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October 7, 2013

By Hand Delivery

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor (filing room)
Harrisburg, PA 17120

RE: Columbia Water Company; Docket No. R-2013-2360798;
REPLY BRIEF OF THE COLUMBIA WATER COMPANY

Dear Secretary Chiavetta:

Enclosed for filing with the Commission is the Reply Brief of the Columbia Water Company in the above-referenced matter. Both a Proprietary version (under seal) and a Non-Proprietary version (for filing) are being provided to the Commission. Copies of Columbia's Reply Brief have been served in accordance with the attached Certificate of Service, as well as upon Administrative Law Judge Dennis J. Buckley.

If you have any questions regarding this filing, please do not hesitate to contact the undersigned.

Very truly yours,

Thomas J. Sniscak
William E. Lehman

Counsel to the Columbia Water [illegible]pany

WEL/bes
Enclosure
cc: Per Certificate of Service
Honorable Dennis J. Buckley, Administrative Law Judge (Proprietary and Non-P[illegible]ietar[illegible]

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

**REPLY BRIEF OF
THE COLUMBIA WATER COMPANY**

Before Administrative Law Judge
Dennis J. Buckley

PUBLIC VERSION

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Dated: October 7, 2013

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I. SUMMARY OF REPLY ARGUMENT

Both the Office of Consumer Advocate ("OCA") and the Bureau of Investigation and Enforcement ("I&E") have set forth a revisionist argument calculated to deny the Columbia Water Company ("Columbia" or "Company") necessary cash flow to support $4.9 million in plant in service which both of these parties admitted is used and useful in providing service. Their argument is based on challenging the PennVest rate base/rate of return and depreciation based volumetric rate which the Commission set in 1993 and they now, some 20 years later, contend it is a debt-service only surcharge. ***Notably, both I&E and OCA's witnesses admitted under cross that when they took their position that it was a debt-service surcharge they were unaware of the 1993 Order's setting a rate base/rate of return depreciation based rate.*** Once having driven this positional stake in the ground, they refuse to remove it. In any event, I&E and OCA are challenging a Commission-made rate, and as such, they bear the burden to show that the rate was a debt-service only surcharge. Contrary to their position, 66 Pa. C.S. § 316 mandates that the 1993 final order is conclusive on all parties affected thereby.

Both OCA and I&E have failed to meet their burden of proof in numerous important respects including, conflicting with the United States Tax Code, retroactive acceleration of depreciation contrary to the 1993 Order, rendering depreciation lives meaningless, transforming company-financed debt or loans used to construct plant into retroactive CIACs simply because the debt or loan was paid off using rate revenues as a source of monies[1] – all in violation of the fundamental Constitutional provisions against confiscation of property and the right to earn a return on and of plant investment, GAAP principles and well-established ratemaking principles.

[1] The I&E and OCA use the tautology that if a utility uses revenues from rates to pay off a loan that such debt and plant in service financed by such debt/loan should be removed because ratepayers funded the plant. That has never been the law in the United States or in PA, and the fallacy and inappropriateness of this argument is addressed in this brief.

The PennVest volumetric rate set by the Commission's Order in 1993, at the request of the OCA, used base/rate of return methodology, including the plant in rate base, along with a return on the plant, depreciation expense and taxes. This rate was never a debt-service only rate, as a comparison of the characteristics of Columbia's rate base/rate of return rate versus a Commission debt-service shows.

Specifically, in *Pa PUC v. Pennsylvania-American Water Company*, the Commission described a debt-service surcharge as not rate base/rate of return in that it "is a dollar-for dollar form of recovery... [that] will *not* provide return on or of PAWC's investment and/or will not produce a profit to PAWC," but rather only principal and interest. (1998 WL 456747; emphasis in original). Moreover, Commission debt service surcharges typically are kept in a separate account for repayment so that monies collected from ratepayers are available and used to pay the loan, and often are customer based charges as opposed to volumetric.

Here, Columbia's volumetric rate for the PennVest plant in the 1993 Order provided for rate base/return and depreciation. (1993 Order *infra.*). The record shows the Company, in compliance and reliance on the 1993 Order depreciated the plant using normal Commission permitted depreciation principles and lives. Moreover, as discussed below, the record shows that Columbia did not collect revenues sufficient to cover the entire loan's debt service on a dollar-for-dollar basis, and in fact was at least approximately $200,000 short. Further, there was no separate account requirement and in any event rates were not the sole source of monies for Columbia's repayment of the loan. Clearly this was not a Commission-style debt service only surcharge.

The few reconciliations of the rate at the request of the Commission did not and could not change the nature of the charge. The reconciliations did not recapture past underages that the plant produced under rate base rate of return and depreciation relative to debt service; rather they adjusted the rate up or down prospectively to try to meet the rate base/rate of return and depreciation money stream goal of the 1993 Order and is consonant with the Commission's obligation under the PennVest Act itself to provide sufficient rates (note the Act does not mandate any particular ratemaking method) to repay the loan.

Similarly, I&E and OCA's argument that the Company did not include the plant in rate base in subsequent rate cases should be rejected because the 1993 rate was an essentially unbundled rate base/rate of return rate with depreciation which was periodically reviewed by the Commission and treated separately. Claiming that plant again as part of a separate rate case, as Columbia's rate expert testified, would have resulted in double claiming or counting that plant.

The Company should be allowed to recover a fair rate of return on the undepreciated amount of its investment which is its right under standard ratemaking principles and the United States Constitution as explained in the *Hope* and *Bluefield* decisions.

The OCA and I&E also make numerous negative adjustments to the Company's expense claims based on speculative allocations to the Marietta Gravity Water Company over and above what the Company had already allocated and not included in its filing. The Company's allocations are based on the general manager's first-hand knowledge of the Company's operations and reflect the actual times spent on Marietta Division tasks unlike the speculative assumptions that OCA, in particular, and I&E in general make from afar.

The OCA also attacks the reasonableness of the Company's officers' salaries and directors' fees, which same or lesser fees were approved as being reasonable in the Company's 2008 rate case, by taking the novel and simplistic approach of converting the salaries and fees to hourly rates and imputing their values or worth of each to the Company. While a convenient and easy basis for OCA to make a sweeping and significant adjustment, even OCA's relatively new witness admitted under cross that this approach has never been accepted by the Commission and does not capture the responsibility, liability or legal risks associated with these positions and should be rejected. In addition, the requirement for officers who are also directors to keep ongoing time records should be discontinued because it is discriminatory, an unnecessary burden to each member, creates a distracting environment, opens them up to additional legal exposure and is a requirement that no other Class A utility in Pennsylvania is required to do.

The Company has fully supported it use of its pro forma capital structure which is virtually identical to its approved capital structure in its 2008 rate case. As stated in much greater detail below and in the Company's main brief, it has fully supported its overall rate of return of 9.09% based on its use of multiple market-based cost of equity models and the additional performance factor premiums based on its acquisitions of less viable companies and exemplary management performance.

II. RATE BASE

A. Additions to Rate Base

1. PennVest Book Depreciation Reserve

As stated in its main brief at 6-7, the Company has adjusted its total depreciated plant in service from its original filing of $24,706,812 to $25,045,850. (CWC Statement No. 2R at 20:12-21; GDS Rebuttal Exhibit No. 3 (Revised) at 3) As Mr. Shambaugh explained, the reason for this adjustment is because Columbia overstated the book depreciation reserve related to the PennVest plant in service. The Company's book depreciation ($1,853,844) for this plant includes annual depreciation accruals based upon the straight-line average remaining life methodology. However, Mr. Shambaugh correctly identified that the PennVest rate was based solely on the 4% Compound Interest method during the term of the rate. Therefore, there exists a difference between the book depreciation reserve and the capital recovery through customer rates of approximately $339,038 for this plant. (CWC Statement No. 2R at 20:12-21; Tr. at 142) Consequently, the adjusted book depreciation reserve for the PennVest plant is $1,514,806. (Attachment to GDS Rebuttal Exhibit No. 3 at 1) OCA did not directly address this issue in its main brief, however; I&E adopted this adjustment on page 25 of its main brief. The Company requests the Commission adopt this adjusted amount.

B. Deductions from Rate Base

1. Materials and Supplies

In its main brief at 21-22, the OCA recommends a $4,592 negative adjustment to the Company's rate base claim of $62,314. (OCA MB at 21) The OCA challenges the Company's 3-year averaging of materials and supplies ("M&S") arguing that its 13-month averaging better recognizes the volatile nature of the balance of this account from month to month within a test year. (Id.) However, as Company witness Shambaugh explained, if Ms. Everette considers a test year element to be volatile, then a larger sample of operating results would be warranted, such as the 3-year average he recommends.[2] (CWC Statement No. 1 at 15:3-7)

Mr. Shambaugh explained that to accurately reflect a 13-month average of materials and supplies, the Company would have to close its books on a monthly basis, which it does not. (CWC Statement No. 2R at 14:18-20) Mr. Shambaugh also noted that to use a 13-month average would require the Company to count each month and to price the inventory for each item that is in inventory, as that is the only way to get an accurate accounting of the inventory for that month. He explained that the company closes its books annually, which is more economical for

[2] OCA argues that Mr. Shambaugh was not able to identify any cases where the 3-year average has been approved by the Commission. (OCA MB at 22) This is not true, however, as Mr. Shambaugh testified the 3-year averaging was approved by the Commission in Columbia's last rate case, *Pa. P.U.C. v. Columbia Water Company*, Dkt. No. R-2008-2045157 (Final Order entered June 10, 2009) at 29-32. (Tr. at 169) On the other hand, the OCA argues that it is Commission policy to use a 13-month average, but provides no support for this proposition. (OCA MB at 21)

smaller companies, and that these annual audited numbers (as opposed to the monthly estimates OCA relies on from a discovery response), based on actual inventory, better represents M&S than Ms. Everette's use of monthly estimates. (Tr. at 135-136) Furthermore, it is not economical for small companies like Columbia to have such a sophisticated accounting system that dovetails with both materials and supplies that would allow the Company to produce accurate numbers on a monthly basis. (Tr. at 165)

In the alternative, Mr. Shambaugh testified that if the OCA's 13-month position is accepted, the most recent 13-months, as provided in CWC Rejoinder Exhibit No. 3 (updating the response to discovery request OCA-I-7) should be used as opposed to the stale and outdated 13 months Ms. Everette used, which understates M&S. Mr. Shambaugh identified that if the most recent 13 months are used, it results in an M&S inventory claim of $64,888, which is $2,574 above the Company's 3-year average, and is also above Ms. Everette's stale 13-month period. (Tr. at 136)

The OCA's negative adjustment to M&S in the amount of $4,592 should be rejected and the Company's 3-year average should be accepted as it was in the 2008 rate case or, in the alternative, the most current 13-month average should be used.

2. Cash Working Capital

All parties agree that the Company's formula method, or one-eighth (12.5%) of operating and maintenance (O&M) expenses, as set forth in GDS Exhibit No. 1 at 1-17, should be used to calculate cash working capital for the Company and that a final allocation will occur upon a Commission determination of the total O&M expense. (GDS Exhibit No. 1 at 1-17; OCA MB at 9)

3. PennVest Plant

a. Introduction

This issue[3] is best described as revisionism by the I&E and OCA calculated to deny the company necessary cash flow to support $4.9 million of plant in service that both of those parties admitted[4] upon cross was used and useful in providing service. They would have Your Honor and the Commission ignore the basis for the rate base/rate of return treatment approved for this plant in its 1993 Order, which was what OCA requested and obtained in that matter. I&E and OCA would also ask the Commission to ignore 66 Pa.C.S. § 316 which mandates such Order "shall be prima facia evidence of the facts found and shall remain conclusive upon all parties affected thereby, unless set aside, annulled or modified on judicial review." As discussed in greater detail below, I&E and OCA's revisionism should be rejected.

Importantly, under cross by the company, both I&E and OCA's witnesses testified ***that they were unaware of the Commission's 1993 Order when they took the position in their direct testimony that the plant at issue was a debt service only charge.*** (Tr. at 179-180 and 187) It is clear here that once they put that positional stake in the ground, they were too stubborn to remove it as they hope it will result in a rate decrease. To suggest that the rate was "transformed" in 1997, just a few short years after it was set by a Commission Order and even fewer years after the 1994 Commission policy was established, without any mention of the "transformation" by the Commission or any of the parties in the 1997 Settlement Order is absurd.

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[3] Both the OCA and I&E have challenged the Company's inclusion of undepreciated PennVest plant in rate base and the associated accrued and annual depreciation. (OCA MB at 9-20, 27; I&E MB at 20-24, 32-33) This challenge is based primarily on OCA and I&E's bald allegation that although the PennVest volumetric rate was set in 1993 by the Company (and OCA) based on rate base/rate of return principles, this rate was somehow converted into a debt-service only surcharge which permitted the Company to only recover the principal and interest on the PennVest loan. As set forth in the Company's MB at 9-16, and more fully described below, the PennVest charge was set using rate base/rate of return methodology in 1993 and was requested and fully supported by OCA. The rate was never transformed into a debt-service only surcharge designed to only recover the principal and interest on the loan.

[4] Tr. at 177 and 187.

It was not mentioned in the 1997 Settlement because the 1993 rate case was still fresh in everyone's mind and it was clear that no transformation was occurring.

b. I&E and OCA failed to carry their burden for their PennVest plant adjustments.

Because the OCA and I&E are arguing that the 1993 Commission-approved PennVest volumetric rate base/rate of return rate is a debt-service only surcharge, they are challenging a Commission-approved rate. Moreover, as they are the proponent of an adjustment to the rate claim, they bear the burden of proving their adjustment is reasonable, lawful and with requisite specificity. Our Supreme Court has held that it was "proper for the PUC, in making its financial and economic determinations, ***to disregard proposed incomplete adjustments ... if the advocates fail to qualify their adjustments properly.***[5] As such, the burden of proof falls on them to show that the rate was a debt-service only surcharge.[6]

As explained below in greater detail, they have failed to meet their burden in numerous important respects including, but not limited to: conflicting with the United States Tax Code, rendering depreciation lives meaningless; and transforming company financed debt or loans used to construct plant into retroactive CIACs simply because the debt or loan was paid off using rate revenues as a source of monies. These all violate the fundamental Constitutional provisions against confiscation of property and the right to earn a return on and of plant investment, Generally Accepted Accounting Principles ("GAAP"), and well-established ratemaking principles. Furthermore, once the plant treatment was approved by final order in 1993,[7] as a rate

[5] *Popowsky v. Pa. P.U.C.*, 550 Pa. 449, 459, 706 A.2d 1197, 1201 (1997); *Pa. P.U.C. v. UGI Utilities, Inc*, 1994 WL 776954 (Pa. P.U.C. 1994) at *34 (emphasis added); *Pa. P.U.C. v Breezewood*, 74 Pa. P.U.C. 431,437 (1991); *Pa. P.U.C. v. PECO*, Docket No. R-891364 (Final Order Entered May 16, 1990).
[6] *Schellhammer v. Pennsylvania Pub. Util. Comm'n*, 629 A.2d 189 (Pa. Cmwlth. Ct. 1993) (citing *Brockway Glass v. Pennsylvania Pub. Utility Commission*, 437 A.2d 1067 (Pa. Cmwlth. Ct. 1981)) (a party challenging an existing rate bears the burden of proof).
[7] *Pa. P.U.C. v. Columbia Water Company*; Dkt. No. R-00932594 (Corrected Opinion and Order at Ordering Para. 4) (GDS Rebuttal Exhibit No. 1) (*1993 Order*).

base/rate of return volumetric rate, it became "prima facia evidence of the facts found and remains conclusive upon all parties affected thereby, unless set aside, annulled or modified on judicial review." 66 Pa. C.S.A. § 316. The volumetric rate base/rate of return rate for this plant was never appealed, and thus it remains conclusive notwithstanding I&E and OCA's revisionist arguments.

Further yet, the OCA has admitted this conclusive effect on page 12 of their MB:

> The determination of rate base/rate of return treatment versus principal and interest surcharge is made during the case in which the plant first becomes used and useful. ... ***once that determination is made by the Commission, there is no opportunity to change the methodology***. (emphasis added)

OCA and I&E's exclusion of PennVest plant argument is that this rate was not rate base/rate of return and depreciation based but rather a debt-service only based rate simply because it was reviewed or reconciled by the Commission a few times over the 20 years in order to meet its rate base/rate of return targeted yield, and because the Company did not include (which would actually have been a duplicate claim) the PennVest plant and depreciation in subsequent rate case filings. (OCA MB at 9-20; OCA Statement No. 1S at 39:12-40:15; I&E MB at 20-24; I&E Statement No. 3-SR at 7:13-20) No matter how they style it, their revisionist arguments are unsupported by the facts and law.

In Ordering Paragraph No. 4 of its Final Order entered June 1, 1993 at Docket No. R-00932594 the Commission approved a Joint Stipulation of Settlement, dated April 30, 1993 between the Company and OCA. The Commission approved a return-on and a recovery of (annual depreciation expense) the investment in the PennVest plant and facilities. The Joint Stipulation for Settlement on page 3, paragraph 7 (GDS Rebuttal Exhibit No. 1) sets forth the ratemaking treatment as follows:

> 7. Regarding the ratemaking treatment of Plant in Service, the Company agrees to Rate Base treatment for plant additions of $4,547,617, constituting amount 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 of increase proposed in this Stipulation: (a) the inclusion of these plant additions in the rate base, along with the return on the increase 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.

(CWC Statement No. 2R at 13:1-15; GDS Rebuttal Exhibit No. 1) Therefore, the PennVest "surcharge" as OCA and I&E, as revisionists, refer to it, was actually a volumetric rate base/rate of return and depreciation based charge applicable to all customer classes. (CWC Statement No. 2R at 2:14-16)

Furthermore, in OCA's own statement in support of the 1993 Joint Stipulation, counsel for OCA stated the following:

> The Proposed Settlement provides for an overall base rate increase of $342,508 on an ongoing basis. 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.

(Tr. 140-141; GDS Rebuttal Exhibit No. 1)

c. Periodic monitoring or review of the rate by the Commission did not change the 1993 Order or how the rate was developed.

First, under the Commission's general powers under Chapter 13 of the Public Utility Code, 66 Pa.C.S. § 1301 *et. seq.*, any rate can be examined to see that it is meeting the revenue and return objective of the rate, and if necessary, adjusted. This does not magically turn a rate base/rate of return volumetric rate into a debt-only PennVest surcharge.[8] OCA and I&E provide no cite to any case or indicate anywhere where the Commission converted the PennVest rate here from a rate base/rate of return volumetric rate into a debt-service only surcharge. As Mr. Shambaugh testified:

> Such PennVest volume rate was an unbundled rate base/rate of return rate which eventually became reconcilable. The 1997 Commission Order allowed Columbia Water to reconcile their rate, but the rate remained one developed based on rate base/rate of return. The reconciliation was to refine the rate to ensure it hit its rate base/rate of return income target.

(Tr. at 139)

The few reconciliations of the rate at the request of the Commission[9] did not and could not change the nature of the charge. The Commission's request for information regarding the rate base/rate of return based rate for the plant and for reconciliations is neither surprising nor unusual. After all, the Commission has an affirmative obligation under The PennVest Act, 35 P.S. § 751.1 *et seq.* to make sure the ratemaking process enables an opportunity to repay the loan.

Unlike a debt service only surcharge with annual or numerous reconciliations, the few reconciliations did not recapture past underages that the plant produced under rate base rate of return and depreciation relative to debt service; rather they adjusted the rate up or down prospectively to try to meet the rate base/rate of return and depreciation money stream goal of

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[8] This rate was a volumetric rate based on usage which is different from a typical PennVest debt-service only surcharge which is a separate line item surcharge divided equally and applied evenly to every customer. *Pa. P.U.C. v. Olwen Heights Water Service Co.*, Docket No. R-00040011 (2005 WL 1060740) (Order entered April 7, 2005) (PUC authorized PennVest Surcharge of $21.02 per customer per quarter); *Pa. P.U.C. v. Wilbar Realty Co. Inc.*, 88 Pa. PUC 1, 1998 (Order entered June 16, 1998) (PUC authorized PennVest Surcharge of $28.80 per customer); and *Pa. P.U.C. v. Mountain Spring Water, Inc.*, Docket No. R-00984346 (1998 WL 8422814) (Order entered July 24, 1998) (PUC authorized PennVest Surcharge of $39 per customer, per quarter for 5/8 inch meters, and $254 per customer, per quarter for 2 inch meters). Therefore, return on Columbia's volumetric rate would fluctuate much more than a separate line item surcharge.

[9] Columbia simply followed the Commission's orders with regard to reconciliations and providing information to the Commission. (Tr. at 145)

the 1993 Order and is consonant with the Commission's obligation under the PennVest Act itself to provide sufficient rates (note the Act does not mandate any particular ratemaking method) to repay the loan.

Finally, I&E and OCA's reading of the Policy Statement itself is wrong as it does not mandate a debt service surcharge as the only PennVest driven rate that may be reconciled. Specifically, 52 Pa. Code Section 69.363(e) states that "Amounts collected under the Section 1307(a) PENNVEST automatic adjustment by means of a sliding scale of rates ***or other method*** are subject to reconciliation and refund." (emphasis added). The 1993 unbundled rate base/rate of return rate clearly under the policy statement itself is an "other method."

i. Comparison of characteristics of Columbia's rate base/rate of return and depreciation rate versus surcharge debt service only rate.

The rate here has the characteristics of a rate base and rate of return rate as opposed to a debt service only surcharge that guarantees 100% collection of the loan as a comparison of the characteristics of Columbia's rate base/rate of return rate versus a Commission debt-service shows. Specifically, in *Pa PUC v. Pennsylvania-American Water Company*, the Commission described a debt-service surcharge as not rate base/rate of return in that it "is a dollar-for dollar form of recovery... [that] will *not* provide return on or of PAWC's investment and/or will not produce a profit to PAWC," but rather only principal and interest. (1998 WL 456747; emphasis in original). Moreover, Commission debt service surcharges typically are kept in a separate account for repayment so that monies collected from ratepayers are available and used to pay the loan, and often are customer based charges as opposed to volumetric.

Here, in contrast, Columbia's volumetric rate for the PennVest plant in the 1993 Order provided for rate base/return and depreciation. (1993 Order *infra.*). The record shows the Company, in compliance and reliance on the 1993 Order depreciated the plant using normal

Commission permitted depreciation principles and lives. (CWC Statement No. 2R at 20:12-21) Moreover, as discussed below, the record shows that Columbia did not collect revenues sufficient to cover the entire loan's debt service on a dollar-for-dollar basis, and in fact was at least approximately $200,000 short. Further, there was no separate account requirement for revenues collected from the charge and in any event ***revenues from the rate were not the sole source of monies for Columbia's repayment of the loan***.[10] Clearly this was not a Commission-style debt service only surcharge.

Revenues produced for rates such as the volumetric rate base/rate of return rate set by the Commission in 1993 have many variables, such as changes in use habits by customers caused by factors like the economy or water use habits. Clearly the Commission was attempting through monitoring and if necessary a few adjustments to the rate, to fulfill its obligation to provide for the chance of repayment. Moreover, the Company never fully recovered the total amount of the PennVest loan. As Mr. Shambaugh testified on cross-examination regarding a company discovery request regarding monies collected versus loan payments due and paid:

> I would like to point out that those same documents reflect the fact that the company never recovered their full principal and interest.
>
> On the final total column, payments are $7,465,166; total revenues received, 7,276,630. So there are fluctuations and variations throughout the course of a company's life and their revenue requirements, and that's just a function of sales, earnings and so forth.
>
> So to look at one specific year and a debt repayment schedule, you could do this with any debt that's out there. They could maybe earn 10 percent this year instead of 9 percent and have excess revenues, and you could apply that then to their outstanding debt and say there is an over-recovery. You have to look at the debt in its totality, and here we're seeing an under-recovery.

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[10] *See* Section (h) at page 22 below.

(Tr. at 159-160) Notably, ***Mr. Shambaugh explained that such over or under recovery is not unusual under a rate base/rate of return methodology***. (Tr. at 159) Accordingly, this important factual distinction distinguishes the rate at issue from a debt service only surcharge that is 100% reconciled.

In sum on this point, these Commission-requested reconciliations of a rate of return/rate base rate did not transform the rate into a debt-service only surcharge, and neither I&E nor OCA have carried their burden on this point. Moreover, the Commission cannot deny a utility return on plant it assumed the obligation to fund during the useful life of that plant.[11]

d. I&E and OCA's PennVest Plant Exclusion Here Violates the Tax Code, the US Constitution, GAAP and Generally Accepted Ratemaking Principles.

As stated above, I&E and OCA bear the burden of proving that their adjustment is reasonable, not incomplete, as well as to make the adjustment correctly. *Popowsky, UGI, Breezewood.* They have not done that here.

i. Accounting and Tax Code Violations Caused By I&E and OCA's Untimely and Retroactive Adjustment.

In reliance upon the Commission's 1993 Order approving the rate base/rate of return and depreciation treatment that OCA wanted in the stipulation, the Company since that time has kept its books and tax accounts in reliance upon that treatment. Now, some 20 years later, the I&E and OCA want to retroactively unwind that by essentially removing that plant—which they admit is used and useful – from the Company's rate base and therefore books. To remove this plant from the rate base and the Company's books (i.e. reflect a zero value), there are only two accounting methods to attempt to accomplish that, and neither of them appear lawful or generally accepted. Both have adverse legal consequences that I&E and OCA blithely fail to consider and

[11] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Bluefield Waterworks Improvement Co. v. Public Service Commission*, 262 U.S. 679 (1923).

address, and as they have the burden on their adjustment, it must fail in addition to the other reasons raised by Columbia. To adopt the PennVest adjustment proposed by the OCA and I&E, the Company would be forced to take one of the following two accounting actions:

First, the Company would need to reflect the PennVest adjustments proposed by OCA and I&E as a Contribution in Aid of Construction ("CIAC")[12] but the repayment of a loan with proceeds from rates does not meet that test under any accounting or Uniform System of Accounts since a CIAC must be given up front by a customer or developer for a utility to fund and install facilities.

Moreover, in generally accepted ratemaking in Pennsylvania the use of monies from rates to repay a loan has never been deemed to be a retroactive CIAC; rather it is debt financing by the Company that is built into the total cost of service. If I&E and OCA's unorthodox theory were correct, then when ***any utility paid off a loan using monies from rates then that plant's useful and depreciable life would be irrelevant and the plant would come out of rate base as a retroactive CIAC.*** That has never been the case and would create financial chaos to utilities. I&E and OCA completely overrule the US Supreme Court *Hope* and *Bluefield* decisions which Pennsylvania and this Commission follow, which provide that a utility is entitled by law to return on (i.e. profit) and return of (i.e. depreciation over depreciable lives) assets it invests in whether by debt or equity. Taken to its end, I&E's same argument could be made or applied to equity funded investment by a utility; for example, if a utility used retained earnings (monies whose source was rates from ratepayers) to build a plant.

[12] If a retroactive CIAC were directed, as I&E and OCA invite, then the Company would have been taxed improperly since 1993, and neither I&E nor OCA offer any solution as to how or if that can be done under the Tax Code. This again typifies the significant problems created by said parties' attempts to rewrite 20 years of financial history by this retroactive adjustment.

Second, and illustrative of the unreasonableness of I&E and OCA's retroactive and untimely adjustment to revise the 1993 Order providing rate base/rate of return and depreciation treatment, the only other way to adopt the PennVest adjustment proposed by OCA and I&E to zero out (remove) the PennVest plant from rate base and the Company's books is to somehow show that it had been depreciated over 20 years or the life of the loan. That, however, results in two illegalities that I&E and OCA ignore. First, under IRS and the Tax Code the facilities involved cannot be depreciated – even if accelerated – for less than 25 years, because the "applicable recovery period" is 25 years.[13] Second, the 1993 Order by the Commission directed ordinary rate base/rate of return and depreciation treatment which obviously does not provide for accelerated depreciation. This illustrates how I&E and OCA overlooked or ignored legal problems with their adjustment and as such failed to carry their burden.

Finally on this point, this retroactive adjustment by I&E and OCA should be rejected, akin the doctrine of laches or estoppel.[14] Specifically, the Company was directed by the 1993 Order, in which OCA was the primary driver, to treat the facilities as rate base/rate of return with depreciation, and now, some 20 years later, after the company in reliance upon that Order and OCA's preference, is now facing an untimely and retroactive adjustment that attempts to unwind the Company's reliance and compliance with that Order, clearly creating harm including removing $4.9 million in used and useful rate base (as I&E and OCA admit), and prospectively

[13] 26 U.S.C. § 168(c); IRS Pub. 946 (2-15-13).

[14] The Commission has stated that the doctrine of laches provides that an action can be barred if one party can show delay arising from the other party's failure to exercise due diligence and prejudice from that delay. See, *Dolman v. Pennsylvania Power and Light Company*, Docket No. C-892353 (Order entered April 30, 1990) (citing *Kehoe v. Gilroy*, 467 A.2d 1 (Pa. Super Ct. 1983). The Commission has found that a "six-year delay in filing a claim raises a presumption of unreasonable delay." *Id.* Here, neither OCA nor I&E did anything to have reconsidered the 1993 Order and now, some 20 years later, they want to rewrite and redo accounting and financial effects relied upon by the Company in following said Order. This is a textbook example of why the adjustment should be rejected as untimely.

requiring the Company to support that plant without any revenue stream mandated by *Hope* and *Bluefield*.

ii. Incomplete Asymmetrical Adjustment by I&E and OCA.

Yet, there are more deficiencies to I&E and OCA's wrong and retroactive adjustment to the PennVest total utility plant in service of $4,902,136 and the corresponding accumulated depreciation reserve of $1,853,844,[15] resulting in a reduction to the Company's utility plant measures of value of $3,048,292. Both adjustments ignore the effect on the Company's accumulated deferred income taxes for rate making purposes, and as such their adjustments are insufficiently developed and lack ratemaking symmetry, and even if they were to be granted (which they should not for the reasons stated in Columbia's Main and Reply Briefs), they should rejected on that basis alone. *Popowsky, UGI, Breezewood.*

Specifically, I&E and OCA's witnesses admitted on cross as to the used and usefulness of the remaining undepreciated utility plant assets of $3,048,292 well beyond the 20 year term of the PennVest loan. (Tr. at 177, 187) However, in making their adjustments, they ignored the offsetting increase to the Company's rate base created by the reduction to the Company's accumulated deferred tax balance as of December 31, 2013 if the assets, as OCA and I&E propose, are stated at a zero (0) dollar value for ratemaking purposes. The Commission's 1993 order established the annual depreciation expense and overall return appropriate for the assets funded by the PennVest loan. Now both I&E and the OCA are challenging that order and ***changing*** the basis of the Company's cost recovery mechanism as stated in that order from a rate base/rate of return basis to a concocted "principal and interest basis."

[15] I&E appears not to have done this in its revision to its revenue requirement calculation offered into evidence at the conclusion of the hearing, and appears to have done so instead in its brief. Its adjustment could be disregarded on this basis alone.

The Company, for the reasons stated in its Main and Reply Brief, submits that there is no basis for I&E and OCA's removal of PennVest plant from rate base. However, *arguendo*, since the life expectancies of the assets are far greater than those lives used for deferred tax purposes, I&E and OCA should have made a significant downward and offsetting adjustment to the Company's claimed accumulated deferred income taxes as of December 31, 2013. At the very minimum, the Company's effective combined state and federal tax rate of approximately 42% applied to the $3,048,292 results in a reduction of $1,280,283 to the Company's accumulated deferred tax balance as of December 31, 2013. This would have increased the Company's measures of value at December 31, 2013 by at least $1.3 million.

iii. I&E and OCA's adjustment is not ground in ratemaking or accounting principles.

Neither I&E nor OCA has set forth the accounting and/or rate making adjustment for the taking of the Company's assets. There are no accounting rules contained in the NARUC Uniform System of Accounts or GAAP that allow for the instant removal of PennVest funded plant, or in fact any assets upon the retirement of the associated debt, thereby stranding the undepreciated assets. To the Company's knowledge, this Commission has never considered or ordered the confiscation of utility assets nor have they accelerated the annual depreciation expense for utility assets to equal the term of the funding for those assets. In fact, accepting the OCA and I&E adjustments, in light of the fact that the depreciation was not accelerated, leaves undepreciated assets floating in limbo. No law or rate making procedure establishes, or even contemplates, the removal of assets from rate base upon the retirement of debt.

If I&E and OCA are successful here, which they should not be, then any loan for any utility that financed plant could be removed from rate base and depreciation eligibility under the fiction that because the utility used revenues from collected rates (for most utilities rates are the only source of revenue) to repay the loan that somehow the ratepayers took the risk of the loan and financed the loan. That has never been the law or a generally accepted ratemaking principle as it essentially substitutes the term or paid in full date of a loan for depreciable lives. The latter is synchronized with taxes and constitutional right to depreciation and profit which the former loan term is not for purposes of setting base rates. A PennVest loan is not by stature or by accounting standards any different than any other debt instrument that a utility would use to finance plant.

The only accounting treatments contained in the NARUC Uniform System of Accounts that even remotely address the parties' position in this proceeding would be the booking of the total $4,902,136 as a Contribution In Aid of Construction (CIAC). However, a CIAC requires an upfront payment of cash from either a customer or a developer. An upfront cash payment was not received from the customers and, thus, this approach must be eliminated. The only other method for removing (establishing zero value for) the assets in this proceeding as proposed by OCA and I&E would have been to accelerate the annual depreciation expense to 20 years (which the Company has not been doing) to match the PennVest loan period. The parties have directly or indirectly testified, and incorrectly, that a full cost recovery of the loan was accomplished through customer rates indicating that accelerated depreciation is the likely basis for their position in this case. There are several serious problems with this approach. The Commission would have had to approve the reduction in useful lives of the plant to 20 years (accelerated depreciation) at the time the assets were placed on the books, which is less time than the parties have previously testified as being used and useful lives. Even if accelerated depreciation is appropriate, and it rarely is adopted for ratemaking purposes, the life expectancies of the assets and annual depreciation rates would have had to have been determined during the 1993 case not retroactively during a rate case proceeding in 2013, and even then the acceleration would have been in conflict with the tax code. The PennVest assets have been and continue to be depreciated to date for ratemaking purposes utilizing the 4% Compound Interest Method. (CWC Statement No. 2R at 20:16-17)

e. I&E and OCA's claim that the PennVest plant was not claimed in subsequent rate cases does not support its position as that would have resulted in double counting such PennVest plant in rates.

I&E and OCA's argument that the Company did not include the plant in rate base in subsequent rate cases should be rejected because the 1993 rate was an essentially unbundled rate base/rate of return rate with depreciation which was periodically reviewed by the Commission and treated separately. Claiming that plant again as part of a separate rate case would, as Columbia's rate expert testified, would have resulted in double claiming or counting that plant. Specifically, with respect to the Company excluding the PennVest plant and depreciation from subsequent rate cases, Mr. Shambaugh explained:

> The PennVest plant was excluded for this particular calculation, because as I testified in my rejoinder testimony, there are two components to the base volume rate. This filing that I'm looking at in Supporting Schedule No. 6 is relative only to the one portion of volume rate that this filing considered.
>
> The PennVest rate was a separate rate that had already been determined, and those two rates then were combined in the Company's subsequent tariff to equal one base rate volume rate.
>
> If I would have included the PennVest in here, it would have, as I testified in my rejoinder testimony, resulted in a double recovery of that investment.

(Tr. at 163-164)

Despite I&E and OCA's continued assertion that the PennVest rate was not a rate base rate of return rate, the facts and law (66 Pa. C.S. § 316) say otherwise. The PennVest volumetric rate was set in 1993 as a rate base/rate of return rate including rate base and depreciation treatment. Simply because that rate is no longer in Columbia's tariff does not mean the remaining undepreciated plant and facilities do not remain used and useful in providing service to the Company's customers. They are, and the fact that the Company did not have a general rate case since 2008 or 2011 until now is of no consequence regarding whether such rate base exists, is used and useful, and subject to further rate recognition relative to its useful and depreciable life. Thus, as Mr. Shambaugh testified, rate base inclusion and associated ratemaking treatment was and remains appropriate. (CWC Statement No. 2R at 2:21-24)

f. The Policy Statement Does Not Support I&E and OCA's Adjustment.

OCA and I&E also argue that the Commission's 1994 policy statement at 52 Pa. Code § 69.361 allows only one method of PennVest loan recovery, either by rate base inclusion or by a PennVest surcharge, (I&E MB at 23) and that the policy statement allows only recovery of principal and interest on the PennVest loans (OCA MB at 11). These arguments should be rejected for several reasons.

First, upon cross, I&E witness Cline conceded that the 1994 policy statement was intended to apply to companies ***who had not yet elected*** rate base or surcharge treatment, and ***Columbia's election in 1993 precedes the 1994 policy statement***. (Tr. at 179) As stated above, Columbia elected through a settlement brokered by the OCA to recover the rates through a rate base/rate of return volumetric charge instead of a debt-service surcharge.

In addition, the policy statement by its own terms does not forbid the continuance of capital recovery and return on investment for the remaining useful and depreciable life of the assets. I&E's witness essentially amends the policy statement to add a prohibition. This prohibition desired by I&E's witness would infringe on a utilities constitutional right to a return on and return of used or useful assets. As Columbia witness Shambaugh explained, under ratemaking fundamentals the term of a loan does not establish the basis for the service lives of the assets or the future life expectancies. (Tr. at 141) Now that the debt service has been retired, the Company simply wants to continue to claim the undepreciated amount of the PennVest plant in service.

g. The *National Utilities* case cited by OCA in support of the adjustment is distinguishable on the facts and law and thus inapposite.

The OCA relies on the case of *Pa. P.U.C. v. National Util. Inc.*,[16] for the argument that post surcharge inclusion of PennVest plant in rate base is not allowed. (OCA MB at 17-20) Reliance on this case, however, is inappropriate because the facts and situation surrounding the PennVest plant in that case are completely different from this case. In *NUI*, the utility was trying to eliminate its initially established PennVest surcharge rate and <u>convert</u> the surcharge rate into a rate base/rate of return rate. *Id.* at *6. That is the complete opposite of what we have here, which is a volumetric rate that is a rate base/rate of return rate, which included the plant in rate base, rate of return, depreciation expense, and income taxes. (CWC Statement No. 2R at 13:1-15; GDS Rebuttal Exhibit No. 1) The Company simply wants to <u>continue</u> including the plant in rate base in order to realize a return on its original cost minus depreciation investment, as is its right.

h. Using revenues from rates to pay a loan does not transform a loan into a retroactive contribution in aid of construction.

Both OCA and I&E make a tautological argument that because a utility loan is paid off with revenues from rates (although for most utilities rates are the only form of revenue and thus all debt is retired using rate generated revenue), and then somehow the ratepayers, not the utility, provided the plant. This assertion is incorrect as rate expert Gary Shambaugh explained:

[16] 1994 WL 711488 (Pa. P.U.C. 1994).

This view by I&E, to which OCA proposes the same adjustment, does not comport with basic Pennsylvania ratemaking. Indeed, for any utility that uses debt as a financing vehicle for its plant investment, which is common, the fact that a utility may use revenues from ratepayers to pay off a loan does not transform that into some type of retroactive contribution in aid of construction. A flaw in their thinking is the reality that a term of a loan does not equal useful or depreciable lives.

That has never been the rule in Pennsylvania ratemaking, and virtually every utility in Pennsylvania has used debt to finance plant and the fact they pay that loan in whole or in part with revenues from rates does not transform that plant into customer-provided plant. The basic source of monies for utilities are rates, so it is improper to conclude that repayment of loans with monies from rates equals a customer purchasing rate base. Thus, rates relative to plant must be viewed on a macro basis and not just on a micro basis fixated on debt service as I&E and OCA have.

It is up to a utility, in its managerial discretion, as to what to apply the monies it collects via rates and what capital to invest in via debt or equity. It could use monies from rates to invest in new plant; however, under the OCA and I&E view, because the source of the monies was customer rates then the new plant would not qualify for rate base and return on because ratepayers were the source of the money. That sets up a Catch 22 that never has been a Pennsylvania ratemaking principle. Contributions in Aid of Construction occur up front to fund facilities unlike rates which, of course, must cover expenses, and other costs including debt service on facilities that are used or useful and provide return on/profit and return of. This Commission must provide rate recovery for the residual which is the undepreciated original cost of the utility plant in service at December 31, 2013.

In fact here, as Company Witness Lewis testified in his rebuttal, the monies used by Columbia to repay debt service were a mix of a variety of the Company's monies including a line of credit, monies from the sale of meter information, and monies from customers from all types of rates collected under its tariff. In fact monies from the Company's general line of credit were deposited into the PennVest account during periods of low cash flow.

Similarly, to demonstrate the fallacy in the proposed adjustment by OCA and I&E, if a utility used monies from retained earnings or, a rainy day fund or general bank account fund and the source of that money is revenues from rates, that does not mean that ratepayers financed that plant and it should be ineligible for return. If that were so, depreciable lives for facilities would become meaningless or irrelevant and utilities would be hamstrung to earn returns on that plant over its useful life on the books.

The OTS and I&E adjustment improperly substitutes customers for the borrower under the loan as if they were responsible for the Loan Obligations themselves and for the risk. They are not. If a customer did not pay rates for service she or he might face only eventual termination of service. There is no risk to a customer as to the PennVest loan. If there was a default on a PennVest loan, penalties or foreclosure, or if the facilities did not operate properly and the Commission deemed them not to be used or useful, then the Company and its shareholders bear that risk. It is without question that since the facilities continue to be used or useful and have remaining depreciable life, the Company and shareholders continue to bear the risk that they will function and remain used and useful for rate base and related cost purposes. Customers do not bear that risk.

Further, loan terms expiring do not at such expiration under fundamental Pennsylvania rate base/ rate of return ratemaking determine a hard stop for recovery of return on or of an asset for ratemaking purposes. For example, useful lives for ratemaking purposes are based upon engineering principles (life expectancies of assets) not lending principles. Like any loan, lenders or borrowers negotiate or in some instances dictate, in the case of lenders, the term of the loan. The Commission's reliance upon such life expectancies has been a fundamental of its ratemaking, and the substitution of loan terms is contrary to generally accepted ratemaking.

Witness Cline further states on Page 8, lines 15 through 17, the following:

"The recovery of plant and the return on any utility plant related to the provision of service should only apply to plant funded by the utility's owners/shareholders."

He is correct as to what he stated as a premise but incorrect in removing the facilities from ratemaking. The plant was funded by the utility's owners/shareholders. I could find no evidence in the PennVest documents in Columbia DTL Rebuttal Exhibit No. 1. where the customers borrowed anything, or provided the security and assumed the legal and financial obligations for the loan. The Company and its shareholders however, clearly did so. Witness Cline's statement could be applied to any utility debt by simply adopting his theory that if the customers pay their rates, then all debt funded plant can be considered contributed property.

(CWC Statement 2R at 4:3-7:6)

Moreover, the record clearly shows rates from ratepayers was not the sole source used to repay the loan; rather, there were multiple sources. Thus, I&E witness Cline's supposition fails entirely. Specifically, Company witness Lewis testified: "[s]everal sources including draws on a line of credit/loan, monies from sales of metering information, a dividend received annually from Workers Compensation insurance, and of course, monies we receive from all our rates under our tariff." (CWC Statement No. 1R at 23:13-15) There was no earmarking or separate account required as for a surcharge under Section 69.363(e) – again another fact distinguishing this rate base rate of return and depreciation based rate from a debt service only surcharge.

i. The Company Bore the Risk of the PennVest Loan.

I&E asserts in its main brief at page 21, that "given the Company's collection of the entire amount of the monies used to add the PennVest-financed plant to the system, it is fair and accurate to state that not one penny of the cost of this portion of plant has come out of the pockets of the Company and they have no right whatsoever to claim that they are entitled to a return of and a return on monies they've invested in plant – because there are none." In other words, as I&E witness Cline testified, "by implementing the PennVest surcharge and collecting the entire original cost of the subject plant, the Company bore virtually no risk." (I&E Statement No. 3-SR at 2:21-22) This argument and testimony is wrong on several bases.

First, as discussed in Section II(3)(c) above, despite the broad (but unfounded) statement of I&E's Main Brief scrivener, the Company did not collect the "entire amount of the monies" through its rate base rate of return rate. (Tr. at 159-160) Second, I&E ignores fundamental ratemaking by essentially suggesting that when a utility repays a loan using monies from rates, that ratepayers financed the facilities, is a mischaracterization of over a hundred years of ratemaking in the US and PA. What the utility is recovering is its investment, and the Company not ratepayers assumed the risk of such investment as the record shows.

Specifically, on cross-examination, I&E witness Cline admitted that the ratepayers did not sign for the loan, promissory note or the pledge of accounts nor do they own the PennVest plant. (Tr. at 177) Furthermore, as Mr. Shambaugh explained, I&E witness Cline ignores the fact that a PennVest loan is like any other loan the Company would take out in that the risk is on the Company and shareholders, not the ratepayers. (Tr. at 143) Mr. Shambaugh continued that, Mr. Cline disregards the financial risk assumed by the Company, such as the loss of a large customer (the loan was a volumetric charge), and the reduction in water use by customers. Mr. Shambaugh explained that Mr. Cline failed to recognize the business risk if the plant fails, or if it needs to be retired early, and the correct view to identify risk is at the beginning point of the loan, not when the debt has been satisfied. (Tr. at 142-143)

I&E and its witness Cline's no risk argument has been refuted by other testimony on the subject. In support of the risk associated with a PennVest loan, in *Lemont Water*, OCA's witness Krauss, in OCA Statement No. 1 aptly described the risk associated with PennVest loans as follows:

> PENNVEST acts very much like a commercial lender on these projects. It frequently requires personal guarantees of stock pledges from the stockholders. It also takes a secured interest in the utility's plant. The documentation and guarantees required by PENNVEST are very similar to those which a commercial lender would require. Thus, the risk to the stockholders is the same as it would be with any other debt financing. Specifically, PENNVEST has first call on the assets of the company. Further, in many instances the stockholders have personal liability to PENNVEST in the event that the utility is unable to meet its obligations. Thus, in a strict financial sense, the stockholders of the utility are bearing risk equivalent to that which they would bear with any debt financing.

(Tr. at 144-145; CWC Rejoinder Exhibit No. 5) The notion that the Company and the shareholders bore no risk by committing to the PennVest loan ignores reality and should be rejected.

In sum, OCA and I&E's arguments are flawed from the beginning as their respective witnesses ***admitted***[17] ***when they took their position they were unaware of the Commission's 1993 Order providing for rate base/rate of return and depreciation treatment of this PennVest plant.*** They stubbornly cling to their revisionist belief that the PennVest rate component was a debt-service only surcharge, which it was not, and that now precludes the Company from earning a return on the PennVest plant. Accepting OCA's and I&E's proposal to remove used or useful assets from the rate base is nothing short of confiscating utility property. The PennVest plant was always included in the PennVest volumetric charge.[18] The remaining undepreciated plant and facilities, as both OCA and I&E admit, remain used and useful in providing service to the Company's customers. (Tr. at 177, 187) The Company is simply requesting that it be allowed to recover a fair rate of return on the undepreciated amount of its investment, which is its right under standard ratemaking principles.

The OCA and I&E have failed to meet their burden of proving that the volumetric rate, which was set in 1993, was a debt-service only 1994 Policy Statement surcharge rate. Accordingly, OCA and I&E's adjustments to remove this plant from rate base should be rejected on this basis as well as for being incomplete.

III. REVENUES

A. Merchandizing Sales and Jobbing Work

The OCA has recommended adding $5,838 of revenue for the sale of bulk water and funds received from the sale of meters and the damage of a fence and air compressor. (OCA MB at 23-26) The Company disagrees that the $5,838 increase recommended by OCA should be

[17] Tr. at 179-180 and 187.

[18] In fact, OTS, now I&E argued in *PUC v. Lemont Water Company* at Dkt. No. R-912114 that it is possible to construct a surcharge that has a rate base/rate of return, which is a return of and a recovery on or recovery of built into it. (Tr. at 140-141; CWC Rejoinder Exhibit No. 4)

included in operating revenues. As Mr. Shambaugh explained, "relative to the other items for bulk water sales and customer disconnect revenue, an average basis calculation will not reflect the lack of stability in those items. Those items are not under the direct control of the Company." (Tr. at 133-134) Mr. Shambaugh testified that those revenues should be booked to the depreciation reserve for the respective plant items under the Uniform System of Accounts. (CWC Statement No. 2R at 17:13-17; GDS Rebuttal Exhibit No. 2) I&E witness Wilson agreed. (I&E Statement No. 2-SR at 3:4-19) Mr. Shambaugh also concluded that "funds received from the sale of meters (salvage) and the damage of a fence and air compressor (insurance) must be recorded to the accumulated depreciation reserve and not recognized as revenue for book and ratemaking purposes." (CWC Statement No. 2R at 18:8-11) Furthermore, he stated that "proper utility accounting dictates that a utility should not recognize the gain or loss on the sale or disposal of fixed capital plant assets. Therefore, any adjustments necessary for the disposal of utility plant should be booked to the respective depreciation reserves." (CWC Statement No. 2R at 18:12-16)

The OCA argues that similar expenses to these were accepted by the Company as operating revenue in the Company's 2008 rate case. However, Mr. Shambaugh testified that he was not the rate expert in that case and he disagrees that it should have been accepted by the Company. (Tr. at 134) Furthermore, the Commission encourages settlements and just because the Company accepted in a previous rate case settlement similar items is not preclusive on the Company in a subsequent case.

The OCA's $5,838 addition to revenue for the sale of bulk water, meters and damage insurance should be rejected.

IV. EXPENSES

A. Acquisition Adjustment

The OCA recommends elimination of the Company's $15,039 amortized expense claim for the expenses associated with the acquisition of the Marietta Gravity Water Company. (OCA MB at 27) I&E does not oppose this expense. The OCA argues that the Company does not qualify under Section 1327 of the Code, 66 Pa.C.S. § 1327, relating to acquisition premiums, and therefore this claim should be denied. This argument fails for numerous reasons.

First, the Company is not claiming an acquisition premium under Section 1327. Company witness Shambaugh explained that the Company is simply requesting a 15-year amortization of the expenses incurred, not the price of the assets in the sales agreement that was in excess of original cost minus depreciation, which is what is contemplated by Section 1327. (CWC Statement No. 2R at 19:9-12) At the hearing, Mr. Shambaugh further testified: "[t]he Company is not making a rate base claim for the difference between the sale price of the assets in the sale agreement and the depreciated book value of the assets. Rather, it seeks the expenses for obtaining a new franchise and the right to serve from this Commission." (Tr. at 137-138)

Second, if the Company's claim is evaluated under Section 1327, which it should not be, this section only pertains to what a utility can elect to do if it wishes to enjoy a rebuttable presumption (1327(a)) that the acquisition premium is reasonable. In essence, it creates an express lane to the approval of the claimed acquisition premium. It does not exclude a party from requesting an acquisition premium or the Commission's evaluation of the same by proceeding down an ordinary speed lane.

The OCA also argues that the Company must petition the Commission in order to amortize these expenses. This is incorrect. A request for deferral is for accounting purposes only. It is not a prerequisite for inclusion in a rate case. The Commission is free to determine the justness and reasonableness of the claim on its merits.[19]

The OCA eliminates all the expenses from the filing. Mr. Shambaugh explained that, at a minimum and in the alternative, the Company's expenditures related to the proceedings to meet the requirements of the Public Utility Code namely, for a certificate of public convenience and to obtain new franchise territory and rights of service and any related regulatory approval such as security certificates to finance the transaction for transferring the permits (such as environmental ones into the Company's name), should be capitalized. (Tr. at 138) He continued that the costs relative to the certificate of public convenience and regulatory approvals are $110,772 for legal services, $9,431.52 for consulting services, and $748.30 for newspaper publication. (Tr. at 138)

Therefore, under this alternative scenario, total capitalized investment would be $120,952 at the Company's recommended rate of return of 9.10%. This would equal an additional net operating income of $11,007. The income taxes would amount to $6,032 for a total increase in revenues of $17,039 which is higher than the Company's $15,039 as claimed in this proceeding by $2,000. (Tr. at 138)

The OCA's recommended elimination of the amortized expense claim of $15,039 for the costs associated with acquisition of the Marietta Gravity Water Company should be rejected, or in the alternative, the Company's revenue should be increased by $17,039 to reflect adding that to the revised Total Measure of Value identified in the Rate Base section of the Company's main brief.

B. Engineering Expense

The OCA recommends a negative adjustment in the amount of $5,505 for Mr. Weigel's services. (OCA MB at 32-33) As Columbia's General Manager Lewis explained, Mr. Weigel's expenses include ongoing monitoring of the Commission and regulatory advice in meeting

[19] *Re Columbia Gas of Pennsylvania, Inc.*, 2012 WL 6208415 (Pa. P.U.C. 2012).

Commission regulatory requirements. (CWC Statement 1R at 3:16-17) He went on to explain that Columbia is a Class A water utility and it is important that the Company stay abreast of and monitor developments at the Commission such as its public meetings, Securities Certificates filings, rulemakings, collaboratives, and legislation (such as the new future test year litigation, Security Planning and Pa One Call administration). (Tr. 110; CWC Rejoinder Exhibit Nos. 1 and 2) He further explained the other alternative would be to hire an attorney or to hire an employee to do those functions and that would cost much more. He then testified it is more economical for the Company to use a consultant with experience in regulatory compliance matters. (Tr. at 110-111) OCA's recommend negative adjustment of the $5,505 for this expense should be rejected.

C. <u>Bad Debt Expense</u>

The OCA recommends a negative adjustment to the Company's bad debt expense claim in the amount of $1,808 based on a four-year average of bad debt expense. (OCA MB at 33-36) Company witness Shambaugh explained that the customer's ability to pay their bills cannot be measured in a four-year average computation, and that in the real world of utility management there is recognition that with customer rate increases, bad debt expense will likely increase because additional customers become delinquent on their water bills. (CWC Statement No. 2R at 15:19-16:2)

Mr. Shambaugh further explained that the Company's filing has a known and measurable level of bad debt expense. (Tr. at 134) He went on to explain that when figuring bad debt expense, it is his position that the Company should use audited numbers and not estimates derived from an averaging basis as suggested by the OCA. (Tr. at 134) In Mr. Shambaugh's opinion, the OCA uses a results-oriented calculation to reduce the Company's claim. (Tr. at 134)

Mr. Shambaugh testified that it has been his experience (over 40 years' experience in preparing various financial studies, including rate studies for electric, gas, water, wastewater, steam heat, chilled water, and telephone companies (CWC Statement No. 2 at 3:5-7)) that when you are dealing with rental apartments and things like that you have a higher level of bad debt expense going forward. (Tr. at 134) Mr. Shambaugh's observations and testimony were, in essence, corroborated by the public input testimony offered by the Manager of the Borough of Columbia, who testified that "[t]he borough is an economically challenged community with a disproportionately high percentage of low-income households, senior citizens and rental housing." (Tr. at 35) The Company's position of using audited, known and measurable current numbers, instead of OCA's 4-year guesstimate is a more accurate way of predicting bad debt expense.

OCA's negative adjustment of $1,808 to bad debt expense based on four-year averaging should be rejected.

D. Allocation of Expenses to the Marietta Division

1. OCA's Allocation Adjustments

The OCA in their testimony and main brief makes numerous adjustments to expenses based on allocations to the Marietta Division over and above what the Company had allocated already and thus did not claim in the filing. The Company's position on the generality and speculative nature of these allocations is set forth in full on pages 22-23 of the Company's main brief but needs some repeating here.

The Company's general manager, Dave Lewis, testified that the Company had already allocated an average of 8% of its employees' time to the Marietta Division; however, the specific percentage varies by employee and the specific amount of time devoted to Marietta Division tasks. (CWC Statement 1R at 2:14-3:8)

In her direct testimony, (and in the OCA's main brief), OCA witness Everette, started by making a sweeping 15% allocation to the Marietta Division per noted employee but later reduced that to specific percentages based on Mr. Lewis' rebuttal testimony, and in some cases eliminated her adjustments altogether. (OCA Statement 1S at 12:21-37:14)

Columbia's allocations to the Marietta Division are based on Mr. Lewis' first-hand knowledge of Columbia's operations. Mr. Lewis testified that he is Vice President and General Manager of Columbia, he has been employed by Columbia for eight years, and before that worked for ARRO Consulting, Inc., providing engineering services to Columbia for approximately 15 years. (CWC Statement No. 1 at 1:7-17) He further testified that he is responsible for the day-to-day management of the Company and his responsibilities include oversight and management of the business office (3 employees), the distribution department (9 employees), the water production department (5 employees), and several part-time/seasonal employees. (CWC Statement No. 1 at 1:20-23) He reports directly to the President of Columbia; however, he also has significant interaction with the other Officers and with the Board of Directors. (CWC Statement No. 1 at 2:3-5)

On the other hand, OCA witness Everette's adjustments are not fact-based and are speculative at best. She conceded on cross that she has never spent any time observing what amount of time the Columbia employees spend working on the Marietta Division tasks. (Tr. at 205) She admitted she is not an expert on private utility water system operations, design or utility financing. She did not even attend the tour of the Company's operations and facilities requested by OCA and I&E and held on July 24, 2013. (Tr. at 190) Mr. Lewis works on a day-to-day basis managing the Company; Ms. Everette does not. It is simply impossible for someone who has no experience working with the water company – and who has never even been there –

to make remote suppositions on the amount of time a Columbia employee spends or should spend working on Marietta Division tasks.

2. Employee Salaries, Wages and Payroll Taxes

The OCA recommends a negative adjustment to the salaries and wages expense claim in the amount of $4,117 based on Everette's speculative 15% allocation factor. (OCA MB at 39). In addition, OCA recommends a corresponding positive adjustment in the amount of $72 to the Company's payroll tax claim.

However, as Company general manager Dave Lewis testified with regard to OCA's sweeping and speculative allocation assignments:

> Q. Throughout their testimony, OCA and I&E make adjustments to expense claims in which they allocate 15% of certain amounts to the Marietta Division of the Company. They base this 15% on your response in a footnote to I&E-RE-06-D where you state that, "Salaried employees have 15 percent of their salaries and benefits expensed to the Marietta Division," and 'On average the salaried employees are spending about 6 hours per week on Marietta Division tasks." How many employees, both salaried and hourly does the Columbia Division employ?
>
> A: The Columbia Division employs 5 salaried employees and 13 hourly employees. The Columbia Division also occasionally uses 3 hourly part-time employees.
>
> Q: Of these employees, how many salaried or hourly employees spend time on Marietta Division tasks?
>
> A: There are 13 employees who may have some involvement with Marietta Division tasks, but most of these employees are involved on a very limited basis. Some of the involvement has been to get the employee familiar with the Marietta Division system in case their help is required in an emergency.
>
> Q: What is the percentage of time that the Columbia Division workforce, as a whole, spends on Marietta Division tasks?
>
> A: The Columbia Division workforce, as a whole, spends about 8% of their time on Marietta Division tasks. The Marietta Division employees and their contract operators were

> retained and continue to do the bulk of the work within that division. The Columbia Division tasks did not magically disappear when the Marietta Division was purchased so the Columbia Division workforce is for the most part consumed and busy with Columbia Division tasks. Some of the field supervisors spend up to 15% of their time on Marietta Division tasks while other employees have no involvement at all, thus as a whole, we spend 8% of our time on Marietta Division tasks.
>
> Q: Do you believe that this percentage is a more accurate reflection of the amount of time that Columbia Division employees spend on Marietta Division tasks?
>
> A: Yes. This percentage reflects the true amount of time spent by the Columbia Division employees as a whole on Marietta Division tasks. There is not enough time in the day for the Columbia Division workforce to dedicate much of their time to Marietta Division tasks. Those employees in the Marietta Division do the bulk of the Marietta Division tasks.

(CWC Statement No. 1R at 2:21-3:8)

Furthermore, with regard to specific allocations by OCA witness Everette, Mr. Lewis testified that she allocates 15% of the foreman's salary to the Marietta Division. (OCA Exhibit AEE-1S, Schedule 2S, line 6) She bases this allocation on his job description. (OCA Statement 1S at 15:10-12) Mr. Lewis testified that a person's general job description is not used as a specific basis for assigning tasks. (Tr. at 107) He explained the foreman's job description may include tasks that get completed in the Marietta Division (in fact they get completed in every water utility in Pa.), but that does not mean that the foreman will be the person actually assigned to complete those tasks. (Tr. at 107) Witness Everette has no knowledge of how Columbia assigns tasks to employees and how they operate their facility. As Mr. Lewis explained, the fact remains that the foreman spends nearly all of his time completing Columbia Division tasks. (Tr. at 107) He further explained that Columbia's allocation of 4.22% for the foreman as explained in its response to OCA-I-25 is based on the time spent in the fourth quarter of 2012 and the way Columbia assigns employees to do work tasks. (Tr. at 107-108)

He further testified that OCA witness Everette allocates 15% of the service person's salary to the Marietta Division. (OCA Exhibit AEE-1S, Schedule 2S, line 10) Mr. Lewis testified that, just like the foreman, a person's job description is not used as the basis for assigning tasks. He further testified that the Company's original allocation of 2.31% was based upon time spent in the fourth quarter (of 2012) and it is based upon the way Columbia assigns employees to do work tasks. (Tr. at 109)

With regard to OCA's corresponding positive adjustment to the Company's payroll tax claim, Mr. Lewis testified that this allocation is based on OCA's flawed and speculative allocations of the Company's employee salaries and wages to the Marietta Division. As Mr. Lewis explained, the Company had already allocated an average of 8% of its employees' time to the Marietta Division; however, the specific percentage varies by employee and the specific amount of time devoted to Marietta Division tasks. (CWC Statement 1R at 2:14-3:8)

The OCA's negative adjustment to the Company's salaries and wages in the amount of $4,117 should be rejected. In addition, the OCA's positive adjustment of $72 should be rejected, and the Company's original claim for payroll tax expense, in the amount of $75,060 should be accepted.

3. Pension and Benefits

a. Health Insurance

The OCA recommends a negative adjustment of $8,681 to the Company's Pension and Benefits expense for employee health insurance that OCA witness Everette allocated to the Marietta Division. (OCA MB at 42) OCA witness Everette bases this allocation on her allegation that the Company did not provide in discovery the particular benefits for each employee, (the Company provided the actual overall cost of the benefit and was not asked to provide a breakdown of this information by employee (Tr. at 113)) so she uses her flawed speculation of what she believes is the time spent by each employee on Marietta Gravity tasks. (OCA MB at 42; OCA Statement 1S at 20:12-21:5) This speculative time allocation is incorrect, and Ms. Everette agreed upon cross that adjustments should not be based upon speculation. (Tr. at 187)

As Mr. Lewis explained, health insurance costs vary widely from employee to employee. Some employees opt out of coverage. Some employees enroll just themselves while others enroll their entire families. (Tr. at 113-114) He further explained that the allocations that the Company provided take into account these discrete, employee-specific, varying health insurance costs. (Tr. at 114) He testified that the Company's allocations of employee health insurance benefits were based upon the percentage of the person's time allocated to the Marietta Division and the actual costs of the person's benefits. (CWC Statement 1R at 10:5-8)

In addition, Mr. Lewis testified that since the Company's filing, the Company received a quote that its health insurance premium will go up by a total of $42,521 over the $105,963 pro forma amount it claimed in its filing which would bring the total to $148,484. (CWC Statement No. 1R at 10:13-17) The OCA recommends complete rejection of this increase because it alleges the Company did not provide any support for this increase. (OCA MB at 40-41) The Company did provide support for this increase through the testimony of Mr. Lewis. (CWC Statement No. 1R at 10:13-17) This cost is known and measurable, and the Company doubts OCA would ask the Commission to ignore the notice if it was a decrease in insurance rates. OCA's position to ignore the increase, if accepted, will guarantee a lack of expense coverage at the approximate time the rates will become effective. That should not be the goal of ratemaking.

The OCA's recommended negative adjustment of $8,681 to the Company's health insurance expense was based on a flawed and speculative allocation and should be rejected, and the total Company claim for health insurance in the amount of $148,484 should be accepted.

b. Pension Expense

The OCA recommends a negative adjustment of $4,846 to the Company's Pension and Benefits expense for pension expense that OCA witness Everette allocates to the Marietta Division using the same faulty, speculative allocation logic she used for health insurance. (OCA MB at 43; OCA Statement 1S at 21:18-22:2; OCA Exhibit AEE-1S, Schedule 6S, line 3) As Columbia's general manager Mr. Lewis explained, the Company's allocation of pension expense to the Marietta Division was based upon the percentage of the person's time allocated to the Marietta Division and the actual costs of the person's benefits. (CWC Statement 1R at 10:19-11:4)

The OCA's recommended negative adjustment of $4,846 to the Company's pension expense was based on a flawed and speculative allocation and should be rejected.

c. Disability and Life Insurance

The OCA recommends a negative adjustment of $765 to the Company's Pension and Benefits expense for disability and life insurance expense allocated to the Marietta Division based on witness Everette's same faulty, speculative allocation logic she used for health insurance and pension expense. (OCA MB at 43-44; OCA Statement 1S at 22:4-12; OCA Exhibit AEE-1S, Schedule 6S, line 4)

As Columbia's general manager Mr. Lewis explained, the Company's allocations of disability and life insurance benefits were based upon the percentage of the person's time allocated to the Marietta Division and the actual costs of the person's benefits. (CWC Statement 1R at 11:9-13)

In addition, Mr. Lewis testified that since the Company's filing, the Company received a quote that its disability/life insurance premium will go up by a total of $1,659 over the $9,147 amount it claimed in its filing which would bring the total to $10,806. (CWC Statement No. 1R at 11:15-19) The OCA recommends complete rejection of this increase because it alleges the Company did not provide any support for this increase. (OCA MB at 44) The Company did provide support for this increase through the testimony of Mr. Lewis. (CWC Statement No. 1R at 11:15-19) This cost is known and measurable, and the Company doubts OCA would ask the Commission to ignore the notice if it was a decrease in insurance rates. OCA's position to ignore the increase, if accepted, will guarantee a lack of expense coverage at the approximate time the rates will become effective. That should not be the goal of ratemaking

The OCA's recommended negative adjustment of $765 to the Company's disability and life insurance is based on a flawed, speculative allocation and should be rejected and the Company's total claim in the amount of $10,806 should be accepted.

d. Employee Recognition

Both OCA and I&E recommend a negative adjustment to the Company's employee recognition claim of $6,051. (OCA MB at 44-46; I&E MB at 35-36). OCA argues that Mr. Lewis put forth no evidence to support the claim that outings are required to retain employees. (OCA MB at 44)

First, these are not outings. As Mr. Lewis explained, this is not a group or Company trip to Hershey Park. Neither is it an event, party nor a picnic. The Company provides Hershey Park tickets to its employees as an economic benefit as part of their overall compensation package. The employees use their ticket when they want during the year. The employee must use it on their own time, perhaps on a weekend, or they take a vacation day to use it. (Tr. at 112). Further, the Company did present credible evidence to support its claim; namely, ***Mr. Lewis's***

direct testimony. Mr. Lewis testified that the Hershey Park tickets and the year-end banquet are economic benefits the Company has been providing for years which are calculated to retain and compensate employees. (CWC Statement No. 1R at 12:30) He testified that Columbia is a tiny Company and must use benefits like this to keep highly skilled workers and to compete with other private water utilities, as well as municipal water and wastewater authorities. (Tr. at 112-113)

The banquet is an equally important tool to foster, retain, and provide reinforcement and feedback for workers who perform very well. Such claims have been accepted by the Commission. For instance, in *Pa. PUC v. York Water Co.*, 62 Pa. P.U.C. 459 at 487 (1986) the Commission allowed expenses related to an end of year service award banquet. The Commission determined that an award dinner or banquet gave the utility the opportunity to recognize employees for service to the utility and its customers. The Commission reasoned that this recognition would, in turn, foster improved employer-employee relations and result in a more satisfied and effective work force. *Id.* The same result should apply here.

The OCA and I&E's recommended elimination of $6,051 to the Company's employee recognition claim should be rejected.

4. Vehicle Insurance

The OCA has recommended a negative adjustment to the Company's vehicle insurance claim in the amount of $589. (OCA MB at 46-48) I&E did not oppose this claim. The OCA's adjustment is based on the same faulty speculative allocation logic Ms. Everette used for Pension and Benefits. (OCA MB at 47) OCA also alleges that there is a contradiction in Mr. Lewis' testimony concerning the allocation of vehicle cost to the Marietta Division. (OCA MB at 47; OCA Statement 1S at 24:11-19) This is simply not true.

Mr. Lewis testified that the Marietta Division has its own vehicle, and, thus, most of the vehicle costs are associated with that vehicle. (Tr. at 114) He explained that many of the employees that do Marietta Division work do not use vehicles; for example, customer service personnel, the office manager, and the production superintendent. Even meter readers mainly walk and only use the vehicle to get to the service area. (Tr. at 114) He further explained that the vehicle use associated with the Marietta Division is minimal even when you include the hours of those employees that do Marietta Division tasks and use vehicles and, if anything, it is less than 4 percent, which is the amount of time the Company allocated for the foreman and the meter readers and other employees who do Marietta tasks. (Tr. at 114-115) The Company's vehicle costs will go up if they are used substantially for the Marietta Division, and those additional costs will be allocated to the Marietta Division. (Tr. at 115) The existing costs cannot be shared but rather the increase in cost will be expensed to the Marietta Division.

In addition, Mr. Lewis testified that the Company, based upon a notice from its insurance carrier received during this rate case that its vehicle insurance rates will be increasing, has adjusted its expense claim upward by $837 due to the increase in the vehicle insurance premium. (CWC Statement No. 1R at 13:7-8; DTL Rebuttal Exhibit No. 1) The OCA recommends complete rejection of the increase because the policy falls partly outside the FTY, or in the alternative, to allocate 8.54% to the Marietta Division. (OCA MB 47-48; OCA Statement 1S at 25:4-11) First of all, the allocation to the Marietta Division should be rejected based on the allocation argument above. Second, the cost is known and measurable, and the Company doubts OCA would ask the Commission to ignore the notice if it was a decrease in insurance rates. OCA's position to ignore it, if accepted, will guarantee a lack of expense coverage at the approximate time the rates will become effective. That should not be the goal of ratemaking.

The OCA's recommended negative adjustment of $589 to the Company's vehicle insurance claim and elimination of the update should be rejected, and the Company's updated total claim of $7,737 (GDS Rebuttal Exhibit No.3 (Revised) at 2), which includes the updated insurance rate information, should be adopted.

5. Workers Compensation Insurance

The OCA recommends a negative adjustment of $2,938 to the Company's workers compensation insurance claim for the portion it allocates to the Marietta Division using the same faulty, speculative allocation logic it used for Pension and Benefits. (OCA MB at 48-50; OCA Statement 1S at 25:14-26:2; OCA Exhibit AEE-1S, Schedule 1S, line 25) I&E did not oppose this claim. The Company's general manager Mr. Lewis testified that workers compensation insurance premiums are based upon wages and the classification of the employee, and it is unreasonable to use a blanket amount to allocate and should be based on the actual amount of time allocated to the Marietta Division. He also explained that the 3.8% allocation in the original filing is based upon the actual hours worked on Marietta Division tasks. (CWC Statement 1R at 13:14-19)

In addition, Mr. Lewis testified that the Company has increased its expense claim by $2,752 based upon information received from the carrier during this case due to an increase in the worker's compensation premium. (CWC Statement No. 1R at 13:21-22; DTL Rebuttal Exhibit No. 1) The OCA recommends complete rejection of the increase because the policy falls partly outside the FTY, or in the alternative, to allocate 11.99% to the Marietta Division. (OCA MB at 50; OCA Statement 1S at 26:6-13) First of all, the allocation to the Marietta Division should be rejected based on the allocation argument above. Second, the cost is known and measurable. It is notice that the insurance premium <u>has</u> increased and if it is rejected, it will guarantee a lack of expense coverage at the approximate time the rates will become effective. Again, that should not be the goal of ratemaking.

The OCA's recommended negative adjustment of $2,938 to the Company's workers compensation insurance claim and the update should be rejected, and the Company's updated total claim of $27,252, which includes the updated worker's compensation insurance rate information, should be adopted.

6. Accounting and Auditing

The OCA recommends a negative adjustment of $2,364 to the Company's accounting and auditing claim for the portion that witness Everette allocates to the Marietta Division using an allocation percentage of 12% for the relative number of Marietta Division customers. (OCA MB at 50-52; OCA Statement 1S at 28:17-29:2; OCA Exhibit AEE-1S, Schedule 1S, line 26)

This allocation is incorrect, however, as the Company's general manager Mr. Lewis testified that the Marietta Division has different rates, and the Company needs to use separate accounting tools to properly track and account for the costs associated with the Marietta Division. (Tr. at 115) He explained that the auditors will use the separate books of the two divisions to prepare one consolidated tax return. (Tr. at 116) He further explained that with the separate divisions, Columbia will be preparing separate budgets, keeping separate books, and preparing separate depreciation calculations and accruals. Moreover, he continued, the Columbia Division's accounting costs will not go down or somehow get shared with the Marietta Division, but instead will increase as discussed above and the additional costs will get allocated to the Marietta Division. (CWC Statement 1R at 14:6-11) For example, as Mr. Lewis testified "our accountants have estimated that our accounting cost will increase by approximately 15% due to increased effort and time that will be associated with the separate Marietta Division books." (CWC Statement No. 2R at 14:11-13; DTL Rebuttal Exhibit No. 2) This statement is not meant to show that Columbia's accounting costs will increase, but is a projection of future accounting expenses associated with additional Marietta Division work. These expenses will be allocated solely to the Marietta Division when they occur. The existing costs cannot be shared but rather the increase in cost will be expensed to the Marietta Division.

The OCA's recommended negative adjustment of $2,364 to the Company's accounting and auditing expenses claim should be rejected and the Company's claim of $28,300 should be accepted.

E. <u>Officers' Salaries and Director's Fees</u>

1. Adjustment to Officers' Salaries and Director's Fees

The OCA recommends a negative adjustment to the Company's claim for officers' salaries and directors' fees in the combined amount of $33,451. (OCA MB at 54) I&E does not contest the salaries and fees. Although officers' salary is a distinct and separate claim from directors' fees, the OCA addresses the reasonableness of the salaries and fees together in its main brief. (OCA MB at 53-59). The Company has set forth its counter arguments in separate sections of its main brief, however, will address both here in reply as the OCA has done.

The OCA's evaluation of the reasonableness of the officers' salaries and directors' fees centers solely around the simplistic view that the value or worth to the Company by an Officer or Director can be measured by the amount of recorded time spent on Company business and then conveniently converts the salaries and fees to an hourly rate. The OCA states that "[t]he time the officers/directors spend on Company business is an indication of their active contribution to the utility" and "[t]he OCA is making a recommendation based on the record evidence regarding the relative amount of each individual's contribution to the Company, taking into consideration their time spent on Company business and the compensation that a competitive business might pay." (OCA MB at 54 and 58) As set forth in the Company's main brief and below, while this method might be simplistic and easy it is not based on any Commission precedent and does not capture the responsibility, liability, or legal risks associated with these positions.

The Company's claim for Officers' salaries is substantially less than the $80,800 that was approved for officers and $68,000 that was approved for directors by the Commission in Columbia's last rate case in 2008. *Pa. Pub. Util. Commn. v. Columbia Water Company*, Docket No. R-2008-2045157 (Final Order Entered June 10, 2009). The OCA has provided no evidence since that Order that the performance of the Company's Officers or Directors has lessened in any way. In fact, as Mr. Lewis testified to, and is set forth in detail in the performance factor section of this brief, Section V(B)(1), the Company has provided exemplary performance over the past several years. Its quality of service has been outstanding and it has found numerous ways to streamline its business and reach out to the community, all the while maintaining its staffing levels, thus saving its customers money. (CWC Statement No. 1 at 5:8-8:17; Tr. at 120-121) This did not happen by accident but instead is the direct result of the thorough and effective oversight and guidance provided by the officers and directors. Furthermore, OCA witness Everette admitted that she did not even review the Commission's management audits of the Company, and was not aware of any Commission audit that said that the Company's Board or its Officers were not actively contributing to the Company's well-being. (Tr. at 203) A review of these audits at Docket Nos. D-2011-2218445 and D-08MEI002 reveals that the Commission found no problems with the compensation of the Officers or Directors. Moreover, Mr. Lewis testified that neither the Company's Officers nor Directors have had any raise in salaries or fees since 2009. (CWC Statement No. 1 at 17:17-18) The Company is not requesting a raise in salaries or fees in this filing. Certainly, the salaries that were accepted as being reasonable in 2009 (and are less in 2013) are reasonable today, particularly given the continued outstanding performance of the Company.

Even though the OCA states that they realize that these employees are salaried and do not work specific hours to earn their compensation (OCA MB at 56; OCA Statement 1S at 30:8-10), they go right ahead and convert their salaries into hourly wages and use those hourly wages as a way to attack the reasonableness of the Officers' and Directors' salaries. (OCA MB at 57, OCA Statement 1 at 56:10-57:16) Ms. Everette states in her testimony that it is her job to "recommend adjustments pursuant to generally accepted accounting and ratemaking principles," (OCA Statement 1 at 3:15-16; Tr. at 186) and goes on to agree that generally accepted principles provide for adjustments based on fact rather than speculation. (Tr. at 187) However, after making those statements she admits making the hourly conversion of the Directors' fees and Officers' salaries, as a way to determine reasonableness, without any Commission or "generally accepted rate making principles" precedent. Specifically, she admitted that her proposed method has never been accepted by this Commission. (Tr. at 204-205)[20] An hourly computation is a bad fit from the start for a non-hourly job, and it is rife with Ms. Everette's subjective judgment. She conceded she has never been an officer or director of a single company, has never been on a Board of Directors and has never met with Columbia Directors or visited Columbia Water. (Tr. at 190) She fails to comprehend the true responsibilities, liabilities, or legal obligations of the Company's Officers and Directors. She also fails to recognize or identify any portion of their salary that is associated with the responsibilities, liabilities, personal exposure and legal obligations that they assume, but instead tries to tie all of the compensation to the time spent within the walls of the Company's office.

[20] On page 62 of its main brief, the OCA states that it also recommended that Newtown Artesian Water Company's officers and directors be required to keep time records, but conveniently fails to mention that this recommendation was never implemented because that case settled, leaving no such time sheet requirement in effect.

The performance of the Company, its ability to consistently meet and exceed regulatory requirements and the consistent quality of water service are what really matter. As much as the OCA tries to make the claim, the fact remains that the Officers and Directors are not paid hourly. As Company general manager Mr. Lewis, who works closely with the Officers and Directors explained, "a timesheet will never capture the true amount of time spent by each, the legal responsibilities that they each have and the personal exposure that each assumes with the position."[21] (CWC Statement No. 1R at 17:7-9)

As Mr. Lewis testified:

> It is well-established business practice across our nation that directors and officers are to be compensated for the corporate responsibilities and legal exposure that they assume. A timesheet never fully captures the phone calls at home from employees, customers or local officials. It never captures time spent with customers who stop them on the sidewalk, in a restaurant or at church to discuss Company business. A timesheet never captures time spent fretting over cash flow, capital needs or staffing issues. A timesheet never captures time spent worrying about how to initiate or complete necessary capital projects. And of course, the timesheet will not limit their responsibility and liability should a legal or regulatory issue arise.

(CWC Statement 1R at 17:6-18)

As Mr. Lewis observed "the OCA ignores quality in exchange for quantity." He explained that "[c]learly the Officers and Directors must be providing the correct amount of time and attention to the Company as evidenced by [its] stellar regulatory and fiduciary record." (CWC Statement No. 1R at 18:1-5) He concluded that "The Company's consistently outstanding regulatory performance and utility service is indication that the compensation is proper and necessary." (Tr. at 117) Well run companies do not happen by accident but instead as the result of deliberate and well executed oversight.

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[21] The duties and responsibilities of the Company's officers and directors are lengthy and are set forth in full in the Company's main brief on pages 35 -39 and will not be repeated here.

Finally, specific to the Directors' fees, Mr. Lewis pointed out in his testimony, the per-meeting cost of the Directors' fees in this filing is $570. (CWC Statement No. 1R at 19:7-8) Mr. Lewis testified further that while the Company continues to believe OCA is engaging in micromanaging and invading the Company's managerial discretion, it believes that even using OCA's position elsewhere on this subject for a Class A water company for comparison, it meets and is well below the OCA's then stated standard in terms of compensation to directors. (CWC Statement No. 1R at 19:10-13)

Specifically, Mr. Lewis testified that his Rebuttal Exhibit, DTL Rebuttal Exhibit No. 3, is OCA's response to Columbia's Set I Discovery Requests, Request 5, and in that response, OCA supplied previous testimony where the OCA employee witness used for Newtown Artesian Water Company the York Water Company's average ***per-meeting*** cost of $1,560 as being reasonable compensation for the directors of Newtown Artesian. Columbia's compensation to its directors is nearly 1/3 of this per-meeting cost that the OCA had deemed reasonable in its 2011 testimony. Clearly the Company's compensation for its Directors in this filing is more than reasonable, and arguably is inadequately low, by OCA's standard. (CWC Statement No. 1R at 19:15-23)

The OCA's negative adjustment to Officers' salaries and Directors' fees in the amount of $33,451 should be rejected.

2. Allocation of Officers' Salaries and Directors' Fees to the Marietta Division.

The OCA recommends a negative adjustment to the Company's Officers' salaries and Directors' fees, in the amount of $14,608, based on a 15% allocation to the Marietta Division. (OCA MB at 63-65; OCA Statement 1R at 37:13-14; OCA Exhibit AEE-1S, Schedule 1S, line 32) I&E recommends, based upon respective customer counts for the two divisions, a negative adjustment to Officers' salaries of $8,268. (I&E MB at I&E Statement No. 2-SR at 4:12-14) Both OCA and I&E recommend these adjustments based on their allocation factors of 15% and 12% respectively. The Company, in response to OCA and I&E's direct testimony, has agreed to allocate 4.3% of its Officers' salaries and Directors' fees to the Marietta Division, thus reducing its claim for Officers' salaries to $66,144 and Directors' fees to $60,036. (CWC Statement No. 1R at 21:4-5; GDS Rebuttal Exhibit No. 3 (Revised), page 2)

The OCA argues that the Company's allocation of 4% (it is actually 4.3%) is unsupported and unreasonably low. (OCA MB at 64) This is not true, however, as the allocation is supported by the direct testimony of the Company's general manager, Mr. Lewis, as are all the Company's direct allocations to the Marietta Division. As discussed previously, Mr. Lewis's allocations are based on his personal experience directly managing the day to day operations of the Company, which includes supervision of its employees and directly working with the Company's Officers and Directors. (CWC Statement No. 1 at 1:7-2:5) The inherent problems with using blanket allocations by OCA and I&E have been previously discussed in Section IV(D)(1). Moreover, as Mr. Lewis explained, equating Officer and Directors' time spent on Marietta Division business with the amount of time that Company field supervisors spend on Marietta Division tasks is simplistic and simply wrong. (CWC Statement No. 1R at 20:10-12) As Mr. Lewis testified, the supervisors for Columbia are overseeing personnel, interacting with regulatory agencies, establishing schedules and work tasks, inspecting work products, evaluating equipment performance and reviewing water quality goals and results. (Columbia Statement No. 1R at 20:5-10) He further testified that equating the time spent by Officers and Directors to that of the supervisors is not reasonable on this basis alone and incorrectly compares full time supervisors to part-time Officers and Directors. (Columbia Statement No. 1R at 20:5-10)

Furthermore, as Mr. Lewis testified, Ms. Everette also tries to justify the 15% by stating that it is similar to the compensation received by the Marietta Gravity Water Company directors and officers, but the Company believes that is flawed because it fails to recognize that that additional compensation was for additional or incremental work and responsibilities that those at Marietta Gravity had to do. (Columbia Statement No. 1R at 20:15-19) Mr. Lewis testified that OCA fails to recognize that the Company's Directors and Officers still will have to provide the same level of effort and work – and potentially more if the need arises – for the Columbia Division. (Columbia Statement No. 1R at 20:21-24) The Company believes that the 4.3% that it agreed to allocate is a more realistic allocation of the Officers' salaries and Directors' fees to the Marietta Division. (CWC Statement No. 1R at 21:1-5)

Moreover, the 4.3% that the Company recommends is based upon the same reasons used for office staff and customer service personnel that were accepted by OCA witness Everette and I&E witness Wilson. (Tr. at 117) Mr. Lewis testified that revenue for the Marietta Division comes into the company on a quarterly basis since these customers are billed quarterly. As a result, most of the financial data related to the Marietta Division also cycles on a quarterly basis. (Tr. at 117) He further testified that most customer-related activity tends to revolve around billing cycles, and that activity is what makes up a lot of the officers' and directors' time. The Marietta Division brings additional work and tasks to the officers and directors. So this work is on top of what they are doing with the Columbia Division. The Marietta Division work is additional work and in no way becomes shared work with the Columbia Division. The Company's 4.3% allocation represents a representative allocation for the Marietta Division's portion of the work done by the officers and directors. (Tr. at 117-118)

The OCA and I&E's recommended negative adjustments to Officers' salaries and Directors' fees based on allocation to the Marietta Division should be rejected, and the Company's 4.3% negative adjustment, resulting in an allocation of $2,756 to the Marietta Division, should be accepted.

V. RATE OF RETURN

A. Capital Structure and Rate of Return on Common Equity

1. The Company's Cost of Capital is Reasonable

The Company has proposed and supported an overall cost of capital of 9.09% in this case, based on its pro forma capital structure and capital component cost rates, including a return on common equity of 11.35%. The overall cost of capital is a function of the capital structure and the component cost rates of the various forms of capital, including long-term debt, short-term debt, preferred stock, and common equity. The Company has demonstrated, through the testimony of Company Witness D'Ascendis, that its recommended cost of capital for Columbia Water is reasonable and should be approved by the Commission.

a. The Company's Proposed Capital Structure Should Be Approved

Columbia Water's pro forma capital structure of 35.60% long-term debt and 64.40% common equity is in accordance with sound ratemaking principles. I&E and OCA proposed hypothetical capital structures of 50% long-term debt and 50% common equity and 44.15% long-term debt and 55.85% common equity respectively, which are unrelated to the Company's pro forma end-of-test-period capital structure. (I&E MB at 16, OCA MB at 66) (CWC MB at 49-50) The capital structure proposed by the Company is consistent with the Commission's expressed preference for using a company's actual capital structure absent the abuse of management discretion or arbitrary action which resulted in a disproportionate weighting of the Company's capital structure on the debt or equity side. *Pa. P.U.C. v. Columbia Water Company,* Dkt. R-2008-2045157 (Final Order Entered June 10, 2009) at 66-68 and 71.

The parties have failed to demonstrate that ratepayers will be unnecessarily burdened by Columbia's capital structure in this case or that Columbia Water's management has purposely used its discretion to manipulate its capital structure to disproportionate levels. The Company's relatively strong capital structure benefits the Company and ratepayers by providing financing flexibility and access to capital when required. Accordingly, the Commission should approve the capital structure proposed by the Company, which is virtually the same as the capital structure approved by the Commission in the Company's last rate case, for setting rates in this case. (CWC St. No. 3R at 2:10-3:6)

b. An Appropriate Return on Equity for Columbia Water is 11.35%.

Of all the cost of equity witnesses in this proceeding, Company Witness D'Ascendis was the only one to use a full array of methodologies available to estimate the cost of common equity, including the Discounted Cash Flow ("DCF") method, the Risk Premium Model ("RPM"), and the Capital Asset Pricing Model ("CAPM"), including the empirical CAPM and to evaluate the market cost of capital for a non-price regulated proxy group. Mr. D'Ascendis selected a group of twenty-nine domestic, non-price regulated companies comparable in total risk to his group of nine water companies and applied the same three cost-of-equity models as additional data points to consider. (CWC St. No. 3 at 2:22-3:11)

Both I&E and OCA criticized Mr. D'Ascendis' use of multiple models in his direct testimony. I&E states in its main brief; "Ms. Maurer provides her definitive opinion that the DCF method is the superior method for determining the rate of return for the current market..." (I&E MB at 49) Additionally, OCA states in its main brief; "[i]t is critical to have one accurate model. Adding more models, particularly if they are flawed, does not increase accuracy." (OCA MB at 74) Both I&E and OCA fail to recognize that all cost of common equity models have underlying assumptions that are not true in reality and that to gain the most insight into the investor-required return on common equity, an analyst must look at multiple models and using their judgment, arrive at their opinion. Mr. D'Ascendis supplied a number of references from the financial literature supporting his use of multiple models, (CWC Statement No. 3R at 5-6) whereas neither I&E nor OCA supplied any financial literature that support using only one model exclusively.

OCA criticized Mr. D'Ascendis' use of analyst forecasts of long-term earnings growth in his DCF analysis, (OCA MB at 79) even though the Company, I&E, and OCA all rely on analyst forecasts in some form for their DCF analysis. (CWC St. No. 3 at 16:12-13; I&E St. No. 1 at 24:16-19; OCA St. 2 at 34:7-11) Both I&E and the Company exclusively relied on analyst forecasts in their applications of the DCF model. (CWC St. No. 3 at 16:12-13; I&E St. No. 1 at 24:16-19) Mr. D'Ascendis again supplied citations to the financial literature that support his position of using analyst forecasts when using the DCF model, (CWC Statement No. 3R at 22-23) whereas OCA did not supply any cite to financial literature that support its use of sustainable growth in any of its testimonies.

OCA criticizes Mr. D'Ascendis' exclusive use of arithmetic mean returns in the application of his risk premium and CAPM / ECAPM analyses. (OCA MB at 85) Again, in his rebuttal testimony, Mr. D'Ascendis provided proof in the form citations from the financial literature that supports the use of the arithmetic mean for cost of capital purposes (CWC Statement No. 3R at 14:26-16:21) and again, neither I&E nor OCA provided evidence from the financial literature that supported using the geometric mean for cost of capital purposes.

I&E criticized Mr. D'Ascendis' analysis of non-price regulated companies, because it opined that the companies were selected based on beta alone and that the companies in the group represented industries different from the regulated water utility industry. (I&E St. No. 1 at 12:11-13:3) I&E fails to understand that Mr. D'Ascendis' twenty-nine non-price regulated companies were selected based on both unadjusted beta (market risk) and the standard error of the regression (diversifiable risk) which equal total risk, and since these non-regulated companies are comparable in total risk to the proxy group of water companies, their common equity cost rates are applicable to what an investor would expect as a return on common equity for Columbia Water. (CWC St. No. 3 at 30:1-31:4) In seeking capital in the marketplace, the Company must compete not only with other price regulated companies, but also with non-price regulated companies. (CWC St. No. 3 at 29:15-25) Therefore, the market-based analysis by Mr. D'Ascendis of the twenty-nine comparable risk non-price regulated companies is highly relevant to the development of a reasonable cost of equity estimate for Columbia Water.

Both I&E and OCA relied exclusively on their DCF results for their recommendations for the cost of common equity. (I&E MB at 46-47 and OCA MB at 75) Mr. D'Ascendis demonstrated that when market prices are significantly above book value, as they currently are, the market-based DCF model understates investors' required return on market price. (CWC Statement No. 3R, Appendix C (R), Schedule DWD-R1) Mr. D'Ascendis noted that this Commission and a number of others have recognized the tendency of the DCF to understate common equity cost rate when market prices exceed their book values and have either disregarded the DCF results or made upward adjustments to compensate for the tendency. (CWC Statement No. 3R at 8:13-27) It should be noted that the Commission orders cited by I&E and OCA to support their position that the Commission prefers the DCF model for deriving the cost of common equity for utility companies (I&E MB at 47; OCA MB at 73) all pre-date Mr. D'Ascendis' cites where the Commission explicitly adjusted the DCF result because of the misspecification of investor returns due to the market-to-book ratios of the companies at that time.

OCA criticized the adjustment made by Mr. D'Ascendis to his common equity cost rate to account for the difference in business risk attributable to the smaller size of Columbia Water, compared to the proxy group of nine water companies based on the testimony of I&E. (OCA MB at 84; I&E Statement No. 1 at 39-41) In rebuttal, Company Witness D'Ascendis responded to Ms. Maurer's criticism and proved that her "evidence" was inconsequential. (CWC Statement No. 3R at 28-29) Ms. Maurer did not respond to Mr. D'Ascendis' rebuttal testimony on the issue of size in her surrebuttal testimony. In view of the foregoing, the Company's upward size adjustment of 40 basis points is warranted.

Mr. D'Ascendis concluded that the indicated common equity cost rate for Columbia Water before adjustments to reflect certain differences in risk between Columbia Water and the proxy group of water companies, including performance factor and acquisition premiums proffered by Company Witness David Lewis, is 10.60%. (CWC St. No. 3 Appendix B at Schedule DWD-1) Mr. D'Ascendis made four adjustments to the common equity cost rate to account for (1) the difference in financial risk related to the Company's higher equity ratio, as reflected in Standard and Poor's bond ratings, (2) the difference in business risk attributable to the smaller size of Columbia Water's jurisdictional rate base compared to the proxy group of water companies, (3) the rate of return premium that the Pennsylvania Public Utility Commission ("PA PUC") grants for performance factor (management efficiency), and (4) the rate of return premium granted by the PA PUC regarding the demonstrated track record of a utility acquiring less viable systems. (CWC St. No. 3 at 33-37) After these adjustments, Mr. D'Ascendis's indicated common equity cost rate for Columbia Water is 11.35%. (CWC St. No. 3 at 37)

For the reasons set forth herein, the Commission should grant the Company an authorized return on equity of 11.35% and approve the Company's proposed capital structure, which results in an overall cost of capital of 9.09%.

B. Performance Factor Premiums

1. Performance Factor Consideration

The Public Utility Code at 66 Pa.C.S. § 523 directs the Commission to consider the efficiency, effectiveness and adequacy of service when setting just and reasonable rates. The record in this case establishes that the Company has provided outstanding service and commitment to the community over the past several years, and should be awarded with a rate of return premium of 0.25%. The OCA contests the premium by downplaying the Company's exemplary performance as "acts routinely performed by utilities in order to provide the reasonable and adequate service required by law and do not demonstrate 'extraordinary' service." (OCA MB at 90) The OCA argues that the record in this case does not support the performance premium. (*Id.*) It is hard to image, however, a record containing more support for a management efficiency premium than the record established in this case.

The Company's General Manager, Dave Lewis, has established that the Company meets or exceeds all Federal and State water quality standards and requirements. For example, the Company routinely monitors for over 90 different contaminants and, in 2012, the Company collected approximately 160 water samples to test for compliance with regulatory requirements. Columbia had no violations and all of its testing confirmed that it is operating well within regulatory requirements. In June of 2013, the Company completed its lead and copper testing at

30 locations within the Columbia Division and was found to be in compliance with lead and copper regulations. (CWC Statement No. 1 at 5:8-16)

Furthermore, he testified that from 2010 until present, the Company has had only two operational issues. In September 2011, Columbia issued a boil water notice as a precaution due to flooding that occurred as a result of Tropical Storm Lee; however, no water quality issues were detected and the notice was issued as a precaution only. In March 2013, Columbia issued a "Do Not Consume" Notice in response to someone who broke into a locked finished water storage tank. The Pennsylvania Department of Environmental Protection ("Pa. DEP") found that the water was safe to consume and the notice was lifted. Pa. DEP complimented Columbia on how the situation was handled. (CWC Statement No. 1 at 5:18-6:3; Appendix 2 to CWC Statement No. 1) The Company's water pressure throughout its system meets all standards. (CWC Statement No. 1 at 6:11)

Moreover, Mr. Lewis testified that since 2010, the Company has had no informal complaints and only one formal complaint filed against it with the Commission. The formal complaint alleged that Columbia caused a leak in the customer's plumbing when a meter was replaced. The issue was resolved by the Company crediting the customer's account by $75.00. Furthermore, the Company has consistently had UCARE statistics that are equal to or better than all the other Class A utilities. (CWC Statement No. 1 at 6:13-19) Since 2010, the Company has received no complaints regarding the taste or the odor of its water. (Tr. at 120-121)

In addition to providing outstanding water quality, Mr. Lewis testified that Columbia has worked hard to keep staffing and operating expenses at a minimum, all the while maintaining outstanding customer service and operating well within regulatory requirements. The Company is continuously evaluating how it does things to identify ways to improve its processes and to drive greater efficiencies in its operations. (CWC Statement No. 1 at 7:1-4) He went on to explain that, for example, in 2010, Columbia's Production Superintendent, with the assistance of operators, was able to identify better treatment chemical combinations and dosing rates to lower chemical costs while maintaining superb water quality standards. The Distribution Department is fully capable and equipped to construct water main extensions and make water main repairs. This capability allows the Company to install nearly twice the amount of pipe annually for the same cost as it would if it contracted out those services. (CWC Statement No. 1 at 7:4-10) These capabilities, combined with a constant desire for better efficiencies, allows Columbia to minimize expenses, and it was able to accomplish this while maintaining staffing levels. (CWC Statement No. 1 at 7:10-12)

Mr. Lewis further explained that Columbia has also taken steps to assist the communities it serves by extending into areas with immediate needs. For example, Manor Township approached the Company about serving two existing communities that were experiencing failing septic systems and contaminated wells. The Township indicated that other adjacent water suppliers had stated that they were unwilling to extend into this area and that there was a strong need for public water. Columbia agreed to serve the area and, after obtaining approval from the Commission to expand its service territory, it began installing water main, using its own staff and equipment to serve these communities. A portion of those communities now have public water service and additional water main will be installed this year and next year, until the whole area has the ability to connect public water. (CWC Statement No. 1 at 7:13-22)

Likewise, he explained that in West Hempfield Township, the Company was able to meet the special needs of the community that was experiencing failing septic systems and contaminated wells by using Columbia's existing staffing levels and equipment, thereby maximizing the amount of water main that was installed for the cost expended. (CWC Statement No. 1 at 8:1-3)

Mr. Lewis testified that the Company has also taken steps to minimize its environmental footprint by minimizing its power consumption, which benefits the ratepayers and the environment we live in. This occurred when the Company chose to use solar powered mixers for its Prospect Tank and its Manor/Mountville Tank to address the need for mixing in those tanks. This has proven to be a long-term solution to the mixing needs of those tanks, while minimizing the Company's power consumption and environmental footprint. (CWC Statement No. 1 at 8:4-9)

Further, Columbia is currently in the process of establishing an e-Billing program to give its customers more options for receiving and paying their water bills. More and more customers are doing business electronically and Columbia is taking steps to meet this growing demand for electronic services. This program will allow the customer to elect to receive and pay bills electronically, which, in turn, will allow Columbia to process an expanding customer base without increasing staffing. This program also has the side benefit of minimizing the Company's environmental footprint by reducing the resources needed to process water bills. (CWC Statement No. 1 at 8:10-17)

Columbia's performance is certainly equal to and in most cases exceeds the performance by Aqua Pennsylvania, Inc. where it was awarded a 22 point positive adjustment based on management efficiency.[22] The adjustment was granted by the Commission, stating "we find that Aqua's managerial performance related to its water quality, customer service and low income program continues to be laudable and should be a factor in its cost of common equity." *Id.* at 50. The positive adjustment was granted even though the record in that case showed that there were severe water quality issues, including water sources that exceeded safe drinking water MCLs and

[22] *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Dkt No. R-00072711 (Final Order Entered July 31, 2008).

hard water, promised infrastructure improvements that were not completed, excessively high unaccounted for water levels, and an ineffective customer assistance program. *Aqua*, Recommended Decision at 40-44. There were also 34 individual formal complaints and 8 formal complaints by companies and boroughs filed against the rate increase. The record in this case shows none of those types of problems with Columbia's water quality or service. In fact, only one formal complaint was filed against the rate increase,[23] and neither the OCA nor I&E have raised any issues with Columbia's water quality or service. OCA's simple contention that the record in this case does not support the efficiency premium should be rejected.

The Company does not dispute that utilities are expected to perform up to certain standards and, indeed, Columbia has done so, and has exceeded those standards in many instances. Section 523 gives the Commission wide latitude to consider efficiency, effectiveness and adequacy of service when setting just and reasonable rates. Columbia believes that Section 523 recognizes that there are graduations of what constitutes adequate, efficient, safe and reasonable service and requires the Commission to take those distinctions into account when ruling upon rate requests. Columbia's performance since its last rate case has clearly exceeded the base requirements. Indeed, it would be most difficult to imagine how a company the size of Columbia could do more. Accordingly, the Commission should exercise its discretion by granting Columbia a rate of return premium on its equity cost rate.

2. Acquisition Incentive

Columbia has made a claim for a rate of return premium of 0.25% based on 52 Pa. Code § 69.721(g) for its purchase of the Mountville Municipal System in 1998 and the Marietta Gravity Water Company in 2012. Section 69.721(g) provides an incentive to foster the acquisitions of smaller, less viable water and wastewater systems by a larger more viable system,

[23] The Borough of Columbia did not file a formal complaint as alleged by the OCA on page 1 of its main brief.

and gives the Commission broad latitude to allow the acquiring utility to request a rate of return premium in a subsequent rate case. The OCA has contested this premium arguing generally that the record does not establish that the Mountville and Marietta systems were less viable, the Mountville request is untimely and there is no established history of acquisitions. (OCA MB at 90-93)

With regard to the allegation that Columbia has not established that the acquired companies were less viable or improved their systems, the testimony of Columbia's general manger shows otherwise. He testified that at Mountville, the Company constructed a new 1 million gallon finished water storage tank and booster pumping station to serve the Mountville pressure zone, it made modifications to the Mountville pressure zone to provide more uniform and acceptable pressures, it replaced all of the meters since they had not been tested or replaced previously, and it replaced old-age water mains on numerous streets in the Borough. (CWC Statement No. 1 at 10:11-16)

He further testified that at MGWC, **[BEGIN CONFIDENTIAL]**

[END CONFIDENTIAL] (CWC Statement No. 1 at 10:17-11:4)

The OCA's allegation that Marietta continues to be operated as a separate system and that costs for customers of both systems remain the same or greater should be disregarded. (OCA MB at 92) First, there is no record evidence of any costs for the Marietta system. Second, to parse a huge record such as this for a few examples of testimony and then falsely infer that these statements show that the costs for Marietta have not decreased is disingenuous. The actual testimony of Mr. Lewis shows that he was simply responding to the speculative allocations of employees' time and accounting issues posed by the OCA as opposed to the actual allocation numbers assigned by Columbia. (CWC Statement No. 1R at 1:21-3:8 and 14:4-15; Tr. at 118-129)

With regard to the allegation that the Company has not established a "history" of acquisitions, this is also unsupported by the record. As Mr. D'Ascendis testified, "although the acquisitions were spaced over time, Columbia has still demonstrated that they have a goal of acquiring and improving less viable systems." (CWC Statement No. 3R at 30:3-6) As Ms. Everette admitted, there is no "magical number" that is required by the policy statement. Section 69.721(g) only requires that the utility has "demonstrated a track record of acquiring and improving the service provided to the customers of smaller and less viable water systems." Columbia believes, that given its size, two acquisitions in the past fifteen (15) years certainly demonstrates the "track record" contemplated by the policy statement. Mr. D'Ascendis explained that if Columbia acquired too many systems in a short period of time, they could have realized extraordinary business risk due to numerous acquisitions in a short time period and could have become unviable themselves. Columbia's acquisition strategy is responsible and prudent and should be rewarded by the Commission at this time. (CWC Statement No. 3R at 30:6-9)

Finally, the OCA's argument that in the 2008 rate case it was determined that a rate of return adjustment was untimely and that should have some type of preclusive effect on this claim is specious. In the 2008 case, the Company requested a rate of return premium for the acquisition of Mountville under 52 Pa. Code § 69.711 (2008 Final Order at 85) It was denied because the Commission determined that under Section 69.711, the improvements to the acquired system must be completed within six(6) months beyond the test year. It had been over 10 years and 3 rates cases later until the company requested the rate premium, therefore it was untimely. (Id.) Here, the Company is requesting the acquisition premium not under Section 69.711 but 69.721(g). There is no such timeliness issue with regard to Section 69.721(g), only that a history be shown as was done in this case.

The Company's rate of return premium of 25 basis points requested pursuant to 52 Pa. Code § 69.721(g) should be granted.

VI. MISCELLANEOUS ISSUES

A. Officers' and Directors' Time Sheets

In Ordering Paragraph 5 of the Commission's Order in Columbia's 2008 rate case, *Pa. Pub. Util. Commn. v. Columbia Water Company,* Docket No. R-2008-2045157 (Final Order Entered June 10, 2009), the Commission, at the request of the OCA, ordered Columbia's officers who are also directors, in future rate cases, to keep an accounting of their hours devoted to Company business, in their roles as officers and directors, in relation to all other business. Although Columbia has complied with this requirement and has provided these hours in its testimony (CWC Statement No. 1 at 15:12-16 and 17:3-5), Columbia is requesting that the Commission rescind this requirement on a going forward basis.

In its main brief the OCA objects to Columbia's request because "time records provide valuable information that can be used to evaluate the reasonableness of the salaries claimed for ratemaking purpose." (OCA MB at 61) What the OCA should have said was that time sheets provide them with a simplistic way to oppose Columbia's officers' and directors' compensation.

Time sheets for officers and directors are not required of any other Class A utility in Pennsylvania. Columbia is unfairly singled out here, and this requirement should be eliminated on that basis alone. However, the Company provided in its main brief and below, numerous reasons why this requirement should be eliminated. The review of hours recorded by a person is completely subjective when viewed from a distance and after the fact. The hours can be used in a multiple of very subjective ways to oppose the Company, limited only by the whims of the reviewer. Without the ability to compare the recorded hours with other Class A utilities, the officers' hours will always be used against them regardless of the quality of the Company's performance.

First of all, as Mr. Lewis testified, both positions are salaried positions and never were and never will be hourly positions. The purpose of the compensation is to attract highly qualified and responsible persons to oversee (what could be argued one of the most important positions in the country) a company that produces and distributes clean potable water to individuals, families, business and industries within our service territory. (CWC Statement No. 1R at 21:10-16)

He further explained that the Company is not making widgets that can be recalled or repaired if flawed, but instead the directors are charged with overseeing, managing and directing a company that makes a product that has to meet the highest of standards 100% of the time and is essential to the health and well-being of every individual and the community as a whole. The public ingests water. (CWC Statement No. 1R at 21:16-20) The record shows that they have executed their duties with the utmost care and diligence.

Moreover, he testified that the Officers' and Directors' compensation goes way beyond how much time they spend inside the office walls,[24] but instead has everything to do with the level of experience and expertise they bring to the table, their responsibilities to the customers, shareholders and community, the quality of the corporate direction they provide, the quality of the decisions they make, the quality of service that they demand of the employees, and the legal exposure they assume. The time sheet will never shield them from their legal exposure or limit their responsibilities to the customers, shareholders and regulatory agencies and thus the timesheet should not be used to somehow justify compensation for positions that carry considerably more responsibility and exposure than that of an hourly employee. (CWC Statement No. 1R at 21:20-22:5)

Finally he testified that the requirement of the Company's directors and officers to prepare an accounting of their time is discriminatory, an unnecessary burden to each member, creates a distracting environment, opens them up to additional legal exposure, and is a requirement that no other Class A utility in Pennsylvania is required to do. The Company feels they are being unfairly singled out. The Company strongly believes that the officer and director salaries are reasonable for the responsibilities and legal exposure they assume and the tallying of time to be an unnecessary and unreasonable requirement. The Company is very concerned that these unnecessary strings imposed on the Board and officers will make it not worth the meager compensation they receive. That will invite Board and officer talent that is not as good as what

[24] On page 60 of the OCA's main brief, they allege that Mr. Lutz's insurance company "brokered the Company's 2013-2014 workers compensation and auto insurance policies." This is not true and typifies OCA's penchant to offer speculation as opposed to fact to meet its desired end. First, OCA never asked a discovery request regarding whether Mr. Lutz had any capacity with the insurance company that bears his name. Had OCA done so, it would have discovered that Mr. Lutz sold his company many years ago, that the new owners still operate under his name because of the excellent reputation associated with the company brand, and that Mr. Lutz is not involved with the company and did not "broker" any insurance policies. The Company has sought competitive bids on its insurance and this information was provided to OCA and I&E through discovery requests and it must have been acceptable because no one made an issue of it or felt that the response was insufficient.

the Company currently has, or one that has no ties to the community. (CWC Statement No. 1R at 22:7-16)

For these reasons the Company requests that it officers and directors be relieved of the requirement to keep hourly time records.

VII. RATE STRUCTURE

The proposed increase in revenues was allocated on an "across-the-board" basis to all customers. No party has opposed this structure or proposed rate structure or design changes.

VIII. CONCLUSION

For all of the foregoing reasons, Columbia's increase in base revenues of $949,426 in this proceeding should be granted by the Commission.

Respectfully submitted,

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OCT 07 2013

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

DATED: October 7, 2013

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document (Proprietary and Non-Proprietary versions) upon the parties, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party).

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Dated this 7th day of October, 2013