Hawke McKeon & Sniscak LLP
ATTORNEYS AT LAW

Thomas J. Sniscak
(717) 236-1300 x224
tjsniscak@hmslegal.com

100 North Tenth Street, Harrisburg, PA 17101 Phone: 717.236.1300 Fax: 717.236.4841 www.hmslegal.com

December 6, 2013

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PA PUC
SECRETARY'S BUREAU

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;
EXCEPTIONS OF THE COLUMBIA WATER COMPANY

Dear Secretary Chiavetta:

Pursuant to the Secretarial Letter issued November 22, 2013, attached are Columbia Water Company's Exceptions to the Recommended Decision filed in the above-referenced matter. Please note, both a Proprietary version (under seal) and a Non-Proprietary version (for filing) are being provided to the Commission. Copies 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

Thomas J. Sniscak
William E. Lehman

Counsel to the Columbia Water Company

WEL/bcs
Enclosure
cc: Per Certificate of Service
Honorable Dennis J. Buckley, Administrative Law Judge
Office of Special Assistants (via hand delivery w/CD enclosure)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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PA PUC
SECRETARY'S BUREAU

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

EXCEPTIONS OF THE COLUMBIA WATER COMPANY
(NON-PROPRIETARY VERSION)

The Columbia Water Company ("Columbia" or "Company"), by its attorneys in this proceeding, Hawke McKeon & Sniscak LLP, files these Exceptions in the above-captioned matter in response to the November 21, 2013 Recommended Decision ("RD") of Administrative Law Judge ("ALJ") Dennis J. Buckley.

Specifically, the Company excepts to the RD's: adoption of the Bureau of Investigation and Enforcement's ("I&E") hypothetical capital structure of 50% long-term debt and 50% common equity and 7.07% overall rate of return; the rejection of its capital structure and return positions particularly in view of its exemplary performance and acquisition of neighboring water systems the Commission approved as in the public interest; denial of amortization of certain extraordinary and non-recurring acquisition expenses related to the acquisition of the Marietta Gravity Water Company ("MGWC"); the apparent inadvertent calculation error in omitting the issue of rate case expense in calculating the necessary increase to revenues; denial of certain employee compensation package expenses; refusal of Columbia's request to discontinue the discriminatory practice of requiring its officers and directors to keep time sheets of their time devoted to Company business; and, a miscalculation of the appropriate tax rates in the RD that understates Columbia's tax expense by $252,911 which, when coupled with gross-up of revenues, would require a total additional revenue requirement of $342,406 instead of the $87,699 granted by the RD, and should be corrected. Notably, if the Commission increases revenues over the ALJ's $87,699 by granting any other Exception, the correct tax factor identified in Exception No. 3 must be used so the same error does not reoccur.

INTRODUCTION AND SUMMARY OF EXCEPTIONS

Columbia's corporate objective is, as it has been since the Company's inception in 1823, to provide safe and reliable water service to its customers in Lancaster and York Counties. As any other undertaking, however, the Company requires reasonable funds to achieve this objective. To that end, the Company requires a fair rate of return on its investment to ensure that its ongoing high quality of service is maintained. Commensurate with these objectives and goals, Columbia filed this rate case seeking additional revenues of $773,210.

While the RD, for the most part, presents a sound and well-reasoned approach to resolving the outstanding issues in this proceeding with an eye toward balancing the interests of Columbia and its customers, the Company asserts that the RD erred in adopting I&E's punitive hypothetical capital structure of 50% long-term debt and 50% common equity that results in a downward revenue adjustment of approximately $197,292 and its 7.07% overall rate of return amounting to a downward adjustment of approximately $81,994, and in this regard deviates from a fair balancing and promotion of Commission policy.

These two adjustments are devastating financially to the Company and promote exactly the opposite of what the Commission should be encouraging by punishing a Company that provides excellent service, invests heavily in improving its aged infrastructure, and has acquired within the last year a neighboring water system (and another 15 years previously) both of which the Commission unanimously approved as a good thing in the public interest.

As to capital structure, the record is clear Columbia's existing capital structure of 35.6% debt to 64.4% equity is nearly identical to the 35.8% debt to 64.2% equity ratio the Commission approved in 2008 and found to be reasonable and not a corporate abuse of discretion.[1] Moreover, the RD adopted I&E's arbitrary 50%/50% capital structure on the basis of I&E's reliance upon a five-year historic average of Columbia's capital structure. While that averaging improperly elevates stale historic information over existing capital structure and thus ignores the prospective nature of ratemaking and should be rejected, even if *arguendo* a five-year average was used, the actual five-year average calculated by I&E was 42.45% debt to 57.55% equity and not the 50%/50% hypothetical capital structure I&E added to further devalue the Company's equity. So clearly here, the RD erred in accepting I&E's invitation to add financial insult to financial injury.

As the Commission observed in Columbia's 2008 rate case in rejecting a 50%/50% hypothetical capital structure, such structure will adversely impair Columbia's ability to obtain capital.[2] It is contrary to good public policy and common business practice to punish a great company by attempting to force it to conform to a hypothetical structure that significantly lowers its equity ratio and raises its debt ratio. The Commission should reward small companies like Columbia for their efforts to provide reasonable and safe service instead of punishing it as I&E and the RD did by rejecting its capital structure where there is no evidence whatsoever of an abuse of managerial discretion by the utility. The RD's adoption of I&E cases adopting hypothetical capital structure are distinguishable and involved holding company situations where there was 100% equity and no debt or close to that. That is far from Columbia's facts.

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[1] *Pa. P.U.C. v. Columbia Water Company*, Dkt. No. R-2008-2045157 (Final Order Entered June 10, 2009) at 71. ("*2008 Rate Case Order*")

[2] *Id.* at 64.

The parties have failed to demonstrate, as Pennsylvania law requires, that ratepayers will be unnecessarily burdened by Columbia's actual capital structure in this case of 35.6% long-term debt 64.4% common equity or to prove the caselaw requirement for adjusting the equity ratio that the Company has purposefully abused its discretion to manipulate its capital structure to disproportionate levels. The Commission should approve the capital structure in this case which is virtually the same as the capital structure approved in the Company's last rate case.

Similarly, the RD sets a return on equity (9.15%) and overall rate of return (7.07%) that is among the lowest set in Pennsylvania and the United States for a well-run Company that does the good things Columbia does resulting in a downward adjustment of $81,993.93. Columbia has supported its recommended 11.35% return on equity using multiple cost of common equity models using a proxy group of water companies unlike the other parties who focused narrowly on the Discounted Cash Flow methodology. Columbia has also supported its .50% point return on equity premium based on its exemplary performance which, in many cases, exceeds requirements, and its prudent policy of acquiring smaller, less viable water companies and improving their service.

The RD also errs in adopting the effective income taxes at present rates instead of proposed rates, resulting in an understatement of the Company's tax liabilities by approximately $252,911. Under the ALJ's recommended net operating income of $975,430 the Company requires an increase in revenues of $342,406 instead of the $87,699 granted by the RD to meet all the expense obligations of the Company, including the state and federal tax liabilities of $498,215, and should be corrected. Notably, if the Commission increases revenues over the ALJ's $87,699 by granting any other Exception the correct tax factor identified in Exception No. 3 must be used so the same error does not reoccur.

Furthermore, the Commission should approve the Company's request to amortize exceptional and nonrecurring costs associated with the acquisition of the MGWC. Neither I&E nor OSBA opposed this adjustment; only OCA did. The Commission promotes regionalization of water service and it should not punish small water companies like Columbia by forcing them to absorb transaction and regulatory approval costs[3] that are associated with acquiring smaller, less viable companies. Otherwise, the Commission will establish a monumental disincentive to acquire other water systems if, as here, it gives Columbia not one penny of $225,581 in acquisition costs. Columbia sought to amortize these costs over 15 years, resulting in a $15,039 adjustment. Finally, the Commission, if it prefers not to expense these costs for ratemaking purposes, could capitalize them as part of franchise costs.

The Company should also be compensated for valid business expenses including its employee compensation packages, not just those portions OCA believes are necessary in its experience (which does not include actually running a water company) to retain or attract employees. Columbia, while small compared to others in its class, is a Class A water company and it is important for Columbia to provide incentives to attract and maintain qualified and highly skilled workers such as its employee compensation package expenses. The RD's omission of these valid expenses resulted in a downward adjustment of $6,051.

The Commission should also eliminate the requirement for Columbia's officers and directors to keep time sheets of their hours devoted to Company business. This requirement is unnecessary and discriminatory in that it unfairly burdens Columbia with a requirement that is not required of any other Class A utility in the state.

[3] Notably, the Company is not seeking an acquisition premium (difference between original cost minus depreciation and the sales price), as erroneously characterized by OCA.

Finally, the RD's error of not including in permitted revenues to be collected monies for rate case expense, which is an uncontested issue and to be normalized at the amount of $86,137 over a three-year period must be corrected.

On the basis of the facts and law set forth below, Columbia requests the Commission reverse these errors in the otherwise well-written and reasoned decision by the ALJ.

EXCEPTIONS

Exception No. 1. **The ALJ erred in (a) adopting I&E's punitive hypothetical capital structure of 50% long-term debt and 50% common equity and (b) recommending a 7.07% overall rate of return. RD at 43-46.**

Aside from the errors identified in these Exceptions, the RD is well-reasoned in striking a fair balance between the Company and its ratepayers in rejecting the costly, impractical, overreaching adjustments by OCA and to a lesser extent by I&E. However, in adopting I&E's punitive hypothetical capital structure of 50% long-term debt and 50% common equity and its 7.07% overall rate of return, the RD works at cross-purposes from its insightful recognition of Columbia's situation and needs.

Commission policy promotes quality service and efficient operation at just and reasonable rates. By recommending that the Company deviate from its actual capital structure of 35.8% long-term debt and 64.2% common equity, the RD forces the Company to take an unnecessary risk which could diminish its current superior performance record. It is contrary to good public policy and common business practice to punish a successful company by attempting to force it to conform to a hypothetical structure that arbitrarily and significantly lowers its equity ratio and raises its debt ratio. Instead, the Commission should reward small companies like Columbia for their efforts to provide reasonable and safe service while minimizing financial risk to the extent possible. For the following reasons the recommended hypothetical capital structure and 7.07% rate of return should be rejected.

1. Capital Structure

Columbia strongly disagrees with the recommended decision of the ALJ regarding the ratemaking capital structure of Columbia. Although Columbia recommended the use of its pro forma capital structure at December 31, 2013 of 35.60% long-term debt and 64.40% common equity, the RD adopts a punitive hypothetical capital structure of 50% long-term debt and 50% common equity. This results in a downward revenue adjustment of approximately $197,293 as the following table illustrates:

Effect of Capital Structure Recommendation:

Ratio	Cost Rate	Weighted Cost Rate
50.00%	5.00%	2.500%
50.00%	12.00%	6.000%
		8.500%

Rate Base:	$ 13,796,745
Return on Rate Base:	$ 1,172,723.33
ALJ Recommended Return on Rate Base:	$ 975,430.00
Effect of Capital Structure on Decision:	**$ 197,293.33**

Company Witness D'Ascendis showed that the circumstances of the instant matter are virtually identical to Columbia's most recent rate case in 2008 where the presiding ALJ and this Commission approved the use of the Company's pro forma capital structure at December 31, 2008 of 35.80% long-term debt and 64.20% common equity for ratemaking purposes.[4] In that well-reasoned opinion, the Commission, in approving Columbia's actual capital structure held:

[4] CWC Statement No. 3R, at pp. 2-3; *2008 Rate Case Order* at 71.

> In order to determine Columbia's overall cost of capital an appropriate capital structure must be used. We agree with the ALJ that Columbia's capital structure is ***not*** disproportionately weighted on the equity side. Columbia's capital structure is not unreasonable or uneconomical under the rational of the *Carnegie* decision as discussed earlier. The record evidence does not indicate that Columbia has abused its managerial discretion with regard to the development of its capital structure. Therefore, we will adopt the ALJ's recommendation to use Columbia's actual capital structure of 35.8% debt and 64.2% common equity for ratemaking purposes.[5]

As set forth in the *Carnegie*[6] case, the capital structure is within the management discretion of the utility and the touchstone for adopting the utility's actual capital structure is whether the utility abused its discretion. As the Commission stated in *Carnegie*, it is the right of the Commission:

> to protect the consumer from excessive wages ... and other such things *including excessive costs of capital*. On the other hand, the right, while always there, should be exercised sparingly, since the problems of corporate finance are extremely intricate and complex, and are best known to the utility which lives with these problems from day to day." [*citing* Garfield and Lovejoy, "Public Utility Economics. Prentis-Hall, 1964, p.130.] ... [t]he Commission has the duty to regulate utilities in a manner which provides customers with reliable service at reasonable cost. This is not to say that we may mandate to regulated utilities the proportion of debt and equity contained in their capital structures. Rather, the actual capital structure is a matter within the discretion of corporate management; however, this does not preclude the commission from determining that a particular utility's capital structure is unreasonable and uneconomical when balancing the goals of safety, prudent management, and economy and utilize a hypothetical capital structure for rate-making purposes.[7]

Here, like in Columbia's prior rate case, there are no excessive capital costs. In Columbia's *2008 Rate Case Order*, the ALJ and the Commission found that using a hypothetical capital structure was not applicable based on reviewing decisions from *Big Run Telephone Co. v.*

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[5] *Id.* (emphasis added)
[6] *Pa. P.U.C. v. Carnegie Natural Gas Company*, 54 Pa. P.U.C. 381 (Order Entered July 17, 1980)
[7] *Id.* at 393 (emphasis in original)

Pennsylvania Pub. Util. Comm'n., 449 A2.d 86 (Pa. Cmwlth. 1982); *Pennsylvania Pub. Util. Comm'n v. Carnegie Natural Gas Co.*, 54 PA. P.U.C. 381 (1980); and *Pennsylvania Pub. Util. Comm'n v. Total Environmental Solutions, Inc. – Treasure Lake Water Division*, Docket No. R-00072491, (Order Entered July 30, 2008) because Columbia was not found to be manipulating its capital structure, was not a wholly-owned subsidiary of a parent corporation, nor was it operating at 100% equity, respectively. No one alleged in the 2008 case that Columbia was abusing its management discretion by maintaining a capital structure with 62.4% common equity and likewise, no one has alleged and proved in the present case that Columbia is abusing its management discretion by maintaining an almost identical capital structure with 64.2% common equity.

Likewise, there is no finding that Columbia's capital structure is unreasonable and uneconomical when balancing the goals of safety, prudent management, and economy.[8] To the contrary, Columbia's relatively strong capital structure benefits both the company and its ratepayers by providing financing flexibility and access to capital when required. Would the OCA and I&E have the Company become less able to borrow money due to less equity? Note neither of these parties gave the Company any additional return for being more debt ridden and riskier as they say it should be for ratemaking purposes. So, they want the borrowing benefits of having the present actual capital structure amount of equity but wish to ignore the obvious increase in risk (which should warrant a higher equity return rate) of becoming more debt ridden.

In fact, the effects on the Company are no different now than when the Commission found in 2008 that the hypothetical capital structure will impair the Company's ability to raise capital.[9]

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[8] *Carnegie* at 393

[9] *2008 Rate Case Order* at 64-65.

The RD adopts I&E's arbitrary, hypothetical 50%/50% capital structure based upon I&E's reliance on a five-year historic average of Columbia's capital structure. This averaging improperly elevates stale historic information over existing capital structure and thus ignores the prospective nature of ratemaking and should be rejected. Even if, *arguendo*, a five-year average is used, it is not the 50%/50% hypothetical I&E recommended but rather the actual average I&E identified, which is a capital structure of 42.45% debt to 57.55% common equity.[10]

The parties have failed to demonstrate the legal standard for a hypothetical capital structure due to too much equity required by the cases cited above; namely, that ratepayers will be unnecessarily burdened by Columbia's actual capital structure in this case of 35.6% long-term debt 64.4% common equity, and that the Company has purposefully abused its discretion to manipulate its capital structure to disproportionate levels. The Commission should approve the Company's actual capital structure in this case which is virtually the same as the capital structure approved in the Company's last rate case. However, if the Commission does approve a 50%/50% capital structure for Columbia, which it should not, there must be an adjustment to the authorized ROE for Columbia to reflect the increased financial risk that it would face in these new circumstances.

2. Rate of Return

Columbia also strongly disagrees with the RD's adoption of I&E's rate of return on equity (ROE) of 9.15% virtually without discussion. RD at 44. This recommended ROE is way out of line considering an authorized ROE of 9.15% would be the lowest authorized ROE in the country for a water utility, at least since 2011 (without provisions for double leverage), and would send the wrong message to any utility that is considering investing in the state. This

[10] I&E Stmt. No. 1 at 14:12

punitive ROE results in a downward revenue adjustment of approximately $81,993.93 as the following table illustrates:

Effect of ROE Recommendation:

Ratio	Cost Rate	Weighted Cost Rate
35.80%	5.00%	1.790%
64.20%	9.15%	5.874%
		7.664%

Rate Base:	$ 13,796,745
Return on Rate Base:	$ 1,057,423.93
ALJ Recommended Return on Rate Base:	$ 975,430.00
Effect of ROE on Decision:	**$ 81,993.93**

The RD on ROE is solely based on the results of I&E's discounted cash flow (DCF) model. Mr. D'Ascendis showed in his rebuttal testimony that in the recent past, this Commission has repeatedly acknowledged that the DCF mis-specifies investor required returns when market value exceeds book value. In its order of August 26, 2005 in Docket No. R-00049862, et al. re: *The City of Lancaster – Sewer Fund* this Commission adopted the Administrative Law Judge's market-to-book adjustment of 65 basis points (0.65%) because such an adjustment was:

> [C]onsistent with our recent orders in *PAWC, Aqua,* and *PPL*" and "as in *PPL*, we find that adjustment is necessary ***because the DCF method produces the investor required return based on the current market price, not the return on the book value capitalization.*** " With the MTB adjustment, the equity return allowance is 10.75 percent. (emphasis added).

In 2007, the Commission again affirmed the tendency of the DCF model to mis-specify investors' required return in its Order of February 8, 2007 in Docket No. R-00061398, *Re: PPL Gas Utilities Corporation* when it stated:

> The ALJ stated that the OTS and the OCA are correct that the Commission favors the DCF method to determine the cost of equity. However, the ALJ concluded, based on recent precedent, that the Commission consistently has adopted a leverage adjustment to compensate for the difference between market prices and book value (used in ratemaking). (*See, Aqua Pennsylvania*, 204, 234 (2004); *Pa. PUC v. PPL Electric Utilities Corp.*, Docket No. R-00049255, at 70-71 (2004); *Pa. PUC v. Pennsylvania American Water Co.*, 2002 Pa. PUC LEXIS 1; *Pa. PUC v. Phila. Suburban Water Co.*, 219 PUR4TH 272 (2002); *Pa. PUC v. Pennsylvania American Water Co.*, 231 PUR4TH 277 (2004)). According to the ALJ, these cases are persuasive that a leverage adjustment should be employed with the DCF analysis. (R.D. at 62-63).

The Company is not requesting a specific adjustment to the DCF result, but they do request that the Commission consider, as it did in the cases cited above, appropriate adjustments and multiple models when determining the ROE for Columbia in this case. Mr. D'Ascendis states on page 5 of his direct testimony:

> Just as the use of market data for the proxy group adds reliability to the informed expert judgment used in arriving at a recommended common equity cost rate, the use of multiple common equity cost rate models also adds reliability when arriving at a recommended common equity cost rate.

The financial literature supports the use of multiple models in arriving at a common equity cost rate. For example, Morin[11] states:

> Each methodology requires the exercise of considerable judgment on the reasonableness of the assumptions underlying the methodology and on the reasonableness of the proxies used to validate a theory. ***The inability of the DCF model to account for changes in relative market valuation . . . is a vivid example of the potential shortcomings of the DCF model when applied to a given company.*** Similarly, the inability of the CAPM to account for variables that affect security returns other than beta tarnishes its use. (Emphasis added.)
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> * * *
>
> *No one individual method provides the necessary level of* precision *for determining a fair return, but each method provides useful evidence to facilitate the exercise of an informed judgment.* Reliance on any single method or preset formula is inappropriate

[11] Roger A. Morin, New Regulatory Finance, Public Utilities Reports, Inc., 2006 pp. 428, 430-431.

> when dealing with investor expectations because of possible measurement difficulties and vagaries in individual companies' market data. (Emphasis added.) While it is certainly appropriate to use the DCF methodology to estimate the cost of equity, there is no proof that the DCF produces a more accurate estimate of the cost of equity than other methodologies. Sole reliance on the DCF model ignores the capital market evidence and financial theory formalized in the CAPM and other risk premium methods. The DCF model is one of many tools to be employed in conjunction with other methods to estimate the cost of equity. *It is not a superior methodology that supplants other financial theory and market evidence. The broad usage of the DCF methodology in regulatory proceedings in contrast to its virtual disappearance in academic textbooks does not make it superior to other methods. The same is true of the Risk Premium and CAPM methodologies.* (italics added) (Morin, p. 431)

Additional financial literature supports the use of multiple methods. Professor Eugene Brigham, a widely respected scholar and finance academician, asserts:

> Three methods typically are used: (1) the Capital Asset Pricing Model (CAPM), (2) the discounted cash flow (DCF) method, and (3) the bond-yield-plus-risk-premium approach. These methods are not mutually exclusive – no method dominates the others, and all are subject to error when used in practice. Therefore, when faced with the task of estimating a company's cost of equity, we generally use all three methods and then choose among them on the basis of our confidence in the data used for each in the specific case at hand.[12]

> *Use more than one model when you can. Because estimating the opportunity cost of capital is difficult, only a fool throws away useful information.* That means you should not use any one model or measure mechanically and exclusively. Beta is helpful as one tool in a kit, to be used in parallel with DCF models or other techniques for interpreting capital market data. (Emphasis added)[13]

> *No single or group test or technique is conclusive.* (Emphasis added)[14]

[12] Michael C. Ehrhardt and Eugene F. Brigham, Corporate Finance: A Focused Approach, Thompson/Southwestern, 2003, pp. 229-230.
[13] Stewart C. Myers, "The Application of Finance Theory to Public Utility Rate Cases", Bell Journal of Economics and Management Science, Spring 1972, pp. 58-97.
[14] James C. Bonbright, Albert L. Danielsen and David R. Kamerschen, Principles of Public Utility Rates, 1988, Public Utilities Reports, Inc., Arlington, VA, p. 317.

In view of the foregoing, it is against basic financial precepts to exclusively rely upon one cost of common equity model, therefore, it is necessary for the Commission to consider multiple cost of common equity models when determining the ROE for Columbia.

Mr. D'Ascendis' ROE recommendation of 10.85%[15] (net of the .50% premium) is based on an assessment of multiple market-based cost of common equity models using a proxy group of water companies.[16] Only Company Witness D'Ascendis relied on multiple methodologies to estimate the required return on equity, whereas both I&E and OCA witnesses narrowly focused solely on the Discounted Cash Flow ("DCF") methodology, which limitations have been addressed above. Neither opposing witness during the testimonial part of the case nor the ALJ in his recommended decision discredited Mr. D'Ascendis' use and application of multiple common equity models to determine his recommendation or any of his adjustments to the indicated common equity cost rate by using financial literature. (Columbia Reply Brief at 53-55)

3. Summary of Exception No. 1 on capital structure and equity return rate.

In sum, the weight of evidence on the appropriate rate of return in this proceeding supports a capital structure of 35.40% long-term debt and 64.60% common equity at cost rates of 5.00% and 11.35%, respectively, as recommended by Company Witness D'Ascendis. This results in an overall rate of return of 9.09%.

By adopting a hypothetical capital structure of 50% debt and 50% common equity and an overall rate of return of 7.07%, this recommended decision is unfairly punishing a company which has been operating efficiently and ignores, in exercising discretion and judgment in determining what return is appropriate, all of the outstanding things Columbia has done. Finally, the failure to grant the Company an adequate overall return will make it more difficult to meet its

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[15] This does not include a cumulative .50% rate of return premium for exemplary performance and acquisition incentives which are addressed in Exception No. 3 immediately following.

[16] CWC Statement No. 3, at pp. 2-3.

capital requirements and access capital markets at a reasonable cost and to continue to provide reliable and high-quality service for its customers.

For the reasons stated above, Columbia's Exception No. 1 should be granted.

Exception No. 2. **<u>The ALJ erred in recommending rejection of Columbia's claim for rate of return premiums for exemplary performance and acquisition incentives. RD at 46-48.</u>**

The ALJ recommends rejection of Columbia's rate of return premiums for exemplary performance and acquisition incentives. RD at 46-48. As correctly acknowledged by the ALJ on page 17 of the RD, Columbia is a small, "local" water company, not, say, a major provider of intrastate electric service. As a small company it does not have the luxury of a large staff overseeing internal operations to achieve results that, in theory, accommodate the valid, but in themselves costly, recommendations of the public advocates. *Id.* Without the staffing and operational advantages of larger companies, however, Columbia has still managed to provide exemplary service and acquire two smaller, less viable water companies and made significant improvements to those companies so their customers could enjoy the same high quality of water service at reasonable rates that Columbia's customers enjoy. (CWC Stmt. No. 1 at 5:7-11:6)

As explained below, the RD was wrong to deny Columbia the performance premiums it deserves. At the very least, the ALJ should have used his discretion to lean more toward Columbia's rate of return and capital structure positions due to its history of doing these good things instead of adopting I&E's punitive recommendation of its first time rate of return witness.

1. Performance Factor Consideration

In pertinent part, Section 523 of the Code, 66 Pa.C.S. § 523 provides:

§ 523. Performance Factor Consideration.

> (a) Considerations. – The Commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when

> determining just and reasonable rates under this title. On the basis of the Commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the Commission.
>
> (b) Fixed utilities. – As part of its duties pursuant to subsection (a), the Commission shall set forth criteria by which it will evaluate future fixed utility performance and in assessing the performance of a fixed utility pursuant to subsection (a), the Commission shall consider specifically the following:
>
> (1) Management effectiveness and operating efficiency as measured by an audit pursuant to Section 516 (relating to audits of certain utilities) to the extent that the audit or portions of the audit have been properly introduced by a party into the record of the proceeding in accordance with applicable rules of evidence and procedure.
>
> * * *
>
> (7) Any other relevant and material evidence of efficiency, effectiveness and adequacy of service.

66 Pa. C.S. § 523.

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 ALJ rejected this claim, saying that the evidence the Company provided in support of its exemplary performance shows nothing more than efficient, reasonable and adequate service by Columbia which does not rise to the level required for a Section 523 premium. RD at 47-48.

The ALJ was wrong. It is hard to imagine a record containing more support for a management efficiency premium – especially from a "small," local water company that doesn't have the luxury of a large staff overseeing operations – than the record established in this case.

The Company's main brief (pp. 52-57) and reply brief (pp. 56-60) sets forth in detail the evidence that more than supports a Section 523 performance premium; however, that evidence needs to be repeated here in summary.

The Company's General Manager, Dave Lewis, testified 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)

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.[17] 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 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, and neither the OCA nor I&E have raised any issues with Columbia's water quality or service.

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

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

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

In its Policy Statement regarding acquisitions of smaller water and wastewater systems, 52 Pa. Code § 69.721(g), the Commission has provided for incentives to encourage viable utilities to acquire smaller, less viable water and wastewater systems. 52 Pa.C.S. § 69.721(g) reads in pertinent part as follows:

> *(g) Acquisition incentives.* In its efforts to foster the acquisitions of smaller, less viable water and wastewater systems by larger more viable systems, the Commission, under 66 Pa.C.S. § 523 (relating to performance factor consideration), has broad latitude to allow the acquiring utility to request a rate of return premium in a subsequent rate case. The allowance of a rate of return premium, as an acquisition incentive for an acquisition that falls outside of the parameters of 66 Pa.C.S. § 1327 (relating to acquisition of water and sewer facilities), may be requested by those utilities that have demonstrated track record acquiring and improving the service provided to the customers of smaller and less viable water systems. The allowance of additional rate of return basis points may be awarded based on sufficient supporting data submitted by the utility within its rate case filing.

52 Pa.C.S. § 69.721(g).

The ALJ recommends rejection of the Company's requested additional 0.25% rate of return premium for acquisition incentives as allowed by 52 Pa. Code § 69.721(g). The ALJ's reasoning in evaluating the factors required under Section 69.721(g) are unclear, but under any scenario they are incorrect.

First, he states that "I agree with the OCA that Columbia's acquisition of Marietta does not satisfy the requirements of Section 1327." RD at 48. First of all, Columbia has never made any claim under Section 1327. Second, if this statement is suggesting that Columbia does not qualify for Section 69.721(g) treatment because the MGWC acquisition does not satisfy the

Section 1327 standard, that is wrong because not qualifying under Section 1327 is exactly what would allow you to claim a Section 69.721(g) premium. However, if this statement is suggesting that Columbia's MGWC acquisition qualifies for Section 69.721(g) treatment, then that is correct; however, his evaluation of the second factor is still incorrect.

The second factor in evaluating a Section 69.721(g) claim is whether the utility has demonstrated a track record of acquiring and improving the service provided to customers of smaller and less viable water systems. 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, and gives the Commission broad latitude to allow the acquiring utility to request a rate of return premium in a subsequent rate case. There is ample evidence of record that Columbia satisfies this standard.

With regard to a "track record" of acquisitions, Columbia purchased the Mountville Municipal System in 1998 and the Marietta Gravity Water Company in 2012 – the Commission finding such acquisitions to be in the public interest.[18] 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 OCA witness Ms. Everette admitted, there is no "magical number" of acquisitions that is required by the policy statement. (Tr. at 193) 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

[18] *Joint Application of the Columbia Water Company and Marietta Gravity Water Company;* Dkt No. A-2012-2282219 (Order Entered on August 30, 2012) Slip Op. at 9 (Certificate of Public Convenience attached as **Appendix B.**)

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)

With regard to the finding that Columbia has not established that the acquired companies were less viable or improved their systems, the testimony of Columbia's general manager shows otherwise. There is no standard, however, for what "less viable" means. Certainly, the amount of improvements that the Company has made to both systems shows that the systems were in need of extensive repair and thus "less viable."

For example, in support of the improvements needed and provided by Columbia, Mr. Lewis 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) The extent of these improvements shows Mountville was "less viable" and Columbia made substantial improvements to correct that situation.

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

[END

CONFIDENTIAL] (CWC Statement No. 1 at 10:17-11:4) Once again, substantial improvements had to be made to a "less viable" MGWC system.

The Commission has wide discretion in rewarding companies such as Columbia for acting in the public interest and furthering the Commission's goals of regionalization. Columbia should be rewarded for its actions of purchasing neighboring water companies and spending the time, effort and money to upgrade their systems so their customers can enjoy the same quality water service as do Columbia's customers.

For the foregoing reasons, Columbia's Exception No. 2 should be granted.

Exception No. 3. **<u>The ALJ erred in adopting the effective tax rates at the time of the Company's filing instead of at present rates resulting in an allowable net operating income shortfall of $254,707. RD at Table III</u>**

In the RD at Table III, the ALJ errs in adopting the effective income tax rates as set forth in the Company's Rate Filing (Supporting Schedule No. 1 at 2-12; **Appendix B** hereto) at present rates. This document was recalculated at proposed rates (Supporting Schedule No. 10 at 2-16; **Appendix C** hereto) and was subsequently updated to correct the deduction for a deferred credit and to deduct for the Qualified Domestic Production Adjustment. (GDS Rebuttal Exhibit No. 3, Page 5 of 5) To reflect properly the effect of accumulated deferred taxes as a current expense to the Company, the current effective state tax rate is 12.968537% and the effective federal tax rate is 38.107911% based upon the RD's $975,430 of allowable net operating income (for ease of reference a Table showing the updated calculations based on the ALJ's recommended operating revenue amount is attached to these Exceptions as **Appendix D** hereto).

Instead of the current effective rates, the RD mistakenly uses effective state and federal tax rates of 7.6803051% and 17.462862% respectively based upon $975,430 of allowable net income as set forth on Table 1 of the ALJ's income summary attached to the RD. The ALJ's effective federal tax rate is approximately one-half of the current federal tax rate of 34% and his effective state tax rate is 2.30% below the state income tax rate of 9.99%. The ALJ's decision understates the Company's tax liabilities by approximately $252,911 as follows:

ALJ's underestimated taxes as set forth in the RD's Table 1:

State Tax	$ 74,916
Federal Tax	170,388
	$245,304

Actual taxes based on the correct tax percentages:

State Tax	$126,499
Federal Tax	371,716
	$498,215
Difference	**$252,911**

Thus, based on the RD's net operating income of $975,430, the correct increase in revenue to cover tax expense would be $252,911 and coupled with accounting for gross-up of revenues would require a total revenue requirement of $342,406 instead of the $87,699 granted by the RD. Notably, if the Commission increases revenues over the ALJ's $87,699 by granting any other Exception the correct tax percentages of 12.968537% state and 38.107911% federal should be used so the same error does not reoccur.

For the foregoing reasons, Columbia's Exception No. 3 should be granted.

Exception No. 4. **<u>The ALJ erred in recommending rejection of the Company's acquisition adjustment claim for extraordinary and nonrecurring expenses or costs related to the acquisition of Marietta Gravity Water Company and promotes disincentives for acquisitions approved by the Commission as in the public interest. RD at 23-26.</u>**

Columbia has claimed in its filing an amortization expense of $15,039 over 15 years for $225,581 in expenditures incurred in the acquisition of the Marietta Gravity Water Company ("MGWC") at Docket Nos. A-2012-2282219 and A-2012-2282221 primarily to obtain PUC and DEP approvals required by law. (CWC Statement 2R at 19:9; GDS Exhibit No. 1 at 1-14) None of this claim for these extraordinary and nonrecurring expenses is for any acquisition premium (the difference between original cost minus depreciation and the asset sale price). ***Neither I&E nor OSBA challenged this claim.*** In the alternative, Columbia requests that the costs at issue be capitalized as franchising costs. The RD recommends rejection of this claim and the alternative, based upon what Columbia believes are OCA's mischaracterizations of Columbia's claim. RD at 23-26.

Denial of these costs promotes an awful policy that punishes or gives disincentives for acquisitions, such as Columbia's acquisition last year of the neighboring and financially challenged Marietta Gravity Water Company that the Commission unanimously found to be in the public interest.[19] Rejection of these types of acquisition costs - here requiring Columbia to "absorb" $225,581 - punishes a company for acquiring smaller, less viable water companies.

The RD accepts OCA's position that the Company's claim does not qualify under Section 1327 of the Code, 66 Pa.C.S. § 1327, relating to acquisition premiums and therefore should be denied. RD at 23-25. The ALJ sets forth the OCA's analysis of the criteria set forth in Section 1327 and adopts this analysis in whole. However, as set forth in Columbia's main

[19] *Joint Application of the Columbia Water Company and Marietta Gravity Water Company;* Dkt No. A-2012-2282219 (Order Entered on August 30, 2012) Slip Op. at 9 (Certificate of Public Convenience attached as **Appendix A**).

brief (pp. 18-19) and reply brief (pp. 29-30), this mischaracterizes the Company's claim as an acquisition premium under Section 1327 – ***which it is not.***

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*** any price of the assets[20] 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)

Furthermore, Section 1327, 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. It does not exclude a party from requesting an acquisition premium or the Commission's independent evaluation of the same.

The Company's reference to this claim as a "Utility Plant Acquisition Adjustment" in its filing is simply a semantics argument that is irrelevant to the analysis of the claim. As stated above, all parties – particularly OCA – knew[21] that Columbia was claiming only acquisition expenses, and not an acquisition premium under Section 1327.

Any argument by OCA - the sole opponent of the claim who apparently believes Companies like Columbia should get zero for expenses for acquisitions - that the claim is somehow retroactive ratemaking is incorrect. Specifically, it is not retroactive ratemaking as

[20] The assets purchased from MGWC are on the books of MGWC and are ***not*** included in this filing.

[21] Mr. Shambaugh testified that "In response to OCA-VI, the Company clearly set forth the acquisition expenses as claimed in this proceeding." (CWC Statement No. 2R at 19:2-3)

the Commission routinely grants recovery of expenses that are extraordinary and non-recurring. The Commonwealth Court has held that "extraordinary expenses" are "a substantial, one-time expense or a substantial item that will not appear as a continuing expense and could otherwise never be recovered in rates because, like the weather-related expenses, it would be normalized out of the test year as abnormal."[22]

The ALJ adopts the OCA's adjustment request and eliminates all the expenses from the filing. RD at 26. 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 RD's rejection of this alternative claim on the basis that there is no evidence that the Company actually capitalized on its books these costs related to legal fees and regulatory expenses should be rejected. RD at 26. Neither the OCA nor the RD cites to any authority for

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[22] *Popowsky v. Pa. Pub. Util. Comm'n.*, 869 A.2d 1144, 1153 n.24 (Pa. Cmwlth. 2005); *UGI Corp. v. Pa. Pub. Util. Comm'n*, 410 A.2d 923,933-934 (Pa. Cmwlth. Ct. 1980)(expenses allowed for studies involving the feasibility of proposals to enhance the utility's supply capability); *Popowsky v. Pennsylvania Pub. Util. Comm'n*, 695 A.2d 448, 452-53 (Pa. Comwlth.. Ct. 1997)(expenses allowed for costs associated with change in accounting method).

this requirement. The Commission for ratemaking purposes is not bound by where a claim is treated by a Company on its books so the ALJ's basis for rejecting it is incorrect. It is common practice in *ratemaking* for claims to be moved from rate base to expense items or vice versa or between expense categories regardless to how a Company treated it on its books.[23] The Company is simply suggesting an alternative way to handle these costs, and to avoid the contra-policy result of punishing a company for an acquisition approved soundly by the Commission by making the Company eat all costs or expenses.

The RD's reason for rejecting this alternative (capitalization) claim on the basis of OCA's objection in its Brief that the alternative adjustment should not have been stated for the first time in rejoinder is error. RD at 26. Commission precedent is clear that OCA's objection in its brief to the opinion and alternative adjustment proposed by Mr. Shambaugh as to capitalizing the costs at issue instead of expensing and amortizing them was untimely and was waived. Specifically, this Commission has recognized that any such objection raised in a brief, as opposed to at the hearing when the opinion occurred, is ***untimely and should be denied.***[24]

Furthermore, this was not "ambush" by surprise, as is frowned on by the Commission. The Company was simply responding to the OCA's mischaracterization in surrebuttal (OCA Statement 1S at 4:6-23) of the Company's expense claim as falling under Section 1327 and OCA's assertion that all costs of the acquisition were included in the price. Hence, the Company was simply responding to the OCA by presenting an alternative way to counter OCA's latest argument to reject these costs.

The RD should not have rejected this alternative scenario for these two reasons, and the Commission should approve the Company's initial expense/amortization proposal or, in the

[23] *2008 Rate Case Order* at 51 (moving an expense from one category to another was appropriate for ratemaking purposes).
[24] *In Re Philadelphia Electric Company*, Docket No. A-98248, 1978 WL 51024, *15 (Order entered June 5, 1978)(Objections to admissibility of evidence not made at hearing are waived.)

alternative, capitalize the costs as franchise costs for the reasons stated in Columbia's Main and Reply Briefs.

For the reasons stated above, Columbia's Exception No. 4 should be granted.

Exception No. 5. **<u>The ALJ erred in recommending rejection of Columbia's claim for certain employee compensation package expense. RD at 32.</u>**

The RD recommends rejection of Columbia's Pension and Benefits claim for $6,051 related to employee recognition and team building for jobs well done. RD at 32. The RD accepts the OCA's and I&E's argument that the expenses are entertainment expenses and not related to the provision of service. RD at 32. This is simply not the case. Rather, the record is clear they are part of the overall compensation package which is necessary to retain and attract skilled workers.

Both OCA and I&E exaggerate this claim as some frolic or detour unrelated to retaining and attracting skilled labor as part of an overall compensation package. In a classic case of superimposing its lack of actual water business experience over actual experienced managerial discretion, the OCA's relatively new revenue requirement witness testified that the benefits at issue were not necessarily needed to attract or retain employees because of other benefits like "regular pay increases and no employee contribution to health insurance." (OCA Stmt. 1S at 22:15-19) Unfortunately, the RD agreed with the characterization despite uncontroverted evidence by Columbia.

Columbia explained this compensation package issue in much greater detail than in the prior rate case. As Columbia's General Manager Mr. Lewis testified, "this is not a trip to Hershey Park. It is not a picnic at the park." (Tr. at 112) Mr. Lewis went on to explain that 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).

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) It is well known that the pool of workers with waterworks skill and experience is shrinking and Columbia must use creative means like this to retain the talent necessary to provide the level of water service that the Commission and customers demand. 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.

For the reasons stated above, Columbia's Exception No. 5 should be granted.

Exception No. 6. **The ALJ erred in recommending allocation of $2,364 in accounting expense to the Marietta Division. RD at 34-35.**

The RD recommends allocation of $2,364 of the Company's claimed accounting expense to the Marietta Division. RD at 35. The RD concludes that because the two divisions keep separate books, budgets and depreciation calculations, and because accounting costs are already built into the Marietta Division's rates, to allow the inclusion of those costs in this case would be to allow double recovery. RD at 35. The error in this logic can be found directly in this statement. First, the fact that the two divisions keep separate books, budgets and depreciation calculations is why the accounting costs should not be shared. The accounting work is ***separate*** for each division, not ***shared.*** Therefore, the accounting costs should be kept ***separate***, not ***shared.*** Second, because the accounting costs are already built into Marietta's rates, allocating any additional costs to the Marietta Division would actually result in double billing Marietta's customers, not Columbia's.

Furthermore, in allocating the $2,364 of accounting expense, the RD relies on the arbitrary and speculative 12% allocation factor of OCA, which it rejects on numerous occasions, and rejects the testimony of the Company's general manager who has first-hand knowledge of the Company's operations.[25] As Mr. Lewis explained, "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 over and above those already allocated to both divisions and which will be associated with additional Marietta Division work. These expenses will be allocated solely to the Marietta Division when they occur.

For the reasons stated above, Columbia's Exception No. 6 should be granted.

[25] Mr. Lewis 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).

Exception No. 7. **<u>The ALJ erred in recommending rejection of Columbia's request to discontinue the requirement that Columbia's officers and directors keep time sheets of their hours devoted to Company business. RD at 37-38</u>**

The RD recommends rejection of the Company's request to discontinue the requirement that Columbia's officers and directors keep time sheets of their hours devoted to Company business.[26] RD at 38. This requirement, which is discriminatory in that no other Class A water utility, gas or electric utility has such a requirement, was put in place in Columbia's 2008 rate case at the request of the OCA. However, OCA's attempted use of this information in this case, and the ALJ's rejection of the same, shows that this requirement was frivolous to begin with, is frivolous now, will be frivolous in the future and is not needed.

As set forth in the RD at pp. 36-37 (addressing the reasonableness of the Company's officer's salaries and director's fees), it is clear the only reason the OCA wants this information is to have a simplistic way – converting salaried officers and director's time into an hourly rate – to attack the reasonableness of their compensation. The ALJ correctly saw through this rouse and rejected this approach:

> the OCA's argument is based on hours and dollar amounts that are entirely hypothetical, and which take no recognition of any unique qualities of individual officers or of the challenges they face or the services they render to a company with its own unique business environment. For that reason, I agree with Columbia that the OCA, if not 'engaging in micromanaging and invading the Company's managerial discretion,' (CWC St. 1R at 19) is coming very close to it. RD at 37

The ALJ's rejection of the OCA's attempted use of the time keeping requirement is a clear indication that this requirement is not needed on a going forward basis.

[26] The ALJ has concluded that Columbia has complied with this requirement. RD at 38; July 23, 2013 Order Denying Motion to Compel.

Furthermore, 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. 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.

In its main and reply briefs, the Company provided numerous other reasons why this requirement should be eliminated. For example, 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, 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 modest compensation they receive. That will invite Board and officer talent that is not as good as what the Company currently has, or one that has no ties to the community. (CWC Statement No. 1R at 22:7-16)

For the reasons set forth above, Columbia's Exception No. 7 should be granted.

Exception No. 8. **The ALJ erred by not including an allowance for rate case expense.**

After careful review by Columbia of the RD and appended Tables, it appears that the RD includes no amount for rate case expense. In Columbia's original filing it requested $252,800 in pro forma rate case expense that should be normalized over 3 years. During the hearing, Columbia witness, Mr. Shambaugh, sponsored CWC Rejoinder Exhibit No. 6, which was a summary of rate case expense in the updated amount of $258,412.05. This Exhibit was moved into the record with no objections from any party. In its Reply Brief, OCA objected to the updated claim. Columbia requests its updated claim of $258,412.05 be used and normalized over three years, resulting in the amount of $86,137 be included in the revenue increase.

For the reasons set forth above, Columbia's Exception No. 8 should be granted.

CONCLUSION

WHEREFORE, for the reasons set forth above, the Columbia Water Company respectfully requests that the Commission grant these Exceptions and enter an Order allowing the Company to put rates into effect that will allow for annual revenues of $773,210.

Respectfully submitted,

Thomas J. Sniscak

Thomas J. Sniscak, Attorney I.D. 33891
William E. Lehman, Attorney I.D. 83936
Hawke McKeon & Sniscak LLP
100 North Tenth Street
P. O. Box 1778
Harrisburg, PA 17105-1778
(717) 236-1300
tjsniscak@hmslegal.com
welehman@hmslegal.com

Counsel for
The Columbia Water Company

DATED: December 6, 2013

PENNSYLVANIA
PUBLIC UTILITY COMMISSION

IN THE MATTER OF THE APPLICATION OF DOCKET NO: A-2012-2282219

Joint Application of Columbia Water Company and Marietta Gravity Water Company for approval of the transfer of the rights, service obligations, water system and assets used and useful in the operation of the water system of Marietta Gravity Water Company to Columbia Water Company.

Effective Date: October 5, 2012

The Pennsylvania Public Utility Commission hereby certifies that after an investigation and/or hearing, it has, by its report and order made and entered, found and determined that the granting of the application is necessary or proper for the service, accommodation, convenience and safety of the public and hereby issues to the applicant this CERTIFICATE OF PUBLIC CONVENIENCE evidencing the Commission's approval.

In Witness Whereof, The PENNSYLVANIA PUBLIC UTILITY COMMISSION has caused these presents to be signed and sealed, and duly attested by its secretary at its office in the city of Harrisburg this 23rd day of October 2012.

Secretary

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Appendix A

The Columbia Water Company

Income Tax Calculations
Year Ended December 31, 2013 at Present Rates

			PA	FEDERAL
OPERATING REVENUES			$4,032,272	$4,032,272
OPERATING EXPENSES			(2,030,398)	(2,030,398)
DEPRECIATION EXPENSE			(984,321)	(984,321)
AMORTIZATION EXPENSE			(15,039)	(15,039)
REGULATORY ASSESSMENTS			(24,159)	(24,159)
PAYROLL TAXES			(75,060)	(75,060)
PA CAPITAL STOCK TAX			(9,000)	(9,000)
PUBLIC UTILITY REALTY TAX			(48,200)	(48,200)
PROPERTY TAXES			(2,597)	(2,597)
STATE CORPORATE LOAN TAX			(74)	(74)
SUBTOTAL NET OPERATING INCOME BEFORE INCOME TAXES			$843,424	$843,424
NON-OPERATING INCOME & EXPENSES:				
MERCHANDISING SALES & JOBBING WORK (NET)			15,762	15,762
INTEREST & DIVIDEND INCOME			8	8
NON-UTILITY			4,300	4,300
MISCELLANEOUS NON-UTILITY EXPENSES			(20,119)	(20,119)
INTEREST EXPENSE			(219,064)	(219,064)
NET INCOME BEFORE INCOME TAXES			$624,311	$624,311
LESS:				
ACCREATION OF DEFERRED CREDIT			(214,095)	(214,095)
			$410,216	$410,216
LESS:				
DEPRECIATION - EXCESS				
	PA	FED		
TAX	$641,824	$829,734		
BOOK	984,321	984,321		
	($342,497)	($154,587)	342,497	154,587
			$752,713	$564,803
PA CNI			$75,196	(75,196)
Fed tax				$166,466

	PA	FED	
ACCRUAL	$75,196	$166,466	
EXPEND	57,818	171,208	
DEFERRED	($17,378)	$4,742	
incr in accum deprec tax	($342,497)		
	x.0999		
state tax deferred	($34,215)		
add: rate case cost amortization	16,837		
state tax deferred (adjusted)	($17,378)		
incr in accum deprec tax		($154,587)	
		x.34	
federal tax deferred		($52,560)	
add: rate case cost amortization		57,302	
federal tax deferred (adjusted)		$4,742	
Deferred taxes accum 1/1/13	$966,190	$4,003,354	4,969,544
Deferred Taxes 12/31/13	$948,812	$4,008,096	4,956,908

APPENDIX B

The Columbia Water Company

Income Tax Calculations
Year Ended December 31, 2013 at Proposed Rates

	PA	FEDERAL
OPERATING REVENUES	$4,805,482	$4,805,482
OPERATING EXPENSES	(2,030,398)	(2,030,398)
DEPRECIATION EXPENSE	(984,321)	(984,321)
AMORTIZATION EXPENSE	(15,039)	(15,039)
REGULATORY ASSESSMENTS	(28,792)	(28,792)
PAYROLL TAXES	(75,060)	(75,060)
PA CAPITAL STOCK TAX	(9,000)	(9,000)
PUBLIC UTILITY REALTY TAX	(48,200)	(48,200)
PROPERTY TAXES	(2,597)	(2,597)
STATE CORPORATE LOAN TAX	(74)	(74)
SUBTOTAL NET OPERATING INCOME BEFORE INCOME TAXES	$1,612,001	$1,612,001
NON-OPERATING INCOME & EXPENSES:		
MERCHANDISING SALES & JOBBING WORK (NET)	15,762	15,762
INTEREST & DIVIDEND INCOME	8	8
NON-UTILITY	4,300	4,300
MISCELLANEOUS NON-UTILITY EXPENSES	(20,119)	(20,119)
INTEREST EXPENSE	(219,064)	(219,064)
NET INCOME BEFORE INCOME TAXES	$1,392,888	$1,392,888
LESS:		
ACCREATION OF DEFERRED CREDIT	(214,095)	(214,095)
	$1,178,793	$1,178,793

LESS:				
DEPRECIATION - EXCESS				
	PA	FED		
TAX	$641,824	$829,734		
BOOK	984,321	984,321		
	($342,497)	($154,587)	342,497	154,587
			$1,521,290	$1,333,380
PA CNI			$151,977	(151,977)
Fed tax				$401,677

	PA	FED
ACCRUAL	$151,977	$401,677
EXPEND	134,599	406,419
DEFERRED	($17,378)	$4,742

	PA	FED
incr in accum deprec tax	($342,497)	
	x.0999	
state tax deferred	($34,215)	
add: rate case cost amortization	16,837	
state tax deferred (adjusted)	($17,378)	
incr in accum deprec tax		($154,587)
		x.34
federal tax deferred		($52,560)
add: rate case cost amortization		57,302
federal tax deferred (adjusted)		$4,742

Deferred taxes accum 1/1/13	$966,190	$4,003,354	4,969,544
Deferred Taxes 12/31/13	$948,812	$4,008,096	4,956,908

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APPENDIX C

The Columbia Water Company

Statement of Net Operating Revenue Under the Existing Rates for the Twelve Months
Ended December 31, 2012 and December 31, 2013, and Under the Proposed Rates
Answer to 52 Pa. Code § 53.52 (c)(1) - Sheet No. 1a
Based Upon ALJ Recommended Decision

	Schedule Number	Per Books Year Ended 12/31/12	Anticipated Revenue at Present Rates Year Ended 12/31/13 Adjustments	Amount	ALJ Recommended Decision Adjustment	Amount
Operating Revenues	b(4)-1a	$4,238,672	($197,008)	$4,041,664	$342,406	$4,384,070
Operating Revenue Deductions:						
Operating Expenses	(c)(1) - 1b,c&d	$1,947,648	$82,750	$2,030,398	($20,431)	$2,009,967
Depreciation	Supporting Sch. Nos. 6&7	1,026,382	(287,122)	739,260		739,260
Amortization Expense - Utility Plant Acquisition Adj.		3,760	11,279	15,039	(15,039)	0
Income Taxes:						
State Income Tax	Supporting	73,302	1,884	75,186	51,313	126,499
Federal Income Tax	Sch. Nos. 8&10	244,431	(73,223)	171,208	200,508	371,716
Regulatory Assessments	Supporting Sch. Nos. 8&10	25,306	(1,147)	24,159	2,108	26,267
Payroll Taxes:						
F.I.C.A.	Supporting	70,458	(5,916)	64,542		64,542
Pa. Unemployment	Sch. No. 3	9,229	(66)	9,163		9,163
F.U.T.A.		1,442	(87)	1,355		1,355
Pa. Capital Stock Tax		17,289	(8,289)	9,000		9,000
Public Utility Realty Tax		48,200		48,200		48,200
Property Taxes		2,597		2,597		2,597
State Corporate Loan Tax		74		74		74
Total Operating Revenue Deductions		$3,470,118	($279,937)	$3,190,181	$218,459	$3,408,640
Net Operating Revenues		$768,554	$82,929	$851,483	$123,947	$975,430

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APPENDIX D
(Page 1)

The Columbia Water Company

Income Tax Calculations
Year Ended December 31, 2013 at Proposed Rates
Based Upon ALJ Recommended Decision

			PA	FEDERAL
OPERATING REVENUES			$4,384,070	$4,384,070
OPERATING EXPENSES			(2,009,967)	(2,009,967)
DEPRECIATION EXPENSE			(984,321)	(984,321)
AMORTIZATION EXPENSE			-	-
REGULATORY ASSESSMENTS			(26,267)	(26,267)
PAYROLL TAXES			(75,060)	(75,060)
PA CAPITAL STOCK TAX			(9,000)	(9,000)
PUBLIC UTILITY REALTY TAX			(48,200)	(48,200)
PROPERTY TAXES			(2,597)	(2,597)
STATE CORPORATE LOAN TAX			(74)	(74)
SUBTOTAL NET OPERATING INCOME BEFORE INCOME TAXES			$1,228,584	$1,228,584
NON-OPERATING INCOME & EXPENSES:				
MERCHANDISING SALES & JOBBING WORK (NET)			15,762	15,762
INTEREST & DIVIDEND INCOME			8	8
NON-UTILITY			4,300	4,300
MISCELLANEOUS NON-UTILITY EXPENSES			*(20,119)*	*(20,119)*
INTEREST EXPENSE			(344,919)	(344,919)
NET INCOME BEFORE INCOME TAXES			$883,616	$883,616
Add: to reduce book depreciation				
ACCREATION OF DEFERRED CREDIT			214,095	214,095
			$1,097,711	$1,097,711
Qualified Domestic Production Adj.				(50,476)
LESS:				
DEPRECIATION - EXCESS				
	PA	FED		
TAX	$641,824	$829,734		
BOOK- NET OF ACCREATION	770,226	770,226		
	($128,402)	$59,508	128,402	(59,508)
			$1,226,113	$987,727
	PA CNI		*$122,489*	(122,489)
	Fed tax			$294,181

	PA	FED	
ACCRUAL	$122,489	$294,181	
EXPEND	126,499	371,716	
DEFERRED	$4,010	$77,535	
incr in accum deprec tax	($128,402)		
	x.0999		
state tax deferred	($12,827)		
add: rate case cost amortization	16,837		
state tax deferred (adjusted)	$4,010		
incr in accum deprec tax		$59,508	
		x.34	
federal tax deferred		$20,233	
add: rate case cost amortization		57,302	
federal tax deferred (adjusted)		$77,535	
Deferred taxes accum 1/1/13	$966,190	$4,003,354	4,969,544
Deferred Taxes 12/31/13	$970,200	$4,080,889	5,051,089

APPENDIX D
(Page 2)

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).

By First Class Mail and Electronic Mail

Christine Maloni Hoover, Esquire
Senior Assistant Consumer Advocate
Erin L. Gannon, Esquire
Assistant Consumer Advocate
Office of Consumer Advocate
555 Walnut Street, 5th Floor
Harrisburg, PA 17101
CHoover@paoca.org
EGannon@paoca.org

Daniel G. Asmus, Esquire
Office of Small Business Advocate
300 North Second St., Suite 1102
Harrisburg, PA 17101
dasmus@pa.gov

Charles Daniel Shields, Esquire,
Senior Prosecutor
Richard A. Kanaskie, Esquire
Bureau of Investigation and Enforcement
Pennsylvania Public Utility Commission
400 North Street, Second Floor West
Harrisburg, PA 17120
chshields@pa.gov
rkanaskie@state.pa.us

Thomas J. Sniscak
William E. Lehman

Dated this 6th day of December, 2013

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