "true-up" its revenues and costs annually. 1997 RD at 5.

[4] That settlement also provided that revenue from the PennVest surcharge would be "excluded from base revenue" and raised the surcharge amount "separate from but concurrently with" the determination of base rates. Id.

recovery was being reconciled to the annual repayment amount and, therefore, not to a rate base/rate of return income target. Pa. P.U.C. v. Columbia Water Co., R-00016423, RD, CWC Statement in Support of Settlement at 3, ¶5 (Nov. 6, 2001); Pa. P.U.C. v. Columbia Water Co., R-00038428, Order at 1-2 (July 17, 2003); Pa. P.U.C. v. Columbia Water Co., R-00050611, Order at 1 (July 14, 2005).

Columbia argues that "[t]he Company simply wants to continue to claim the undepreciated amount of the PennVest plant in service" or, stated otherwise, it wants to continue "capital recovery and return on investment for the remaining useful and depreciable life of the assets." CWC M.B. at 14. Otherwise, it contends, that it will be denied a return on the plant. The Company fails to recognize that, first, it was given the opportunity to earn a return on its PennVest-financed investment in 1993. When the Company chose to recover the plant through a reconcilable surcharge, it made a choice to recover its investment over the life of the loan (a much faster recovery) rather than depreciation and return over the life of the plant.[5] OCA St. 1S at 43. Second, the Public Utility Code does not prescribe rate base/rate of return regulation as the only permissible means of cost recovery for PennVest loans. See OCA M.B. at 18-19 (citing Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944)). Third, there is no rate base on which to earn a return. Where a utility recovers its PennVest obligation by surcharge, the utility recovers the return of investments (depreciation) at a faster rate during the period of the loan than if the plant had been included in rate base and depreciated over its useful life. I&E St. 3-SR at 5-6. Columbia retired its PennVest debt in 2011. Columbia has no remaining "loan

[5] The OCA notes that the Company's "choice" of a recovery method is not consistent with how every other utility has recovered its PennVest-financed investment. OCA St. 1S at 40; OCA M.B. at 10-12. There is only rate base treatment or surcharge recovery, and no provision for a self-serving blend of the two.

> 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).

balance," so there is no value to include in rate base. OCA St. 1S at 39; Pa. P.U.C. v. National Util., Inc., 1994 PaPUC LEXIS 55 at *29-30 (NUI Order); Pa. P.U.C. v. National Util., Inc., R-00932828, RD at 24-28 (July 1, 1994) (NUI RD).

The remaining, related arguments raised by the Company in its brief have been addressed within the OCA's discussion of the evidence in its Main Brief, pages 9 to 21. Moreover, the same arguments sponsored by Mr. Shambaugh in this proceeding were rejected by the Presiding Officer and Commission when he raised them on behalf of NUI in 1994. See OCA M.B. at 17-20.

Consistent with the Commission's decision in NUI, Columbia's proposal to include PennVest-financed plant in its rate base at original cost less book depreciation would result in double recovery from the ratepayers. NUI Order at *29-30. Accordingly, the OCA's Table II (updated) reduces the Company's rate base claim $3,048,292, to remove the net plant in service as of 12/31/13 that was funded by PennVest loans. OCA Table II (updated), line 14. The OCA has also removed Columbia's claim for associated annual depreciation expense of $115,913. OCA Table II (updated), line 17.

It should be noted that the Company proposed rate base shown in OCA Table II (updated) reflects the amount of PennVest-funded plant prior to the Company's proposed change to depreciation reserve. Accordingly, the OCA's recommended adjustment to remove the PennVest-funded plant from rate base also does not include the Company's proposed change to depreciation reserve.

III. REVENUES

A. Merchandising Sales and Jobbing Work

As discussed on pages 23 to 26 of the OCA's Main Brief, the Company claimed $15,762 of revenue received for merchandising sales and jobbing work as non-operating revenue. OCA M.B. at 23. The OCA recommended that the $15,762 of revenue should be included as above-the-line operating revenue. OCA St.1 at 8-10; OCA St. 1S at 2-3; OCA M.B. at 23. The revenue resulted from sewer billing data, assisting with water turn-ons and turn-offs, bulk water sales, revenues for used meter sales, insurance payments for damage to a fence, and repairs to an air compressor. OCA St. 1 at 8; OCA St. 1S at 2 n.2; OCA M.B. at 23. The Company subsequently accepted I&E's adjustment to add $9,932 of revenue related to sewer billing data as operating revenue. OCA St. 1 at 8-9; OCA M.B. at 23. Consequently, the only amount of merchandising sales and jobbing work revenue at issue is the remaining $5,838.[6]

In its Main Brief, the Company argued that "the OCA's additional $5,830 to revenue for the sale of meters and insurance should be rejected." CWC M.B. at 17. In I&E's Main Brief, it indicated that $4,300 of merchandising sales and jobbing revenue was related to the sale of used meters and accepted the Company's position that meter sales should not be included as operating revenue. I&E M.B. at 28-29. Both of these statements are not correct. Only $640 of the $5,830 relates to meters and insurance items. OCA St. 1, App. B (CWC response to I&E-RE-21); OCA St. 1S at 2; OCA M.B. at 24-25. Even though Company Witness Shambaugh indicates that the revenue related to meters and insurance should be booked as depreciation reserve, the Company did not do so. OCA M.B. at 24-25. As emphasized in the OCA's Main Brief, the expenses related to these revenues were charged to operating expenses and paid for by Columbia ratepayers. Id. at 25. Thus, customers should get the benefit of the additional revenues. Id.

[6] $15,762 – $9,932 = $5,830.

Further, even if the amount of revenue related to meters and insurance was removed ($640), there would still be $5,198 of revenue that should be included. The $5,198 relates to revenues for bulk water sales and assisting Columbia Borough with turn-offs and turn-ons. OCA M.B. at 26; OCA St. 1, App. C (CWC response to I&E-RE-21). The Company argues in its Main Brief that the revenues related to non-meter and non-insurance ($5,198) should not be included as operating income because there is a lack of stability in those items. Yet, the Company has not offered any evidence to support or demonstrate this claim. CWC M.B. at 17. The Company charged the expenses associated with these revenues to the customers of Columbia Water Company and, therefore, the customers should receive the revenues. OCA M.B. at 25; OCA St. 1S at 2. The OCA's recommendation is consistent with the Commission's Order in Columbia's last rate case. Pa. P.U.C. v. Columbia Water Co., 2009 PaPUC LEXIS 1423, *27-28 (May 28, 2009) (2008 Order). For the foregoing reasons, the $15,762 of revenue the Company received for merchandising sales and jobbing work should be included as operating income. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 13.

IV. EXPENSES

A. Depreciation Expense Related to PennVest

The Company does not address this expense in its Main Brief. As discussed above, Columbia's PennVest-funded plant should not be reflected in rate base. *Supra*, Section II.C. 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 (updated). OCA Exh. AEE-1S, Sch. 1S (updated), line 12.

B. Acquisition Adjustment

The Company claimed $225,581, amortized over 15 years (an annual expense of $15,039) for acquisition adjustment for costs incurred while acquiring Marietta Gravity Water Company (MGWC). OCA M.B. at 27; OCA St. 1 at 10. In its Main Brief, the OCA argued that the Company has claimed an acquisition adjustment and recommended that the expense be rejected due to the Company's failure to satisfy Section 1327 of the Public Utility Code, which is required for a public utility to be eligible for an acquisition adjustment. OCA M.B. 27-29. The Company does not dispute in its Main Brief that it does not satisfy the requirements of Section 1327. See CWC M.B. 18-19. Instead, the Company argues that it is not requesting an acquisition adjustment (*i.e.*, making a rate base claim for the difference between the sale price and the depreciated book value) but only requesting expenses incurred to acquire new assets. CWC M.B. at 18-19. The difference between the net plant in service and the purchase price for Marietta Gravity is $570,827.[7] Under Section 1327 of the Public Utility Code, if the Company meets the requirements, then it can reflect the full purchase price in rate base and must amortize the amount over net plant in service as an addition to depreciation expense. 66 Pa. C.S. § 1327.

[7] This amount is comprised of $345,246 for the assets of MGWC in excess of the book value and $225,581 for related expenses.

Although Columbia is not claiming the rate base portion in this case,[8] it is reflecting the expense portion of the acquisition adjustment. Thus, its argument that it is not asking for an acquisition adjustment is incorrect; rather it is asking for the expense portion, but not for the rate base portion. As the OCA pointed out in its Main Brief, however, the Company cannot separate the expenses incurred to acquire MGWC assets and the cost of the assets. OCA St. 1S at 4; OCA M.B. at 30. The total acquisition cost includes all of the expenses incurred. OCA St. 1S at 4; OCA M.B. at 30. Thus, because the expenses and cost of assets cannot be separated and the Company implicitly admits that it is incapable of satisfying Section 1327, the Company's claim of $15,039 should be rejected. OCA M.B. 30.

As noted in the OCA's Main Brief (at 30-31), even if the Company's claim is not considered to be an acquisition adjustment (despite the fact that it calls it that), it still has not justified the claim for a number of reasons, including that it would not be appropriate to allocate all of the costs to Columbia Water customers, and it should have requested permission to defer these costs in order to claim an amortization in this case.

In its Main Brief, the Company argues in the alternative that the expenses related to the requirements of the Public Utility Code, totaling $120,952, should be capitalized and attempts a new calculation to argue that capitalization would cause more of an increase to revenue than the current request of $15,039. Tr. 138; CWC M.B. at 19. The Company's argument is without merit. First, to reiterate, in addition to being untimely, this position should be rejected because it is not what the Company actually did. OCA M.B. at 31. Second, the Company has not claimed an associated depreciation expense or a time period to depreciate these costs. This amount cannot stay in rate base *ad infinitum*. Moreover, if the costs related to satisfying the

[8] It has reflected the full difference between the purchase price and net book value, less legal and consulting fees in rate base for Marietta Gravity. OCA M.B. at 30; OCA St. 1S at 5.

requirements of the Public Utility Code were capitalized and put into rate base, the costs would have to satisfy Section 1327, which the Company admits it cannot do.

In addition, if the expenses are capitalized, the Company's attempted calculation of the total revenue increase is flawed. See CWC M.B. at 19. The Company opines that at its recommended rate of return (9.10%[9]), the Company would receive a total revenue increase of $17,039, which would be comprised of $11,007 of additional operating income and $6,032 of tax on that income.[10] This calculation is incorrect. For the additional income of $11,007 to result in an increase in taxes of $6,032, the tax rate would have to be 54.8%. For the foregoing reasons, the Company's claim of $15,039 representing at fifteen year amortization of $225,581 of expenses incurred while acquiring MGWC should be rejected. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 14.

C. Engineering Expense

Columbia claimed a pro forma 2013 expense of $13,500 for Engineering Contractual Services. GDS Exh. 1 at 1-15. The OCA recommends that $5,505 of that amount be removed from the Company's engineering expense. OCA M.B. at 32-33; OCA St. 1 at 10-17; OCA St. 1S at 4-5, 8. In its Main Brief, Columbia alleges that the engineering expense at issue was incurred for "ongoing monitoring of the Commission and regulatory advice in meeting Commission regulatory requirements." CWC M.B. at 20. Its witness has also testified, however, that the expense relates to "review of documents in the acquisition of the Marietta Gravity Water Company assets." CWC St. 1R at 3. As discussed in the OCA's Main Brief and above, with regard to the acquisition adjustment, consulting fees related to the acquisition should not be charged to the Columbia Division customers because *inter alia* the Company has not met the

[9] Although the Company used a 9.10% rate of return in this calculation, it claimed elsewhere that it is requesting a rate of return of 9.09%. CWC M.B. at 6, 50.
[10] The figures to which the Company refers appear nowhere in the record.

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 M.B. at 32; OCA St. 1 at 10-17; OCA St. 1S at 4-5, 8.

Again, in its Main Brief, Columbia provides examples of functions that a consultant like Mr. Weigel could or might serve that would not be related to the acquisition of Marietta. CWC M.B. at 20 (citing tr. 110-11; CWC Rejoinder Exhs. 1, 2). The problem is that the Company has never identified what portion – if any – of the specific expenses invoiced on August 5, 2012 for monitoring the Commission were unrelated to the acquisition. OCA St. 1S at 8. It is a basic ratemaking tenet that expenses must be known and measurable in order to be recoverable in rates. Pa. P.U.C. v. PPL Gas Util. Corp., 2007 PaPUC LEXIS 2, *78. Accordingly, the OCA recommends that the $5,505 (invoices for $2,325 + $3,180) expense be removed because the Company has not provided evidence showing what portion of the services invoiced on August 5, 2012 were not related to the Marietta Gravity acquisition. See OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 15; OCA St. 1S at 8.

D. Bad Debt Expense

The OCA addresses the issue of bad debt expense in its Main Brief at pages 33 to 36. The Company claimed a pro forma bad debt expense of $11,000. OCA St. 1 at 24; OCA M.B. at 33. The OCA recommended that the claimed bad debt expense be adjusted to $9,192, a four year historical average, to more accurately account for year-to-year variations in the bad debt expense. OCA M.B. at 33. The OCA supported this adjustment by citing to Commission precedent, see Pa. P.U.C. v. LP Water & Sewer, 1993 PaPUC LEXIS 149, *63 (July 14, 1993) (LP Water & Sewer), which indicates that a multi-year average is the appropriate method to compute bad debt expense. Contrary to this precedent, in its Main Brief, the Company asserts that audited numbers, not an average, should be used. CWC M.B. at 20-21. The use of an audited number is only appropriate when it represents a normal annual level of expense. OCA M.B. at 33-35. Due to the fluctuation from year-to-year, the audited number on which the Company relies does not represent a normal annual bad debt expense. Thus, the use of a four year average is an appropriate way to reflect a normalized level of bad debt expense, consistent with the Commission's holding in LP Water & Sewer. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 16; OCA M.B. at 33-36.

E. Allocation of Expenses to Marietta Division

The OCA's recommended adjustments to allocate expenses to the Marietta Division are discussed on pages 36 to 52 and 63 to 65. In its Main Brief, Columbia argues generally that Mr. Lewis has first-hand, daily knowledge of Columbia that OCA witness Everette does not have and, therefore, his allocations should be accepted instead of hers. CWC M.B. at 22-23. The Company ignores that the OCA's allocations are based on Mr. Lewis' experience. For example, with regard to salaried employees, he estimated that 15% or 6 hours per week of Columbia employees' time is spent on Marietta Division tasks. This estimate was based upon his prior experience as Superintendent for the Marietta Gravity Water Company. OCA M.B. at 36 (citing CWC response to OCA-III-17). Ms. Everette relied on this experience, rather than inadequate data, in recommending annualized allocations for other Company expenses.

1. Employee Salaries and Wages

As noted in the OCA's Main Brief, the OCA has accepted the Company's allocation for salaries of Customer Service personnel, Meter Reader, Fire Hydrant Painter and Operator. OCA M.B. at 38-39; OCA St. 1S at 17-18. Issues remain with regard to the Foreman's and Service Person's salary.

The Company allocates only 4.22% of the Foreman's salary and 2.31% of the Service Person's salary to the Marietta Division. CWC M.B. at 24; Tr. 107-08. In its Main Brief, Columbia argues that these allocations are appropriate because they are based on time spent on Marietta tasks during a three month period in 2012. CWC M.B. at 24. Ms. Everette has 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. "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. The Company provided no specific information to show that these two employees spend substantially less time on Marietta Division tasks than the 15% average estimated by Mr. Lewis even though their job descriptions include tasks in both divisions. Thus, until at least a year's worth of data is available, Ms. Everette's recommended allocations are fair and reasonable. OCA M.B. at 37-39; OCA St. 1 at 28-30; OCA St. 1S at 15-16.

Columbia's brief does not mention that the Company has claimed Salaries & Wages expense for two Service Person employees. See OCA M.B. at 39; OCA St. 1S at 16. The Company allocated one person at 2.31% and the other at 28.4%. Id. 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. For this reason, if the OCA's adjustment to the Service Person expense on line 10 of Schedule 2S (updated) is not accepted, Ms. Everette's adjustment on line 17 of Schedule 2S (updated) must also be adjusted so that her recommended revenue requirement decreases by $735. Id.

The OCA notes that, as stated on page 25 of Columbia's Main Brief, the OCA withdrew an adjustment related to the Fire Hydrant Painter but failed to remove the adjustment from its schedules. The OCA has made this change in the schedules attached to this Reply Brief. OCA Table II (updated), OCA Exh. AEE-1S, Sch. 2S (updated), line14.

The OCA's total recommended Salaries & Wages adjustment is $3,637. See OCA Table II (updated); OCA Exh. AEE-1S, Schs. 1S (updated), line 21, 2S (updated), line 26. It is also necessary to adjust Payroll Taxes to correspond to the OCA's Salaries & Wages adjustments. OCA M.B. at 39-40; OCA St. 1 at 30; OCA St. 1S at 18. The Company did not challenge the OCA's method of calculating its payroll adjustment. CWC M.B. at 25-26. These calculations are detailed on updated OCA Exh. AEE-1S, Schedule 3S, and the $108 increase is shown on line 22 of Schedule 1S (updated). OCA Table II (updated).

2. Pension and Benefits

The OCA's total Pension and Benefit adjustment of $16,141 is developed on Schedule 6S (updated).

a. Health Insurance

The OCA challenged the amount and allocation for Columbia's Health Insurance expense claim. OCA M.B. at 40-42. Specifically, OCA witness Everette pointed out that the Company only provided support for $102,881 of the Company's total health insurance expense claim of $105,963.[11] OCA St. 1 at 31 (citing CWC response to OCA-I-29). Accordingly, Ms. Everette recommended an adjustment of $3,082, which allows only the supported $102,881.

In its Main Brief, Columbia addresses only the allocation issue. CWC M.B. at 26-27. The Company's position in its Main Brief, pages 26-27, is that health insurance costs vary widely between employees and that any allocations should be based on the percentage of each person's time allocated to the Marietta Division and the actual costs of the person's benefits.[12] CWC M.B. at 26-27. As noted in the OCA's Main Brief, the OCA's recommendation does take

[11] Additionally, $102,881 was the annual health insurance cost approved at the Board of Director's meeting on July 24, 2012. Id. (citing CWC response to I&E-RE-19).
[12] Originally, Columbia proposed no allocation of Health Insurance expense. OCA St. 1 at 31 (citing CWC response to OCA-III-24). In rebuttal, the Company stated that if there were any allocation for health insurance, it should be 5.4%. CWC St. 1R at 9.

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. OCA M.B. at 41; OCA St. 1S at 20-21; OCA Exh. AEE-1S, Sch. 4S (updated). The time estimate is not speculative because it is based on the allocation percentage provided by Mr. Lewis for salaried employees. This produces a more reasonable allocation (8.41%) than Columbia's proposal to extrapolate an annualized allocation from three months of data.[13] OCA St. 1S at 19-20; OCA St. 1 at 28 (citing CWC response to OCA-III-17). The Company criticizes the OCA for not asking it to provide the specific costs of each employee's benefits in developing its allocations. CWC M.B. at 26. The OCA did, however, know which employees did and did not have health insurance and incorporated that in its allocations. OCA St. 1S at 19-20 (citing CWC response to OCA-IV-2). Ms. Everette's calculation results in an allocation to the Marietta Division of $8,648. OCA Exh. AEE-1S, Schs. 4S (updated), line 37, 6S (updated).

Accordingly, the OCA recommends that $8,648 related to Health Insurance expenses be moved to the Marietta Division. OCA Table II (updated); OCA Sch. 6S (updated), line 2.

b. Pension Expense

As with Health Insurance, the Company failed to support a portion of its claimed total Pension expense. OCA M.B. at 42-43; OCA St. 1S (citing CWC response to OCA-1-29). The OCA recommends an adjustment of $1,738 to reflect the amount that is not supported by the record. The Company does not address this adjustment in its Main Brief.

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[13] It is not clear from the Company's Main Brief and attached schedules whether the Company ultimately allocated 0% or 5.4% to the Marietta Division. Either proposal is less reasonable than the 8.41% allocation proposed by the OCA. OCA Exh. AEE-1S, Sch. 4S, line 36. As stated above, the 5.4% is extrapolated from data for hourly employees that the Company has deemed insufficient. CWC St. 1R at 9; OCA St. 1 at 31. Clearly 0% is not appropriate, given that 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. 1 at 31-32. Pensions and Benefits are part of the total cost of employees and must also be allocated to the Marietta Division for ratemaking purposes. Id.; OCA M.B. at 41.

The OCA also recommends an adjustment to Columbia's allocation of pension costs to the Marietta Division. OCA M.B. at 43; OCA St. 1 at 33. In its Main Brief, Columbia argues that its allocation is more reasonable because it is based upon the actual time spent on Marietta Division tasks and using the actual cost of employees' pension benefits. CWC M.B. at 27 (citing CWC St. 1R at 10-11). To be clear, the Company's allocation is still based on only three months of data, which the Company indicated was "insufficient" to support any "meaningful study." OCA M.B. at 43; OCA St. 1 at 28; OCA St. 1S at 14 (citing CWC Response to OCA-III-17). The OCA's recommended allocation does recognize that the cost of pensions is related to salaries or wages and is based on time spent. OCA St. 1S at 21-22; OCA Exh. AEE-1S, Sch. 5S (updated). The OCA recommends that $4,846 related to Pension expenses be allocated to the Marietta Division. OCA Table II (updated); OCA Exh. AEE-1S, Schs. 5S (updated), line 35, 6S (updated).

c. Disability and Life Insurance

As discussed in the OCA's Main Brief, the OCA recommends that the Company's $10,176 claim for Disability/Life Insurance expense be reduced by $1,029 because the invoice provided in support of the claim supports only $9,147. OCA M.B. at 43; OCA St. 1 at 34 (citing CWC response to OCA-III-26). In rebuttal, the Company claimed that it had received a renewal notice for the Disability/Life Insurance premium, which would increase the expense by $1,659 but did not provide any documentation or specify a time period for the alleged increase. CWC St. 1R at 11. Accordingly, OCA witness Everette adjusted the claim to the $9,147 amount supported by the invoice. OCA Exh. AEE-1S, Schs. 5S (updated), lines 37, 43, 6S (updated), line 4. Columbia does not address this adjustment in its Main Brief.

The Company raises the same arguments regarding the OCA's recommended allocation for Disability and Life Insurance – that the adjustment is based on speculation about the time spent by each employee on Marietta Division tasks. CWC M.B. at 26-28. Again, the Company's allocation is based on only three months of data. OCA M.B. at 44; OCA St. 1 at 28; OCA St. 1S at 14 (citing CWC Response to OCA-III-17). The OCA's method of calculating the allocation recognizes that the cost of disability and life insurance benefits is related to salaries or wages and is based on time spent. OCA St. 1S at 21-22; OCA Exh. AEE-1S, Sch. 5S (updated).

The OCA's proposed allocation is fair and reasonable. The OCA recommends that $765 related to Disability and Life Insurance expenses be moved to the Marietta Division. OCA Table II (updated); OCA Exh. AEE-1S, Schs. 5S (updated), line 44, 6S (updated), line 4.

d. Employee Recognition

The OCA provides a thorough discussion of the reasons why the Company's Pension and Benefits expense should be adjusted to remove $6,051 in expenses related to a "Hershey Park Outing" and the Employee/Officers Year End Banquet. OCA M.B. at 44-46; OCA St. 1 at 35 (citing CWC response to OCA-1-29). The principle question is whether the expense is "necessary" for the Company to attract and retain skilled employees or otherwise 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); Pa. P.U.C. v. Citizens Utilities Water Co. of Pa., 169 PUR4th 552, 584-85 (1996). In Columbia's last rate case, the Company made similar arguments with regard to a Hershey Park outing and a Christmas party. Pa. P.U.C. v. Columbia Water Co., R-2008-2045157, RD at 23-25 (Mar. 20, 2009) (2008 RD). Consistent with these prior Commission Orders, the ALJ removed the expense from the Company's claim. Id.

In its Main Brief, the Company argues that even though Columbia provides regular pay increases and requires no employee contribution to health insurance, the Hershey Park tickets are necessary to retain and compensate employees. CWC M.B. at 28; see OCA M.B. at 45-46. As noted in the OCA's Main Brief, however, the tickets are explicitly not for employee recognition

– all employees receive them, regardless of performance, and they can be used anytime. OCA M.B. at 45-46; Tr. 112. There is no direct relation between the tickets and the provision of utility service. Consistent with the Commission's decision in Columbia's last base rate case and in the other cases cited above, the $2,779 expense for Hershey Park tickets must be denied. 2008 RD at 26. Nothing prevents 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.

Although the Commission has allowed utilities to recover costs related to "employee recognition" dinners, 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 M.B. at 29; OCA M.B. at 44-46. The portion of Columbia's claimed Employee Recognition expense related to the dinner is $3,271.79. OCA St. 1, App. B. (CWC response to OCA-I-29).

If any part of the claim is allowed, 8.49% of the expense should be allocated to the Marietta Division. OCA St. 1S at 23; OCA Exh. AEE-1S, Sch. 2S (updated), line 31. This percentage reflects Ms. Everette's updated allocation of Columbia salaries to the Marietta Division as shown in the schedules attached to this brief.

For the reasons set forth here and in the OCA's Main Brief, the OCA made a negative adjustment of $6,051 to the Company's claim of employee benefits that relate to Hershey Park tickets and a dinner. Table II (updated); OCA Exh. AEE-1S, Sch. 6S (updated), line 5; OCA M.B. at 44-46; OCA St. 1 at 35-36; OCA St. 1S at 22-23.

3. Vehicle Insurance

The Company claimed a vehicle insurance expense of $6,900. OCA St. 1 at 37-38; OCA St. 1S at 23-25; OCA M.B. at 46. The OCA addressed the issue of the Company's claimed vehicle insurance expense on pages 46 to 48 of its Main Brief.[14] The OCA recommended that a portion of the claimed expense be allocated to the Marietta Division because Columbia vehicles were used to perform work for the Marietta Division. OCA M.B. at 46. In its Main Brief, the Company argues that none of the vehicle insurance expense should be allocated to the Marietta Division because employees that do work for the Marietta Division do not use Columbia vehicles.

Despite the Company's argument in its Main Brief to the contrary, this position is inconsistent with earlier statements made by the Company. See OCA M.B. at 46-47. In response to OCA-III-48, the Company indicated that "other vehicles on the policy are used by workers when doing work for the Marietta Division," and when it had more data, "[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; OCA M.B. at 47. It is inherently inconsistent to indicate that Columbia vehicles were used to perform work for Marietta and that part of the vehicle insurance expense would be allocated to the Marietta Division when more data became available and then not allocate any vehicle insurance expense to Marietta by claiming that the work done for the Marietta Division is performed by workers that do not use a vehicle. Thus, based on the Company's own statements in response to OCA-III-48, it is appropriate to allocate vehicle insurance expense to the Marietta Division. OCA M.B. at 47.

The Company also claims the vehicle insurance expense is increasing and requests to adjust the vehicle insurance expense upward by $837. CWC M.B. at 30. The OCA argued that

[14] The OCA notes that its recommended allocation percentage has decreased from the 8.54% referenced in its Main Brief to 8.49% in its updated schedules. OCA Exh. AEE-1S (updated), Sch. 2S (updated), line 31. Accordingly, the updated adjustment to the Company's claimed vehicle insurance expense is $586. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 24.

such an increase should not be permitted because it does not fall within the future Test Year, or in the alternative, a portion of the increase should also be allocated to the Marietta Division. OCA M.B. at 48. In its Main Brief, the Company stated that the increase should be allowed because it is known and measurable and "it doubts OCA would ask the Commission to ignore the notice if it was a decrease in insurance rates." CWC M.B. at 30. The purpose of the test year concept, however, is to capture all revenues and all expenses and match them at a point in time. While some expenses may go up and others may go down, increases or decreases are not added at the last minute. Based on the foregoing, 8.49%, or $586, of the Company's vehicle insurance expense should be allocated to the Marietta Division, and the Company's request to increase the vehicle insurance expense should be denied. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 24; OCA M.B. 46-48.

4. Worker's Compensation Insurance

The Company claimed a worker's compensation insurance expense of $24,500. OCA St.1 at 38; OCA St. 1S at 25-26; OCA M.B. at 48. The OCA recommends that 11.95%[15] (or $2,927) of the worker's compensation insurance expense should be allocated to the Marietta Division. OCA M.B. at 48-49; OCA Exh. AEE-1S, Sch. 7S (updated), line 3; OCA St. 1 at 38-41; OCA St. 1S at 25-26. The OCA argued that the Marietta Division has three employees that work solely for Marietta, but the Marietta Division does not carry its own worker's compensation insurance. OCA M.B. at 48-49. Consequently, assuming that the Company has complied with the requirement that it provide worker's compensation insurance, the expense claimed by the Company must include the expense for insuring the employees that work solely

[15] This number has been updated to be consistent with updates to the OCA's recommended adjustment to Salaries & Wages expense. <u>See</u> Section IV.E.1, *supra*; OCA Exh. AEE-1S, Schs. 1S (updated), line 25, Sch. 7S (updated).

for the Marietta Division. Id. The Company does not address this issue or provide any explanation in its Main Brief.

Further, after the Company initially proposed allocating none of the worker's compensation expense to the Marietta Division, including the amount for Marietta-only employees, the Company created a new argument that only 3.8% of the expense should be allocated to the Marietta Division "based upon the actual hours worked on Marietta Division tasks. CWC M.B. at 31. The Company has the burden of proof to establish that 3.8% is the proper allocation but has provided no evidence or data to support this allocation, only a conclusory statement by Company Witness Lewis that worker's compensation should be allocated accordingly. See CWC St. 1R at 9.

Similar to the vehicle insurance expense, the Company has also requested the worker's compensation expense be increased by $2,752 after receiving a letter from its insurance provider indicating that the Company's premiums are expected to increase. OCA St. 1S at 26; OCA M.B. at 50. Just as with the vehicle insurance, the increase does not fall within the Test Year and last minute estimated increases should not be permitted because the purpose of the test year concept is to capture all revenues and all expenses and match them at a point in time. For the foregoing reasons, 11.95% of the Company's worker's compensation insurance expense should be allocated to the Marietta Division, and the Company's request to increase the expense should be denied. OCA Table II (updated); OCA Exh. AEE-1S, Schs. 1S (updated), line 25, 7S; OCA M.B. at 48-50.

5. Management Fees

The Company claimed an expense of $26,063 for management fees, a portion of which were related to banking services provided by Wells Fargo Bank for check and credit card processing. OCA St. 1 at 43; OCA St. 1S at 29; OCA M.B. at 52. As discussed in the OCA's

Main Brief on page 52, the OCA initially proposed to allocate twelve percent of the management fees to the Marietta Division. However, after clarification from Company Witness Lewis that the Company only claimed management fees associated with the Columbia Division, the OCA withdrew its recommended adjustment. OCA M.B. at 52. The Company did not address management fees in its Main Brief, and the OCA merely reiterates that it has withdrawn its recommended adjustment. OCA M.B. at 52.

6. Accounting

The OCA's adjustment relating to the allocation of the Company's Accounting expense is addressed in detail on pages 50 to 52 of the OCA Main Brief. The OCA will only address here the issues raised in Columbia's Main Brief that require additional clarification. First, Columbia argues that because the Columbia and Marietta divisions will keep separate books for purposes of auditing and preparing one consolidated tax return that there is no reason to allocate any costs with Marietta.[16] CWC M.B. at 32. The Company has 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 expense for the joint filings will benefit the Marietta customers but will be borne exclusively by Columbia ratepayers. OCA St. 1S at 27; OCA St. 1 at 42. It should, therefore, be allocated to the Marietta division.

Second, Columbia argues that its accounting costs will go up as a result of the merger. CWC M.B. at 32. Ms. Everette did not allocate the Company's total accounting costs, however; she only allocated the $19,700 related to joint tax preparation and the audit. OCA M.B. at 50-52; OCA St. 1S at 27; OCA St. 1 at 42. Therefore, any increase is not affected by the OCA's recommended adjustment. Also, the OCA noted that the Company's estimation of future expenses does not meet the Company's burden of proof. "[T]his is not a known and measurable

[16] The Company does not object to the specific allocation factor, 12%, that was used. CWC M.B. at 32.

expense for the Columbia Division. An estimate of future expenses does not meet the Company's burden of proof." OCA M.B. at 50-52; OCA St. 1 at 42 (citing CWC response to OCA-III-32, 33).

For all of these reasons and as discussed in the OCA's Main Brief, the OCA recommends approval of its proposed allocation of 12% of those costs, or $2,364, to the Marietta Division. OCA M.B. at OCA Exh. AEE-1S (updated) Sch. 1S, line 26.

7. Office Expenses and Utilities

The Company claimed an $18,000 future Test Year expense for office expenses and utilities. OCA St. 1 at 46; OCA St. 1S at 29-30; OCA M.B. 53. The Company did not address the issue of office expenses and utilities in its Main Brief. However, the OCA reiterates the discussion in its Main Brief on page 53 that the Company and the OCA subsequently agreed that 4.3% (or $774) of office expenses and utilities should be allocated to the Marietta Division. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 30; OCA M.B. at 53.

F. Officers' Salaries and Directors' Fees

1. Reasonableness Adjustment

The OCA's Main Brief contains a comprehensive discussion demonstrating that the Company's claim for officers' salaries and directors' fees should be reduced to a combined amount of $130,835, which is a reasonable level of costs to recover from ratepayers for their services. The OCA also recommended an adjustment to allocate a portion of these expenses to the Marietta Division. OCA M.B. at 63-65; OCA St. 1 at 47, 56-57, 59-61; OCA St. 1S at 30-34, 37; OCA Exh. AEE-1S, Sch. 1S (updated), line 32. The Company's request to end the Commission's directive in the 2008 case should be denied, so Columbia remains obligated to account for actual hours spent by its officers and directors on Columbia business in relation to all other business interests. OCA M.B. at 59-62; OCA St. 1 at 59-61; OCA St. 1S at 35-36.

Here, the OCA will address a number of problems with the Company's numbers. Next, the OCA will respond to several assertions by the Company. First, the OCA will address the claim that the Commission's approval of a higher amount for Officers' Salaries and Directors' Fees in the last base rate case shows that the claim is reasonable here. CWC M.B. at 33-34, 42-43. Second, the OCA will address the argument that the Company's provision of adequate service means that the compensation claimed in rates is reasonable. Id. at 35-36, 43. As part of that response, the OCA will also address the claim that the per-meeting compensation of the Directors of the York Water Company shows that Columbia's costs are reasonable. Id. at 43-44. Third, the OCA will address the Company's contention that hours cannot measure the responsibilities and time spent by the Officers and Directors.

With regard to the numbers, Columbia states in its Main Brief that it claimed $68,000 for Officers' salaries and subsequently allocated 4.3% of that amount to the Marietta Division. CWC M.B. at 33. The cited schedule shows that the Company claimed $68,900. GDS Exh. 1 at 1-15. The Company says that the claim was subsequently adjusted to $66,144, which is correct. However, that represents a 4.0% allocation rather than 4.3%. CWC M.B. at 33; GDS Rebuttal Exhibit 3 (Revised) at 2 ($68,900 - $66,144 = $2,756. $2,756 ÷ $68,900 = 4.0%.)

With regard to Directors' Fees, Columbia states in its Main Brief that it claimed $62,165. CWC M.B. at 42 (citing GDS Exh. 1 at 1-15). The Company's schedule shows that this amount was their test year amount; the Company made a pro forma adjustment of $335 resulting in a claim of $62,500. It is not clear what the correct adjusted number should be. If the Company intends to allocate that amount at 4.3%, the adjustment would be $2,688 and a claim of $59,812. ($62,500 x 4.3% = $2,688.) If the Company intends to allocate 4.0%, as it did for Officers' salaries, then the adjustment would be $2,500 and a claim of $60,000. ($62,500 x 4.0% =

$2,500.) GDS Rebuttal Exhibit 3 (Revised), page 2, shows an adjustment of $2,464. It is not clear how that number was derived but it does not appear to be consistent with a 4.3% allocation.

Moving to the substance of the argument, Columbia argues that its claims for Officers' salaries and Directors' fees are reasonable in this proceeding because they are lesser amounts than what was approved in the 2008 rate case. CWC M.B. at 33-34, 42-43. In the last case, however, the OCA raised an issue with regard to the reasonableness of salaries paid to officers. 2008 Order at 38, 41. The Company provided only estimates of time devoted by its officers/directors to Columbia business. Id. at 38. The OCA did not adjust Columbia's claim, but recommended that in future rate cases, the Company be required to provide an actual accounting of hours devoted to Columbia business by its officers, so that it would have the information to evaluate and, if necessary, challenge future claims. Id. at 38, 41. This is the first proceeding where actual time records have been provided.

Second, the Company argues that the fact that no quality or adequacy of service issues were raised in this proceeding establishes that Columbia's officers and directors have been properly performing their duties and their level of compensation is reasonable. CWC M.B. at 33-35. The OCA has not argued that the officers or directors have not carried out their duties, however. The issue is that there must be some additional check on compensation; under the Company's theory, there would be *no* limit on the level of compensation recoverable through rates where a utility provides adequate service. This is why the hours are relevant. 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 for ratemaking purposes. 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

> 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. The OCA is making a recommendation about what costs should reasonably be reflected in rates 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.

As noted in the OCA's Main Brief, Columbia may choose to set salaries and fees at any level; its Board of Directors is accountable to the shareholders. OCA M.B. at 54; 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.

Regarding Directors' fees in particular, one way to evaluate reasonableness is to consider what other utilities are paying their directors on a per-meeting basis. The Company argues that its per-meeting cost in this filing is $570 and thus should be considered reasonable by the OCA's standard. CWC M.B. at 43-44. As addressed in the OCA's Main Brief, in the 2011 Newtown Artesian Water Company (NAWC) case, the OCA was unable to make a utility-specific adjustment because the utility did not provide an actual accounting of its hours. OCA M.B. at 56; OCA St. 1S at 33-34. In the absence of any actual hours available for NAWC, the OCA considered the per-meeting cost for York Water Company. Id. Here, the actual hours are available. Further, Columbia does not indicate whether York Water Company and NAWC have directors who are also officers, as is the case for Columbia.

Third, the Company argues that the use of hours as a check cannot fully capture the "tremendous amount of job responsibilities" and time spent by its Officers and Directors. CWC M.B. at 35. At the outset, it is unclear why the time spent is not recorded on the time sheets kept for the purpose of recording time spent on Columbia business. 2008 Order at 41. That aside, the OCA's adjustment is based on the information that Columbia provided regarding Mr. Nikolaus' active contribution to the Company as an Officer and Director. OCA M.B. at 55-56; OCA St. 1 at 56-57. The OCA disagrees that consideration of the time Mr. Nikolaus spends on Company business means that the OCA is ignoring "quality in exchange for quantity." CWC M.B. at 39. The OCA has not challenged the quality of work provided by the officers and directors. Rather, the OCA is evaluating the active contribution of these individuals to the Company's provision of water service. OCA M.B. at 54-55; OCA St. 1 at 51-53, 55-56. As discussed above, the shareholders may pay any amount, but the hours spent on Company business are a reasonable check on the amount recoverable in rates.

The evidence 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. The OCA recommends that the Officers' Salaries expense of $68,900 be reduced by $12,456 and Directors' Fees of $61,935 by $20,995, or a total reduction of $33,451. See OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 31.

2. Ongoing Time Sheet Requirement

As explained in the OCA's Main Brief, on pages 59 to 62, 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 the Company does not want its officers/directors to keep hourly time records. CWC M.B. at 59-61. The OCA recommends that this requirement be continued. OCA St. 1 at 59-61; OCA St. 1S at 35-36.

Columbia argues that the time records are unreasonable and asks the Commission to rescind its requirement that the Company keep records in future cases. CWC M.B. at 59. Specifically, the Company contends that the time sheets "should not be used to somehow justify compensation" for their positions. Id. at 60. The Company's position ignores its obligation to establish the justness and reasonableness of every element of its requested rate increase. 66 Pa. C.S. § 315(a); Lower Frederick Twp. v. Pa. P.U.C., 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980); Brockway Glass v. Pa. P.U.C., 63 Pa. Commw. 238, 437 A.2d 1067 (1981); Burleson v. Pa. P.U.C., 461 A.2d 1234, 1236 (Pa. 1983). The Company does have to justify the compensation for officers and directors that is recovered from ratepayers.

This is the first proceeding in which Columbia's officers and directors prepared time sheets. Those records provided information that permitted the OCA to evaluate the reasonableness of the Company's claim for Officers' salaries and Directors' fees. The records also contributed to the evidence available to the Commission in reviewing the claim and the OCA's recommended adjustment. OCA M.B. at 54-59; OCA St. 1 at 55-57. This usage is consistent with the Commission's intent in establishing the ongoing requirement for time records. 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. 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.

The Company also argues that Officers' and Directors' compensation goes beyond how much time they spend inside office walls. CWC M.B. at 60. This is similar to another statement the Company made about the time sheets not capturing all of the time spent on Company business. CWC M.B. at 35. The Commission Order is clear that the timesheets should include "hours devoted by its officers to company business, in their roles as officers and directors." 2008 Order at *138. Going-forward, the timesheets should reflect actual hours spent on Columbia business, whether inside or outside office walls. This would seem to address a number of the Company's concerns that the timesheets reflect the officers' and directors' active contributions to the Company.

Columbia contends that the Officers and Directors bring more to the table than the hours they spend on Company business. CWC M.B. at 60. As discussed in the OCA's Main Brief, while these employees are salaried and do not work specific hours to earn their compensation, it is unreasonable to suggest that the amount of compensation that is properly recovered in customer rates should have no relationship to the amount of time an individual spends on Company business. OCA M.B. at 54-57; OCA St. 1 at 51, 53, 55; OCA St. 1S at 30. For example, 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. OCA M.B. at 57, n.28. The typical duties are the same for all directors and, Mr. Nikolaus is Chairman of the Board. Id.; CWC St. 1 at 16. 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. OCA M.B. at 57-58; CWC St. 1 at 17-19.

Finally, CWC refers to the compensation received by its officers and directors as "meager." CWC M.B. at 61. The OCA points out that while the total amounts are not very large, they are significant compared to the time spent by the individuals. Applying the adjustment recommended by the OCA in this case, the average rate of pay for an officer is $178 per hour and $206 per hour as a director. OCA St. 1 at 53, 56.

For the reasons discussed here and in the OCA's Main Brief, the Commission's requirement for time records is serving its intended purpose and should continue. The Company's request should be denied.

3. Allocation

As discussed above with regard to the number errors in Columbia's brief, Columbia proposes to allocate some portion, in the range of 4.0% to 4.3% of its Officers' salaries and Directors' fees to the Marietta division. CWC M.B. at 40. Where the Company's objections to the OCA's recommended allocation mirror those addressed in Section IV.E, *supra*, and in the OCA's Main Brief, pages 62 to 64, the OCA will not address them here. The Company also argues that time spent by Officers and Directors cannot be equated to the amount of time that Company field officers spend on Marietta Division tasks. CWC M.B. at 40. In support, Columbia provides a list of activities the supervisors spend their time on. Id. In contrast, Columbia says that the responsibilities of officers and directors are mostly customer-related and therefore tend to revolve around billing cycles. Id. at 41. Because Marietta customers are billed quarterly, compared to Columbia's monthly bills, this supports a 4.3% allocation. OCA St. 1S at 16. When that list is compared to the list of Officers' duties on pages 36 to 40, however, it is clear that most of the officers' and directors' responsibilities are (1) not revolving around the billing cycle, *e.g.*, annual reports, employee interviews and evaluations, approving financial statements, or (2) are the same for officers and directors as field supervisors, *e.g.*, reviewing treatment plant performance and water quality test results. CWC M.B. at 36-40; OCA M.B. at 64.

Next, Columbia argues that work that was performed by the Marietta Officers and Directors is additional work, not work that will become shared. CWC M.B. at 41. The time sheets show little to no fluctuation in the hours for Officers and Directors. Even in 2012, when the Company was in the midst of the acquisition, only one officer and one director showed a significant increase in their number of hours.

The Marietta Division customers have an amount for Officers' Salaries and Directors' Fees built into base rates. OCA St. 1 at 57-59 ($34,650 in 2011). They should contribute a fair amount toward the expenses of their new Board and Officers. OCA St. 1 at 52. Further, if these amounts are not allocated to the Marietta Division, Columbia will be overcollecting. The Company seeks to recover approximately $126,180 from the Columbia Division. GDS Exh. 1 at 1-15 (as discussed in Section IV.F.1, the precise claim is not known). If approved, the Company would collect this amount plus the amount in Marietta Division rates ($34,650) for a total of $160,830. But the Company is only paying the Officers and Directors $131,400, which means it would overcollect annually by $29,430. GDS Exh. 1 at 1-15.

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.[17] OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 32.

Also, as noted in the OCA's Main Brief, on page 65, based on the record in this proceeding, it appears that affiliated interest agreements may need to be filed with the

[17] 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 $130,835 ($68,900 Officers' Salaries + $61,935 Directors' Fees), 15%, or $19,625 should be allocated to the Marietta Division. OCA St. 1S at 59, n.22.

Commission regarding CWC's purchase of services from Donegal Mutual Insurance Company and Lutz. See 66 Pa. C.S. §§ 2101 and 2102.

G. Regulatory Assessments

The Company does not address the OCA's adjustment in its Main Brief. Consistent with the OCA's recommended reduction to revenues, the OCA recommends adoption of its reduction to regulatory assessments. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 38.

H. Rate Case Expense

In its filing, the Company claimed $252,800 amortized or normalized over three years at $84,267. CWC St. 2 at 10; GDS Exh. 1 at 1-15, 1-16; GDS Rebuttal Exh. 3 (Revised) at 2. On page 1-15 of the Company's filing states "Amort. Of Rate Case Costs" and page 1-16 shows the Company used a "normalization period" of three years. The OCA has not challenged the amount of the Company's claim throughout this proceeding or the three-year period. OCA St. 1 at 23-24. The OCA has two objections to the rate case expense claim made in Columbia's Main Brief, however.

First, in direct testimony, the OCA's witness objected to amortization and recommended that, consistent with Commission precedent, the rate case expense be normalized. Id. In its Main Brief, Columbia states that "the OCA and I&E will no doubt favor normalization." CWC M.B. at 45. This ignores that the OCA has specifically objected to amortization in testimony. The OCA reiterates its objection and its contention that normalization is the appropriate means of reflecting rate case expense. See, e.g., 2008 Order at *30-31 (adopting a two-year normalization period consistent with the intervals at which the Company filed rate cases in the last several years); Pa. P.U.C. v. Western Util., Inc., 1997 PaPUC LEXIS 175, *58-61; Pa. P.U.C. v. Lemont Water Co., 81 PaPUC 392, 401-04 (1994).

Second, at hearings, Columbia witness Shambaugh sponsored an exhibit updating the Company's total rate case expense to $258,412.05. Tr. 149-50; CWC Rejoinder Exh. 6. Counsel for Columbia represented that the Company was not increasing its rate case expense claim. Id.

> [T]he point I would add is we're not asking for a claim in excess of what we claimed on that item, but we do have an updated exhibit.

Tr. 149-50. As discussed, the total claim in the case was $252,800. The Company does not make this distinction in its brief and makes no mention that its original claim was $5,612 less. CWC M.B. at 45. The OCA recommends that no more than $84,267, or $252,800 normalized over three years, be allowed for rate case expense.

I. Summary

For the reasons discussed above and in the OCA's Main Brief, the Commission should accept the OCA accounting adjustments as being necessary, proper, and correct. The Company has not met its burden of proof with regard to these claims. The OCA has also demonstrated that its adjustments are in the public interest and should be adopted.

The OCA recommends a total adjustment of $220,447 to the Company's expense claim, as shown on line 34 of Schedule 1S (updated).

V. COST OF CAPITAL AND RATE OF RETURN

A. Introduction

As addressed in the OCA's Main Brief (at pages 66-95), Columbia's cost of capital is overstated and its requests for a performance factor premium and an acquisition incentive in addition to the already overstated return on equity claim should be rejected. As discussed in the OCA's Main Brief, the appropriate capital structure is 44.15% long-term debt and 55.85% common equity. The equity cost rate should be 8.25% for an overall cost of capital of 6.75% with no recognition given for the claimed performance factor premium and acquisition incentive.

B. Capital Structure

As explained in the OCA's Main Brief, the Commission adopted Columbia's actual capital structure in the last case. The OCA has shown that the Company's actual capital structure was not correct because it did not match its total capitalization. OCA M.B. at 70-71. When the total measures of value is used, as Mr. Rothschild did, the actual capital structure is 55.85% equity and 44.15% debt. Id.

In its Main Brief at 50, the Company states that Mr. Rothschild ignored the regulatory precedent of allowing the use of the pro forma capital structure in Columbia's last rate case. As discussed in the OCA's Main Brief, Mr. Rothschild recognized the Commission's determination in the last Columbia rate case and used the Company's actual capital structure. The only difference is that Mr. Rothschild corrected the total capitalization because it did not match the total measures of value that was claimed by Columbia.

Specifically, 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. To assign a cost rate to the long term debt that was not reflected by Columbia, Mr. Rothschild noted that the Company received a $2.2 million Wells Fargo Loan on October 4, 2012 at a 4.50% interest rate and determined that it is appropriate to assign 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.

Thus, Mr. Rothschild's recommendation does not ignore the Commission's determination in the last rate case. Rather, it recognizes it and makes a necessary correction to the Company's claim in this case. The OCA's recommended capital structure of 55.85% equity and 44.15% debt should be adopted.

C. Cost of Debt

As discussed in the OCA's Main Brief, the OCA and the Company accepted I&E witness Maurer's cost of debt of 5.00%. OCA M.B. at 71-72. Mr. Rothschild made an adjustment to reflect the $1,789,622 of additional debt at a 4.5% cost rate, which resulted in a long term debt cost rate of 4.85%. Id. The Company did not address this issue in its Main Brief.

D. Cost of Equity

1. Introduction

The OCA recommends a DCF-derived cost of equity of 8.25%. OCA M.B. at 72-85. This cost rate is consistent with investor expectations and current market conditions and thus is appropriate in today's financial market. Moreover, as also discussed in the OCA's Main Brief, the Company's 11.35% equity cost rate is overstated, is derived from the application of multiple flawed models and flawed analyses and should be rejected. Finally, the record does not contain sufficient evidence to support Columbia's proposed adjustments for superior performance or for its acquisition activities. OCA M.B. at 85-94. The OCA's cost rate of 8.25% should be adopted.

2. DCF Results Are Favored By the Commission

As addressed in the OCA's Main Brief at 73-74, for more than 25 years, the Commission has favored DCF results in determining the appropriate cost of equity in rate proceedings. In its Main Brief, Columbia did not address the Commission orders that indicate the Commission's preference for the DCF methodology. The only statement made by the Company is that its witness used multiple models because they "add reliability" to his recommended common equity cost rate recommendation. CWC M.B. at 47. This statement is without merit. Using multiple flawed models does not add reliability to the results. The Commission has specifically rejected the use of the Risk Premium and CAPM models as primary methods of determining the equity cost rate. See, e.g., Pa. P.U.C. v. City of Lancaster – Bureau of Water, 2011 PaPUC LEXIS 1685, *101, 108 (adopting OTS cost of equity recommendation derived from the DCF method exclusively); Pa. P.U.C. v. Roaring Creek Water Co., 84 PaPUC 438, 462 (1995). Moreover, as Mr. Rothschild noted, "It is critical to have one accurate model." The OCA's recommendation is based on the DCF model, does not rely on many different models with many flaws, and should be adopted.

3. OCA's Recommendation Is Reasonable Given Current Market Conditions and Investor Expectations

As explained in the OCA's Main Brief at pages 74-80, Mr. Rothschild derived his recommended equity cost rate by using the same comparison group as Company witness D'Ascendis, with the exception of removing two companies that are not included in Value Line's standard reports. The Company did not address this issue in its Main Brief. The OCA submits that its comparison group is reasonable and should be used in deriving the equity cost rate.

Mr. Rothschild used the constant growth DCF method and determined the growth rate based on the sustainable growth procedure, rather than the overinflated analysts' growth rates used by Company witness D'Ascendis. In its Main Brief, the Company argues that the literature supports analysts' growth rate forecasts as the most accurate predictor of investor required returns and that using a sustainable growth rate is circular. CWC M.B. at 50. As explained below, the Company's criticisms are without merit and should be rejected.

First, regarding literature that supports analysts' growth rate forecasts as the most accurate predictor, Mr. Rothschild explained that there are studies that refute that position. Specifically, a 2010 study conducted by McKinsey & Company found that analysts have been persistently over optimistic for the past 25 years. Even more telling, the growth rates have been inflated by almost 100%. OCA M.B. at 79-80; OCA St. 2 at 23; OCA St. 2S at 3. A more recent study establishes that earnings per share growth rates are not the best indicator of investor required returns. Id. Thus, the criticism of Company witness D'Ascendis should be rejected.

Second, Mr. Rothschild refuted the allegation that the sustainable growth rate is circular. This criticism is often floated by utility rate of return consultants but it is without merit. The constant growth model is $k=D/P + (br+sv)$ where "k" equals the cost of equity and "r" is the future expected return on equity. OCA M.B. at 76-78; OCA St. 2 at 31-33. The cost of equity (k) is not the same variable as the future expected earned return on equity (r). Moreover, the value of "r" is based on the value expected by investors during the same time frame as the stock price and dividend yield used to calculate D/P in the equation. Id. Thus, even if investors' expectations change in the future, the calculation of "k" is correct at the time the computation is made. Thus, the equation is not circular and the Company's criticism should be rejected.

4. The Company's 11.35% Equity Cost Rate Should Be Rejected

As discussed in the OCA's Main Brief at 83-85, Company witness D'Ascendis used the Risk Premium and CAPM, in addition to an inflated DCF analysis to arrive at an equity cost rate of 10.6%. He then added 40 basis points for a size adjustment, 25 basis points for managerial performance and 25 basis points for acquisition incentives and (0.16) basis points for financial risk. Id. The flaws in Company witness D'Ascendis' analysis are addressed in the OCA's Main Brief and in OCA St. 2 at 44-51 and OCA St. 2S at 2-3, 5-6. For the reasons discussed in the OCA's Main Brief and testimony, his analyses are flawed and should be rejected.

5. Performance Factor Adjustments

The OCA agrees with Columbia that Section 523 of the Public Utility Code, 66 Pa. C.S. § 523, together with 52 Pa. Code § 69.711, permits awards of rate of return premiums for certain water system acquisitions and for exemplary performance by a utility that are supported by specific evidence. CWC M.B. at 51-52. The OCA disagrees that Columbia's performance has been exemplary, based on the record evidence, for purposes of increasing its return by 25 additional basis points. OCA M.B. at 86-90. Also, the OCA flatly disagrees that Columbia's request in this case for a 25 basis point premium for a 15-year old acquisition of a neighboring system and a 2012 acquisition of an affiliate water system is appropriate or supported by specific evidence. OCA M.B. at 90-93.

The OCA notes that the requested fifty basis point reward would add approximately $44,150 to the Company's annual revenue requirement.[18] Id. at 85. As discussed in the OCA's Main Brief and below, the evidence put forth by Columbia does not warrant any upward adjustment to the DCF-indicated return on equity related to management efficiency or acquisitions.

[18] 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%). CWC Sch. DWD-1 at 1. Using the rate base claimed in Columbia's Table I $13,796,745, each 0.25% adder results in an additional $22,075 of revenue requirement ($13,796,745 x 0.16% = $22,075). CWC Table I.

a. Management Efficiency Adjustment

On pages 86 to 90 of its Main Brief, the OCA reviewed the record evidence in this proceeding and demonstrated that Columbia has not adduced sufficient evidence to warrant any kind of a positive management performance factor adjustment. The actions that the Company points to in its Main Brief as being "exemplary" do not show that Columbia's performance is more than efficient and reasonable and therefore required by Section 1501 of the Public Utility Code. 66 Pa. C.S. § 1501. For example, the Company highlights the fact that it has not violated State and Federal primary and secondary drinking water standards as well as the Commission's regulations regarding water pressure and unaccounted for water. CWC M.B. at 53-54. Columbia points to its extension of service to customers in Manor and West Hempfield Townships. CWC M.B. at 54-55. The Company 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 mains in-house rather than contracting those services, and establishing an electronic billing and payment program. CWC M.B. at 54-56; OCA St. 1 at 19-20. As discussed in the OCA's Main Brief, these directly echo the types of actions the Company used to support its claim for a 25 basis point increase in the 2008 case. 2008 RD at 64-65. There, the ALJ correctly 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. 2008 Order at 91-93; 2008 RD at 67. For the same reasons, there is no evidentiary basis in the current proceeding to allow an additional 25 basis points on equity under Section 523 of the Public Utility Code. 66 Pa. C.S. § 523.

Columbia makes the argument that its performance since the last rate case has exceeded the base requirements. CWC M.B. at 57. As discussed in above and in the OCA's Main Brief, however, the Company's performance here mirrors its performance in the 2008 case. OCA M.B. at 87-90. Further, unlike the 2008 proceeding, there are additional facts weighing against a performance factor adjustment. According to its 2011 management audit report, the auditors determined that Columbia needed minor improvement in all areas assessed except for customer service, for which it met expected performance levels. CWC M.B. at 34. This is consistent with the feedback provided by DEP after someone broke into a locked finished water storage tank in the system. The email says that the security incident helped show parts of its Emergency Response Plan that "need tweaked" and vulnerabilities in existing security measures. CWC M.B. at 53; CWC St. 1 at 5-6, App. 2.

For the reasons presented here and in the OCA's Main Brief, pages 86 to 90, the evidence regarding Columbia's adequacy of service and water quality is not sufficient to warrant a rate of return premium of 0.25%.

b. Acquisition Adjustment

In the OCA's Main Brief, pages 90 to 93, the OCA has discussed each element of its opposition to Columbia's request for a 25 basis point increase to its return on common equity related to its acquisitions of Marietta Gravity and Mountville Water Company. Columbia's focus in its Main Brief is on what "magic number" constitutes a track record for purposes of 52 Pa. Code § 69.721(g). CWC M.B. at 57-59. The more germane question is whether the acquisitions themselves serve the purpose of the Policy Statement. As discussed in the OCA's Main Brief, Columbia has not established that Marietta was a less viable system or that it has improved service to those customers as envisioned by Section 69.721. OCA M.B. at 91-93. The evidence does not show that Marietta was less viable:

> 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. The Company provides a confidential list of improvements made to the Marietta system in its Main Brief. CWC M.B. at 58. Although the Company characterizes them as "critical," the OCA's engineering witness 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 M.B. at 91; OCA St. 3 at 4. Nor did the Company provide evidence to show that MGWC was not able to implement the improvements on its own. OCA M.B. at 91-92; OCA St. 3 at 5. Further, the record shows 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. OCA M.B. at 92; CWC St. 1R at 14, tr. 115, 118, 129.

Accordingly, 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. *Summary*

As discussed above and in the OCA's Main Brief, Section 523 requires "specific findings upon evidence of record" to support a performance factor adjustment. OCA M.B. at 60; 66 Pa. C.S. § 523(a). The Company 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, Columbia has asked the Commission to approve an equity claim of 11.35%. CWC M.B. at 45.

VI. CONCLUSION

For the reasons set forth in the Office of Consumer Advocate's Main Brief and 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. The Office of Consumer Advocate respectfully requests that the Commission approve a rate decrease of $319,728. The OCA submits that a rate decrease is just, reasonable, and in the public interest.

Respectfully submitted,

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DATED: October 6, 2013

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2008-2045157
	:	
The Columbia Water Company	:	

APPENDIX A TO THE
REPLY BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

OCA TABLES I AND II (UPDATED)

Columbia Water Company
Docket No. R-2013-2360798

Table I (Updated)

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	(319,728)	$3,728,306
Deductions:					
O&M/Amort. Expenses	2,045,437	(102,713)	1,942,724		1,942,724
Depreciation	739,260	(115,913)	623,347		623,347
Assessments	24,159		24,159	(1,821)	22,338
Other Taxes	134,931		134,931		134,931
Income Taxes	246,394	70,201	316,595	(17,959)	298,636
Total Deductions	3,190,181	(148,425)	3,041,756	(19,780)	3,021,976
Net Income Available for Return	$842,091	$164,187	$1,006,278	(299,948)	$706,330
Rate Base	$13,527,774	(3,063,631)	$10,464,143		$10,464,143
Rate of Return	6.22%		9.62%		6.75%

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Columbia Water Company
Docket No. R-2013-2360798

Table II (Updated)

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		(10,747)						
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				(3,637)			1,081	2,556
Payroll Taxes	OCA Statement 1				108			(32)	(76)
Adjust Pensions & Benefits	OCA Statement 1				(16,141)			4,797	11,344
Vehicle Insurance	OCA Statement 1				(586)			174	412
Workman's Compensation Insurance	OCA Statement 1				(2,927)			870	2,057
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					(1,821)		541	(541)
Total Adjustments			$ (3,063,631)	$ 15,762	$ (102,713)	$ (1,821)	$ (115,913)	$ 70,201	$ 164,187

* These adjustments are not in dispute.

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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 Reply 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 7^{th} day of October 2013.

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