COMMONWEALTH OF PENNSYLVANIA

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December 16, 2013

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

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

Dear Secretary Chiavetta:

Attached for electronic filing are the Reply Exceptions of the Office of Consumer Advocate in the above-referenced proceeding.

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

Respectfully submitted,

Christine Maloni Hoover

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Senior Assistant Consumer Advocate
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Attachment
cc: Honorable Dennis J. Buckley
Office of Special Assistants at ra-OSA@pa.gov
Certificate of Service
175747.DOC

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

<u>REPLY EXCEPTIONS OF THE</u>
<u>OFFICE OF CONSUMER ADVOCATE</u>

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DATED: December 16, 2013

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I. INTRODUCTION

On November 22, 2013, the Office of Administrative Law Judge issued the Recommended Decision (R.D.) of Administrative Law Judge Buckley (ALJ) regarding Columbia Water Company's (Columbia or CWC or Company) base rate filing.

In his Recommended Decision, the ALJ adopted the use of a DCF analysis to determine the cost of common equity and, specifically, the 9.15% return on common equity calculated by the Bureau of Investigation and Enforcement (I&E) as well as the capital structure recommended by I&E, and rejected both of Columbia's proposed rate of return premiums. R.D. at 47-61. In addition, the ALJ adopted OCA's adjustments for the acquisition adjustment, employee recognition, accounting, office expenses and utilities, and retaining the ongoing requirements for time records. CWC did not file exceptions regarding the ALJ's recommendations to adopt the OCA's adjustments to the claims for engineering and office expenses and utilities. Thus, those recommendations should be considered to be uncontested and should be adopted by the Public Utility Commission (Commission or PUC). The OCA files these Reply Exceptions in response to the Exceptions of Columbia filed on December 6, 2013. A complete discussion of each issue in these Reply Exceptions can be found in the OCA's Main and Reply Briefs.

II. REPLY EXCEPTIONS

REPLY TO CWC EXCEPTION 1: The ALJ Correctly Adopted A DCF-Based Overall Rate of Return For Columbia. ALJ R.D. at 43-46; OCA M.B. at 66-85; OCA R.B. at 42-46.

In determining a rate of return for Columbia, ALJ Buckley agreed with OCA and rejected the Company's proposed rate of return, finding it "excessive due to an equity-rich capital structure and an overstated equity cost rate." R.D. at 44. The ALJ adopted I&E's 50% debt/50% equity capital structure as well as I&E's recommended cost of equity of 9.15%, based on the

DCF model and informed judgment. Both I&E and OCA used such an analysis, which produced cost of equity recommendations of 9.15% and 8.25%, respectively. The ALJ specifically found Columbia's requested 9.09% overall rate of return is "excessive and is based on an overly generous methodology." R.D. at 45. He recommended that I&E's capital structure and overall rate of return of 7.07% be adopted. In Exceptions, CWC argues that the hypothetical capital structure is "punitive" and that the return on equity and resulting overall return are too low because the ALJ did not rely on multiple methods of determining the return on equity. CWC Exc. at 6-15. As discussed below, contrary to CWC's claims, the resulting overall rate of return adequately balances the interests of shareholders and ratepayers as is required by the Public Utility Code and relevant case law. See OCA M.B. at 71-74.

A. Capital Structure

The ALJ was presented with two reasonable alternatives to CWC's capital structure which is heavily weighted with higher cost equity. First, as discussed, I&E presented a hypothetical capital structure of 50% debt and 50% equity because the actual capital structure was not in line with the industry average and because the estimated 2013 capital structure is more heavily weighted with higher cost equity than any of CWC's actual capital structures over the last 5 years. I&E M.B. at 41-43.

The OCA presented evidence recommending a modified actual capital structure of 44.15% long-term debt and 55.85% common equity because Columbia's proposed capital structure does not match its total capitalization. OCA witness Rothschild presented evidence showing that the Company's capital structure was not the correct actual capital structure. OCA M.B. at 75-76; OCA St. 2 at 5-6. Mr. Rothschild used the Total Measure Value of $13,527,774 used by the Company to set rates as the total capitalization and the $7,555,405 common equity reported by the Company to determine the amount of long-term debt of $5,972,369 ($13,527,774 - $7,555,405). Id. The Company's development of capital structure ratios for rate making purposes includes only $11,738,152, which is $1,789,622 less than the $13,527,774 Total Measure of Value used to set rates. Id. Considering that the Company received a $2.2 million Wells Loan on October 4, 2012 at a 4.50% interest rate, it is appropriate to allocate this cost rate to this unexplained gap between the Company's claimed capitalization and the Total Measure of Value to set rates. OCA St. 2 at 6 (citing CWC response to I&E-RE-3). The correct actual capital structure is 55.85% common equity and 44.15% long-term debt. Id.; OCA St. 2 at 5-7, Sch. ALR 1 at 1, Sch. ALR 6. Mr. Rothschild also offered an alternative hypothetical capital structure recommendation based on the capital structure ratios of the comparative water group of 48.24% common equity and 51.76% long-term debt. Id.; OCA St. 2 at 5, 7, Sch. ALR 1 at 2.

It is clear that the ALJ's rejection of Columbia's actual capital structure is well founded based on the evidence in this proceeding. The use of the hypothetical capital structure recommended by I&E is reasonable. However, if the Commission is inclined to use another capital structure, the OCA notes that the alternative capital structures presented by OCA reflect the current debt financing obtained by CWC and are more reasonable for ratemaking purposes than CWC's proposed capital structure.

B. Return on Equity and Overall Rate of Return

Columbia claims that the ALJ erred because his recommendation is based on the discounted cash flow (DCF) method. CWC Exc. at 10-14. As discussed in the OCA's testimony and briefs, and below, reliance on the DCF is reasonable. Moreover, reliance on models that have multiple flaws does not represent a reasonable approach to determining the appropriate return on equity.

The Pennsylvania Public Utility Commission favors the use of the DCF analysis. OCA M.B. at 77-80. The Commission has relied on the DCF approach for setting returns on equity for many years. See, e.g., Pa. P.U.C. v. York Water Co., 75 PaPUC 134, 159-69 (1991) (York) Pa. P.U.C. v. Phila. Suburban Water Co., 71 PaPUC 593 (1989)(PSWC 1989); Pa. P.U.C. v. Pennsylvania-American Water Co., 71 PaPUC 210, 279-82 (1989); Pa. P.U.C. v. The Peoples Natural Gas Co., 69 PaPUC 1, 167-68 (1989); Pa. P.U.C. v. Pennsylvania Power Co., 67 PaPUC 91, 164, 93 PUR4th 189, 266 (1988) (Penn Power); Pa. P.U.C. v. National Fuel Gas Dist. Corp., 67 PaPUC 264, 332 (1988). Pa. P.U.C. v. Roaring Creek Water Co., 84 PaPUC 438, 462 (1995) (Roaring Creek 1994); Pa. PUC v. Western Pa. Water Co., 67 PaPUC 529, 559-70 (1988); Pa. P.U.C. v. Equitable Gas Co., 73 PaPUC 345-46 (1990); Pa. P.U.C. v. Pennsylvania-American Water Co., 2002 PaPUC LEXIS 1 at *90.

In the 2008 Columbia case, the Commission used the DCF as its primary methodology along with informed judgment, and consulting other methods used by the parties. Pa. P.U.C. v. Columbia Water Co., R-2008-2045157, Order at 111 (June 10, 2009) (2008 Order). See also Pa. P.U.C. v. City of Lancaster Water, R-2010-2179103 Slip Op. at 56 (June 30, 2011)(DCF method has historically been the primary method used by the PUC.)

Mr. Rothschild's common equity cost evaluation is consistent with the Commission's approach and using this approach he determined an 8.25% common equity cost rate is appropriate for Columbia Water. OCA St. 2 at 3. As noted by Mr. Rothschild, "It is critical to have one accurate model. Adding more models, particularly if they are flawed, does not increase accuracy." OCA M.B. at 80; OCA St. 2S at 2. Moreover, Mr. Rothschild used the non-constant DCF method as a check on his results.

In summary, the ALJ's recommended overall rate of return is reasonable based on the evidence in this proceeding and is consistent with the PUC's approach to determining a rate of return that balances the interests of ratepayers and the utility. As shown by the OCA's recommendations, the overall return should not be higher than the ALJ's recommendation.

REPLY TO CWC EXCEPTION 2: The ALJ Correctly Rejected CWC's Claims for Performance Adjustments. ALJ R.D. at 46-48; OCA M.B. at 91-101; OCA R.B. at 48-52

The ALJ adopted the adjustment made by OCA to remove CWC's 50 basis point premium to its rate of return claim. CWC's claim is based on its claimed superior performance, a 1998 acquisition of a neighboring system and the 2012 acquisition of an affiliate water system. The ALJ agreed with OCA that CWC had not established that its performance goes beyond what every utility is required to do under the Public Utility Code. In addition, the two acquisitions used by CWC are not a sufficient basis to support a premium to its rate of return. In its Exception, Columbia argues that it provides "exemplary service" and appears to argue that it should be given higher returns because it is a "small company". CWC Exc. at 15. Columbia also states that it acquired two "less viable water companies." Id. As discussed below, the arguments made by Columbia are inconsistent with the Public Utility Code, are not supported by the evidence in this proceeding, and should be rejected and the ALJ's recommendations should be adopted. Section 523 of the Public Utility Code makes clear that a utility cannot be rewarded with a rate of return premium without specific evidence to support the adjustment. 66 Pa. C.S. § 523(a). The statute provides that the Commission will consider evidence regarding the utility's efficiency, effectiveness and adequacy of service.

A. Management Efficiency

Columbia has requested an 11.35% return on equity in this proceeding, which includes a 25 basis point adder to recognize its "outstanding service and commitment to the community." CWC St. 1 at 10. Specific reasons cited by Columbia as justification for awarding a rate of return premium include: (1) compliance with water quality and pressure requirements, (2) efforts to minimize expenses and use existing staff efficiently, (3) extending lines to an area of Manor and West Hempfield Townships, and (4) acquiring Marietta Gravity Water Company. Id. at 7-9.

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

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

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

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

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

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

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

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

In addition to the lack of evidence in the 2008 proceeding, there are additional facts weighing against a performance factor adjustment. According to its 2011 management audit report, the auditors determined that Columbia needed minor improvement in all areas assessed except for customer service, for which it met expected performance levels. CWC M.B. at 34.

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

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

> With regard to the extensions of its franchise territory the evidence indicates that Columbia is providing adequate, reasonable service. These franchise expansions

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

2008 RD at 67.

Columbia also argues that it should receive a 25 basis point adjustment to its return on equity because Aqua Pennsylvania received a 22 basis point adjustment in its 2008 base rate case.[2] CWC Exc. at 20. Based on the record in this proceeding, however, Columbia has not adduced sufficient evidence to warrant any kind of a positive management performance factor adjustment.[3]

Finally, Columbia argues that Section 523 has "graduations *(sic)* of what constitutes adequate, efficient, safe and reasonable service and requires the Commission to take those distinctions into account when ruling upon rate requests." CWC Exc. at 20. CWC does not cite to any specific language in Section 523, nor is there any language that would support this statement. Moreover, CWC does not cite to any case law that supports its statement that the Commission must take into account that it is a small utility versus medium, large or very small. Moreover, there is nothing in Section 1501 of the Public Utility Code, 66 Pa. C.S. § 1501, that distinguishes the requirements contained therein by the size of the public utility. CWC's statement is simply incorrect. Customers of small utilities, like customers of large utilities, are entitled to safe, adequate, and reliable service under the provisions of the Public Utility Code. If that is what Columbia is providing, then it is meeting its obligations as a public utility. As

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[2] In the 2008 rate case proceeding involving Aqua Pennsylvania, the Commission permitted a 22 basis point performance factor adjustment, "in recognition of [Aqua's] exemplary managerial performance."[2] Pa. P.U.C. v. Aqua Pennsylvania, Inc., R-00072711, Order at 50 (July 31, 2008).

[3] As OCA Witness Everette noted, the examples provided by the Company are acts routinely performed by utilities in order to provide the reasonable and adequate service required by law and do not demonstrate "extraordinary" service. OCA St. 1 at 19-20; OCA St. 1S at 6.

discussed above and in the OCA's testimony and Briefs, that does not entitle CWC to a 25 basis point adder to the return on equity determined by the Commission.

B. Acquisition of Mountville and Marietta Gravity

In its Exceptions, CWC argues that the ALJ erred by rejecting the 25 basis point adder for what Columbia claims is its history of acquiring less viable water systems, because, "There is no standard, however, for what 'less viable' means." CWC Exc. at 23. There is a standard that has been in place for nearly 20 years and the ALJ was correct in denying the claim. The Commission has defined viability as determination of whether the small system has financial, managerial and technical fitness currently and in the future. 52 Pa. Code § 69.701(a)(2) ("A viable water system is one which is self-sustaining and has the commitment and financial, managerial and technical capabilities to reliably meet Commission and Department of Environmental Resources (Department) requirements on a long-term basis"). As summarized below and discussed in full detail in the OCA's Briefs and testimony, Columbia has not established that Marietta Gravity was less viable.

Columbia cites the Commission's policy statement at Section 69.721(g). CWC St. 1 at 10-11; CWC St. 3 at 37. Specifically, Section 69.721(g) provides that a rate of return premium may be requested where an acquisition (1) falls outside of the parameters of 66 Pa. C.S. § 1327 and (2) the utility has a "demonstrated track record of acquiring and improving the service provided to the customers of smaller and less viable water systems."[4] Columbia has not established, however, that Marietta was a less viable system or that it has improved service to those customers as envisioned by Section 69.721. Subsection (a) of the Policy Statement provides:

[4] As discussed in the OCA's Briefs, Columbia's acquisition of Marietta does not satisfy the requirements of Section 1327. OCA M.B. at 27-31; OCA R.B. at 16-18.

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

52 Pa. Code § 69.721(a). The testimony of OCA witnesses Everette and Fought show that Marietta was not less viable than Columbia. Ms. Everette summarized the evidence regarding Marietta's viability as follows:

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

OCA St. 1 at 19-20.

Further, Columbia has not provided sufficient evidence to show that service to MGWC customers has improved as a result of the acquisition. The Company did not identify any improvements (CW Exc. at 23-24) that the Marietta system needed at the time of acquisition that, if not completed, would jeopardize the adequacy of service. OCA St. 3 at 4. Mr. Fought stated:

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

Id. at 4, 6. Nor did the Company provide evidence to show that MGWC was not able to implement them. OCA St. 3 at 5. Further, the record shows that, in many ways, Marietta continues to be operated as a separate system and that costs for customers of both systems remain the same or greater. OCA M.B. at 92; CWC St. 1R at 14, tr. 115, 118, 129.

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

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

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

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

C. Summary

OCA agrees with Columbia that Section 523 of the Public Utility Code, 66 Pa. C.S. § 523, together with 52 Pa. Code § 69.711, permits awards of rate of return premiums for certain water system acquisitions and for exemplary performance by a utility that are supported by specific evidence. CWC M.B. at 51-52. The OCA disagrees that Columbia's performance has been exemplary, based on the record evidence, for purposes of increasing its return by 25 additional basis points. OCA M.B. at 86-90. Also, the OCA flatly disagrees that Columbia's request in this case for a 25 basis point premium for a 15-year old acquisition of a neighboring system and a 2012 acquisition of an affiliate water system is appropriate or supported by specific evidence. OCA M.B. at 90-93. As discussed in the OCA's Main and Reply Briefs, the evidence put forth by Columbia does not warrant any upward adjustment to the DCF-indicated return on equity related to management efficiency or acquisitions.

REPLY TO CWC EXCEPTION 3: CWC Has Miscalculated the Effective Tax Rate. ALJ R.D., Table III.

The Company correctly states that the R.D. makes adjustments to the Company's taxes under present rates, rather than under the Pro Forma Present Rates claimed by the Company. R.D. Table I. In order to attempt to correct this oversight, the Company uses the revenue and expense adjustments recommended by the ALJ I order to compute effective tax rates that they believe the R.D. allows. The Company claims that the R.D. allows an effective state tax rate of 12.968537%; *i.e.* an effective tax rate higher than the marginal tax rate of 9.99%. CWC Exc. at 24. The Company also claims that the R.D. allows an effective federal tax rate of 38.107911%; *i.e.* an effective tax rate higher than marginal tax rate of 34.0%. Id. An analysis of Appendix D attached to the Company's Exceptions shows that the Company incorrectly computed the effective tax rate. The formula for the effective tax rate is the amount of income tax divided by the pre-tax Net Operating Income (NOI) requirement, as shown on line 49 of OCA Exhibit AEE-1S, Schedule 8S.

In Appendix D, the Company shows State Income Tax of $126,499, Federal Income Tax of $371,716, and Net Operating Revenues (after tax) of $975,430. In order to properly compute the effective tax rate, the Net Operating Revenues (*i.e.* NOI) must be added to the income tax allowances in order to determine the pre-tax NOI. The resulting pre-tax NOI is $1,473,645 ($126,499 + $371,716 + $975,430). To compute the effective tax rates, the respective income tax amounts can then be divided by the pre-tax NOI, as follows:

State taxes: $126,499 / $1,473,645 = 8.58%
Federal taxes: $371,716 / $1, 473,645 = 25.22%

Thus, the Company is incorrect that the Commission should use the Company's claimed tax percentages (12.97% and 38.11% for state and federal taxes, respectively), as it does not represent an accurate calculation of the effective tax rate. The Company implies that "the effect of accumulated deferred taxes as a current expense to the Company" (CWC Exc. at 24) influences the fact that the effective tax rates are higher than the marginal tax rates. As the Company is required to normalize depreciation for ratemaking purposes, the Company's federal effective tax rate will never be higher than the marginal tax rate. For state taxes, deferred taxes would only make the effective tax rate higher than the marginal tax rate when, at some future point in time, the deferred taxes are actually being paid by the Company. This is not the case here. As shown on page 2 of the Company's Appendix D, the Company's deferred taxes have continued to accumulate.

REPLY TO CWC EXCEPTION 4: The ALJ Properly Rejected CWC's Acquisition Adjustment. ALJ R.D. at 23-26; OCA M.B. at 27-31; OCA R.B. at 16-18

The ALJ correctly rejected CWC's acquisition adjustment claim of $225,581 finding that the claim was not appropriate for ratemaking purposes. As explained below and in the OCA's briefs, Columbia's claim does not comport with Section 1327 requirements or basic ratemaking requirements. In its Exceptions, Columbia claims that the ALJ's recommendation "promotes an awful policy that punishes" Columbia. CWC Exc. at 26. As discussed below, Columbia is attempting to portray its claim as something different from an acquisition adjustment yet it is exactly that. Next, Columbia appears to argue that Section 1327 is an option but that a utility can still request an acquisition premium. CWC Exc. at 27. As will be discussed below, there is no legal support for Columbia's position.

Columbia is requesting that an acquisition adjustment of $225,581, related to the acquisition of Marietta Gravity Water Company (MGWC) be reflected in expenses in this case by amortizing it over 15 years, for an annual amount of $15,039. OCA St. 1 at 10. The Company's claimed expense related to this acquisition should be rejected because the Company is not eligible for an acquisition adjustment under Section 1327[5]. OCA St. 1 at 10-17; OCA St. 1S at 3-6. In October 2012, the Company purchased the assets of the MGWC; the total cost of the acquisition was $570,827. OCA St. 1 at 10, 16-17. The Company has not included the cost of MGWC assets in rate base, but the Company has claimed an expense of $15,039, which represents a fifteen year amortization of $225,581, the amount of expense the Company incurred in the process of acquiring the MGWC assets. OCA St.1 at 10; CWC St. 2R at 19. This claimed expense is an acquisition adjustment for which the Company is not entitled.

In the event that the costs are not considered an acquisition adjustment, the Company is not eligible for recovery through a fifteen year amortization. OCA St. 1S at 5. First, the Company has allocated 100% of the costs to acquire MGWC to Columbia customers. OCA St. 1S at 5. "The 2012 Annual Report to the Commission for the Marietta Division indicates that the Company has recorded on the books of the Marietta Division the full difference between purchase price and net book value, other than the legal and consulting fees." OCA St. 1S at 5. Thus, "the Columbia Division is being charged for all of the acquisition costs related to this purchase." OCA St. 1S at 5. Such an allocation is inappropriate. While the Company is

[5] For a full discussion of the reasons why 1327 is not applicable, see OCA Main Brief at 27 - 31, and OCA Reply Brief at 16 - 18.

proposing that the Columbia Division be charged for 100% of the costs, the Columbia Division is only acquiring "a very small amount of benefit from the acquisition of MGWC (*i.e.*, in the direct case, they allocated a small portion of salaries but none of the associated benefits, insurances, utilities, etc.)." OCA St. 1S at 5.

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

First, the claim is untimely.[6] Second, the Company has not claimed an associated depreciation expense or a time period to depreciate these costs. This amount cannot stay in rate base *ad infinitum*. Moreover, if the costs related to satisfying the requirements of the Public Utility Code were capitalized and put into rate base, the costs would have to satisfy Section 1327, which the Company admits it cannot do.[7] Columbia cannot create its own method to justify its claim. For the foregoing reasons, the Company's claimed expense of $15,039, representing a fifteen year amortization of $225,581 expenses incurred while acquiring the Marietta Gravity Water Company should be rejected.

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[6] In its Exceptions, CWC claims that it was responding to OCA's surrebuttal testimony. CWC Exc. at 29. What it fails to acknowledge is that the testimony was first provided in OCA's direct testimony (OCA St. 1 at 10-17) and thus should have been addressed in CWC's rebuttal testimony.

[7] In addition, if the expenses are capitalized, the Company's attempted calculation of the total revenue increase is flawed. The Company opines that at its recommended rate of return (9.10%), the Company would receive a total revenue increase of $17,039, which would be comprised of $11,007 of additional operating income and $6,032 of tax on that income. This calculation is incorrect. For the additional income of $11,007 to result in an increase in taxes of $6,032, the tax rate would have to be 54.8%.

Finally, in Exceptions, Columbia argues that Section 1327 is an option, but a utility is not excluded from requesting an acquisition premium. CWC Exc. at 27. CWC does not cite to any cases, statutes or regulations for its argument. Moreover, it is important to note that Section 1327 was enacted in 1990 as an exception to the rule that only original cost, and not any premium above cost, could be included in rate base and in rates. Specifically:

> Before June 5, 1990, Section 1311(b) provided the sole basis for valuing the property of a utility that is used and useful in providing public service, that is the rate base: "Method of valuation. – The value of the property of the public utility included in the rate base shall be the original cost of the property when first devoted to the public service less the applicable accrued depreciation....

Popowsky v. Pa. Public Utility Commission, 615 A.2d 857, 861 (Pa. Commw. 1992). Thus, Section 1327 is the only way under the Public Utility Code, to request an acquisition adjustment.

For the foregoing reasons, the Company's claim of $15,039 representing at fifteen year amortization of $225,581 of expenses incurred while acquiring MGWC should be rejected. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 14.

REPLY TO CWC EXCEPTION 5: The ALJ Properly Rejected A Portion of CWC's Employee Compensation Expense Claim. ALJ R.D. at 32; OCA M.B. at 47-50; OCA R.B. at 26-28

The ALJ adopted the recommendations of OCA and I&E that $6,051 of the Company's claim for Pensions and Benefits should be denied because it represents costs for items such as a Hershey Park outing and employee/officers year end banquet. R.D. at 32. The ALJ noted that the PUC rejected similar arguments made by Columbia in its last rate case and adopted the adjustment recommended by OCA in that case. Id. In its Exception, CWC claims that OCA and I&E "exaggerate" the claim. The OCA submits that there is no exaggeration, rather, CWC has once again claimed expenses that the PUC has already determined are not appropriate for ratemaking purposes. As discussed below, Columbia's exception repeats arguments rejected by the ALJ in this case and by the Commission in its last case. OCA witness Everette recommended that these items be removed from expenses for ratemaking purposes because they are not part of the employees' compensation. OCA St. 1 at 35-36; OCA St. 1S at 22. I&E witness Wilson also recommended that the entire claim be denied. I&E St. 2 at 10.

The Company did not put forward any evidence to support its claim that outings are required to retain employees. These employee entertainment expenses are not necessary to the provision of public utility service to customers. See I&E St. 2 at 10. The Commission has consistently disallowed these types of entertainment expenses based on its reasonable determination that they are not necessary in the provision of public utility service. See Pa. P.U.C. v. Pennsylvania-American Water Co., 79 PaPUC. 25, 62-63 (1993) (PAWC 1993) (expenses for entertainment and gifts inappropriately included in utility's rates because they did not directly relate to the provision of quality water service); see also Pa. P.U.C. v. Citizens Utilities Water Co. of Pa., 169 PUR4th 552, 584-85 (1996) (disallowing expenses for gifts, flowers, in-house luncheons and horticultural service despite the Company's claim that these items improved employee morale). Only expenses directly related to "employee recognition" dinners are permitted. See PAWC 1993 at *123; Pa. P.U.C. v. Pennsylvania-American Water Co., 1995 PaPUC LEXIS 170, *38-39 (PAWC 1995). In Columbia's last rate case, the Company made similar arguments with regard to a Hershey Park outing and a Christmas party. 2008 RD at 23-25. Consistent with these prior Commission Orders, the ALJ removed the expense from the Company's claim. Id.

The testimony shows that the Company admits that the Hershey Park trip is not for employee recognition.[8] The Company does not provide any specific information about the year-end banquet to demonstrate that it qualifies as an "employee recognition" dinner or is otherwise necessary to the provision of service. CWC St. 1R at 11-12.

The OCA notes that customers already pay the full cost of the Company's employee salaries and benefits and should not be required to compensate the Company for these entertainment expenses. Moreover, the fact that "Columbia has been providing its employees these benefits for years" only serves to show that there is no nexus between the entertainment expenses and the provision of utility service, *i.e.* the expenses are not related to recognizing employee performance, for which the Commission has allowed rate recovery in some cases. PAWC 1993; PAWC 1995 at *38-39. The OCA's position does not preclude the Company from continuing these expenditures if they are funded by its shareholders, which is what Columbia Water has done since its last case, when these costs were not permitted for ratemaking purposes.[9]

In Columbia's last rate case, the Company made similar arguments with regard to a Hershey Park outing and a Christmas party. 2008 RD at 23-25. Consistent with these prior Commission Orders, the ALJ removed the expense from the Company's claim. Id.

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[8] "It's not a trip to Hersheypark. It's not a picnic at the park. We provide our employees tickets. The employee uses the tickets when they want and they use them throughout the year. The employee must use them on a weekend or they take a vacation day to use them." Tr. 112

[9] If any part of the claim is allowed, however, Ms. Everette recommends that a portion of the cost should be allocated to the Marietta Division to reflect the portion of time that is allocated to the Marietta Division. OCA St. 1S at 23. Ms. Everette explained that, "Considering the adjustments to salaries that I made in Schedule 2, I have allocated 8.54% of CWC salaries to the Marietta Division. Therefore, if the Commission decided that this expense should be included for ratemaking purposes, 8.54%, or $517 should be allocated to the Marietta Division." OCA St. 1S at 23.

Consistent with the Commission's decision in Columbia's last base rate case and in the other cases cited above, the $2,779 expense for Hershey Park tickets must be denied. 2008 RD at 26.

REPLY TO CWC EXCEPTION 6: The ALJ Properly Recommended Allocating a Portion of the Accounting Expense to the Marietta Division ALJ R.D. at 34-35; OCA M.B. at 47-50; OCA R.B. at 26-28

The ALJ adopted the OCA's adjustment to allocate a portion of the accounting expenses to the Marietta Division because accounting costs are built into the Marietta Division rates. Thus, the ALJ agreed that if a portion of the total accounting expenses were not allocated to Marietta, then Columbia and Marietta's rate payers would be paying more than the total accounting expenses, or stated differently, it would be a double recovery. R.D. at 34-35.

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

Columbia to recover the full cost of preparing/filing the tax return and audit would allow the Company to double-collect this expense. OCA St. 1 at 42-43.

Company witness Lewis objected to any allocation of the expense on the basis that the Company expects overall accounting costs to go up as a result of the acquisition. CWC St. 1R at 14. He stated that the two divisions will keep separate books, budgets and depreciation calculations that will be used for the consolidated tax filings and audits. Tr. 115. The Company's position seems inconsistent with its position during the proceeding to acquire Marietta.[10] OCA St. 1S at 28. The Company provided an email from the Company's accountant with an estimated fee increase of 10% to 15%. CWC St. 1R at 14; DTL Rebuttal Exh. 2. There are three reasons why the claimed increase does not change the need to allocate a portion of the $19,700 invoice expenses to Marietta. First, this is not a known and measurable expense for the Columbia Division. An estimation of future expenses does not meet the Company's burden of proof. Second, the invoices provided show that $19,700 of the total $28,300 of costs was for tax preparation and auditing. The Company's tax return and audit will include both Columbia and Marietta. Therefore, these costs should be allocated in part to the Marietta Division. OCA St. 1S at 28. Third, the claimed increase is not relevant because Ms. Everette did not allocate the Company's total accounting costs; she only allocated the $19,700 related to tax preparation and the audit. For all of these reasons, the OCA recommends approval of its proposed allocation of 12% of those costs to the Marietta Division. OCA Exh. AEE-1S, Sch. 1S, line 26.

[10]There, Columbia asserted that the transaction would benefit the customers of both water systems through financial, managerial and operational efficiencies which may be realized over time... Additionally, CWC claimed that the transaction will likely result in a consolidation of reporting and operations that may impact future rate increase requests to the benefit of ratepayers. OCA St. 1S at 27 (quoting Joint Application of Columbia Water Co. and Marietta Gravity Water Co., A-2012-2282219, Order (Aug. 30, 2012)).

REPLY TO CWC EXCEPTION 7: The ALJ Correctly Recommended That Columbia's Officers and Directors Continue to Provide Time Sheets. ALJ R.D. at 37-38; OCA M.B. at 59-62; OCA R.B. at 35-38

Columbia claimed $68,900 of Salaries for Officers, Directors and Majority Shareholders and $62,500 for Directors' Fees & Expenses in this proceeding.[11] OCA M.B. at 53. The ALJ accepted the OCA's third recommendation which is that the Commission deny Columbia's request to end the Commission's directive in the 2008 case and continue to require the Company to account for actual hours spent by its officers and directors on Columbia business in relation to all other business interests. The ALJ specifically noted that, "Columbia cannot have it both ways and argue lack of time/experience with the Marietta Division acquisition on one hand, but refuse reasonable accountability on the other." R.D. at 38. He recommended continuation of the record keeping as directed by the Commission in the 2008 Columbia rate order, specifically, an accounting of hours in relation to all other business interests. Id. In its Exceptions, Columbia again argues that this is an unreasonable requirement and that is "frivolous." CWC Exc. at 33. As explained below and in the OCA's Briefs, a record keeping requirement that should support a claim that Columbia makes in its rate filing and that recognizes the multiple tasks performed by its officers and directors is not frivolous.

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

[11] The OCA recommended an adjustment based on the reasonableness of these costs and also an adjustment to allocate a portion of these expenses to the Marietta Division. The ALJ did not accept those adjustments so the OCA's position was addressed in Exceptions.

required to provide an actual accounting of hours devoted to CWC business by its officers and directors, in relation to all other business interests. OCA M.B. at 24.

The OCA based its request on the statutory requirement that the Company support every element of its claim with specific evidence to show it is reasonable for ratemaking purposes. 66 Pa. C.S. § 315(a); see also 66 Pa. C.S. § 1301, et seq. 66 Pa. C.S. § 315(a); Lower Frederick Twp. v. Pa. P.U.C., 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980); Brockway Glass v. Pa. P.U.C., 63 Pa. Commw. 238, 437 A.2d 1067 (1981); Burleson v. Pa. P.U.C., 461 A.2d 1234, 1236 (Pa. 1983). The Company does have to justify the compensation for officers and directors that is recovered from ratepayers. To prevail in its challenge, Pennsylvania law requires only that the OCA show how Columbia failed to meet its burden of proof. The Commission agreed with the OCA that, in light of the officers/directors' multiple other business interests, the officers/directors should provide an actual accounting for their hours, relative to those interests, in future cases. 2008 Order at 41.

This is the first proceeding in which Columbia's officers and directors prepared time sheets. Those records provided information that permitted the OCA to evaluate the reasonableness of the Company's claim for Officers' salaries and Directors' fees. The records also contributed to the evidence available to the Commission in reviewing the claim and the OCA's recommended adjustment. OCA M.B. at 54-59; OCA St. 1 at 55-57. This usage is consistent with the Commission's intent in establishing the ongoing requirement for time records. Pennsylvania law is clear that there is no similar burden for a party proposing an adjustment to a utility base rate filing. Nothing in the record in this case shows a change in circumstances in this case. Thus, the continuation of this requirement is reasonable.

REPLY TO CWC EXCEPTION 8: The ALJ Correctly Reflected The Company's Claim for Rate Case Expense. ALJ R.D. Tables I and II.

In its Exception, CWC argues that the ALJ did not include any amount for rate case expense. CWC Exc. at 35-36. The OCA submits that CWC is incorrect. CWC claimed $252,800 of pro forma rate case expense and asked that it be normalized over three years. Id. The OCA did not make any adjustments to the pro forma claim or the normalization period. I&E did not make any adjustments to the pro forma rate case expense claim or the normalization period. Thus, the Company's pro forma expense claim included $84,267, which is the full annualized amount of the $252,800 rate case expense claim. In its Exception, CWC argues that not only was this original claim not included by the ALJ, neither was its updated amount of $258,412, or $86,137 on an annual basis included by the ALJ. In other words, according to CWC, its original annual claim should be increased by $1,870. CWC Exc. at 36.

First, it is important to note that CWC, through its counsel, specifically represented that it was not updating its rate case expense. Tr. 149-50. Thus, the updated amount should not be considered. Second, the original pro forma claim is included in the pro forma expenses listed on Tables I and II attached to the Recommended Decision. As can be seen from a review of those tables, there is no adjustment made for either the level of rate case expense or the normalization period. Thus, the original claim of $84,267 is included and recognized in rates. Third, Tables I and II of CWC's Main Brief show that the Company made no claim for an additional amount of rate case expense above and beyond what was included in their original claim. Therefore, the R.D. did not adjust or remove any additional claim for rate case expense by the Company, because the Company made no such claim. CWC's Exception is incorrect and should be denied.

III. CONCLUSION

For the reasons set forth above and in its Main Brief and Reply Brief, the Office of Consumer Advocate respectfully requests that the Pennsylvania Public Utility Commission deny the Exceptions of the Columbia Water Company.

Respectfully submitted,

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December 16, 2013
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CERTIFICATE OF SERVICE

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

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

Dated this 16th day of December 2013.

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