



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

December 16, 2013

Secretary Rosemary Chiavetta
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary Chiavetta:

Enclosed please find an original copy of the Bureau of Investigation and Enforcement's (I&E) **Reply Exceptions** in the above-captioned proceeding.

Copies are being served on all active parties of record, as reflected in the attached Certificate of Service. If you have any questions, please contact me at (717) 783-6151.

Sincerely,

Charles Daniel Shields
Senior Prosecutor
Bureau of Investigation and Enforcement
PA Attorney I.D. No. 29363

CDS/snc
Enclosure

cc: Parties of Record
Hon. Dennis J. Buckley
Robert F. Powelson, Chairman
John F. Coleman, Jr., Vice Chairman
James H. Cawley, Commissioner
Pamela A. Witmer, Commissioner
Gladys M. Brown, Commissioner
Chief Counsel Pankiw, Law Bureau
Director Cheryl Walker Davis, OSA

RECEIVED
2013 DEC 16 PM 2:09
SECRETARY'S BUREAU

TABLE OF CONTENTS

A. INTRODUCTION	1
B. REPLY EXCEPTIONS	5
I&E REPLY EXCEPTION NO. 1	5
Columbia’s Exception No. 1 To The ALJ’s Recommended Adoption Of The I&E Recommended 50/50 Capital Structure and 7.07% Overall Rate Of Return Should Be Denied.	5
Capital Structure	7
Common Equity	10
I&E REPLY EXCEPTION NO. 2	16
Columbia’s Exception No. 2 To The ALJ’s Recommended Rejection of Sought After Equity Cost Premiums for Management Performance and Acquisitions Incentives Should Be Denied.....	16
Properly Rejected Performance Factors Claim	18
I&E REPLY EXCEPTION NO. 3	21
Columbia’s Exception No. 5 To The ALJ’s Recommended Rejection Of An Expense Claim For Hershey Park Tickets and A Banquet Should Be Denied.	21
C. CONCLUSION	24

TABLE OF CITATIONS

Cases

<i>Pa. P.U.C. v. Consumers Pennsylvania Water Company – Roaring Creek Division, 87 PA PUC 826 (1997)</i>	12
<i>Pa. P.U.C. v. Roaring Creek Water Company, 81 PA PUC 285, 323, 150 PUR 4th 49, 483-488 (1994)</i>	12

<i>Pa. P.U.C. v. York Water Co.,</i> 75 PA PUC 134, 153-167 (1991).....	12
<i>Pa. P.U.C. v. Equitable Gas Company,</i> 73 PA PUC 345-346 (1990).....	12
<i>Pa. P.U.C. v. Philadelphia Suburban Water Company,</i> 71 PA PUC 593, 623-632 (1989).....	12
<i>Pa. PUC v. Pennsylvania-American Water Co.,</i> 1993 Pa. PUC LEXIS 79, *121-23 (PAWC 1993).....	23

A. INTRODUCTION

The Bureau of Investigation and Enforcement (“I&E”) respectfully submits these instant Reply Exceptions in response to the Exceptions filed on December 6, 2013, by The Columbia Water Company (“Columbia” or “Company”) to the Recommended Decision of Administrative Law (“ALJ”) Dennis J. Buckley issued on November 25, 2013. I&E filed its Exceptions on December 6, 2013, and the positions presented here are fully consistent with the positions presented there and in the I&E Main and Reply Briefs. The Office of Consumer Advocate (“OCA”) also timely filed their Exceptions on December 6, 2013. The I&E Main and Reply Briefs reference the I&E testimony and exhibits and present argument and cite record evidence and applicable law supporting an overall recommendation that the Commission disallow any rate increase whatsoever and instead direct the Columbia to file a tariff that reduces their present level of annual revenues.¹ As detailed in the Recommended Decision, the ALJ recommends a substantial reduction to Columbia’s requested \$773,210 increase in annual revenues. RD, pp. 1, 51. In doing so, the ALJ recommended adoption of the I&E positions to (1) utilize an overall rate of return percentage figure of 7.07%, derived from incorporating the I&E-recommended 50/50 capital structure, the I&E-

¹ The tables attached to the I&E Main Brief as Appendix A, Tables I, II and III, provide the figures and revenue effect for each recommended adjustment and the computation of the appropriate \$243,609 decrease in current annual revenues. The I&E testimony and exhibits explaining and supporting each I&E recommended adjustment were admitted into the record during the evidentiary hearing held on September 5, 2013. As noted in the I&E Main Brief submitted on September 26, 2013, Columbia had already accepted and incorporated a number of the I&E recommendations made during the course of the proceeding into their final overall claim. I&E MB, p. 14.

recommended debt cost rate of 5.00% and the I&E-recommended 9.15% cost of common equity, at RD, pp. 43-45; (2) reject the Company's claims for an additional 50 basis point common equity premium for a claim of management efficiency and acquisition incentive, at RD, pp. 11, 46-48; (3) disallow an expense claim of \$6,051, styled in the Company's filing as "Employee Recognition," at RD, pp. 32 & 43; and (4) incorporate a necessary adjustment to state taxes, at RD, p. 42. Further, the ALJ noted the Company's acceptance during the proceeding of I&E positions, including the removal of their claim for "Charitable Contributions" and the partial reduction to the "Membership Dues" claim. RD, p. 18. The I&E Exceptions addressed I&E positions not recommended for adoption by the ALJ.²

Of Columbia's eight (8) filed Exceptions, three (3) of those Exceptions relate to positions put forth by I&E that were recommended for adoption by the ALJ. As such, those three Columbia Exceptions, Nos. 1, 2 and 5, are individually addressed here in these I&E Reply Exceptions. And while Columbia has provided

² The statements, assertions and recommendations contained in those I&E Exceptions remain accurate and valid, are hereby incorporated herein, and are titled as follows:

I&E EXCEPTION NO. 1

The ALJ Erred By Not Recommending That The Commission Exclude The Fully Financed PennVest Plant From The Company's Measure of Value [Rate Base] Claim.

I&E EXCEPTION NO. 2

The ALJ Erred By Not Recommending A Reduction To The Company's Depreciation Expense Claim by \$115,913 To Reflect The I&E-Recommended Removal Of The PennVest Plant From Rate Base.

I&E EXCEPTION NO. 3

The ALJ Erred By Not Recommending That The Commission Adopt the I&E Recommended Reduction of \$5,512 to the Company's Updated Expense Claim of \$66,144 for Officers, Directors & Majority Stockholders Salaries.

both Proprietary and Non-Proprietary versions of its Exceptions, these I&E Reply Exceptions contain no reference(s) to the subject matter of the proprietary language found on pages 23-24 of the Company's Proprietary Exceptions, and therefore need not be treated as confidential.

Upon addressing the Columbia Exceptions, it must be first observed that they abound with unwarranted and unsupportable contentions of victimization of the Company and allegations of persecution by I&E towards the Company. To wit, the I&E positions and arguments put forth in this proceeding in fulfillment of its duty to represent the public interest are mischaracterized at various points in Columbia's Exceptions as "punitive" [page 2] an "invitation to add financial insult to financial injury" [page 3]; seeking to "punish a great company" [page 3]; "punitive" [reiterated at page 6]; leaving the Company "less able to borrow money" [page 9]; "punitive" [reiterated again at page 11]; "unfairly punishing a company" [page 14]; and as presenting a "punitive recommendation of its first time rate of return witness" [page 15].³

³ The last quoted phrase from the Company's Exception shown above display the use of the classic "Ad Hominem" logical fallacy of attacking the individual instead of the argument. Here, the Company apparently attempts to successfully advance its argument by claiming that some infirmity exists in the I&E position regarding the appropriate level of rate of return for Columbia simply because this was the I&E witness' first appearance on the stand addressing those issues. And this "Ad Hominem" fallacious argument was not directed solely to I&E, as the OCA witness was similarly characterized as a "relatively new revenue requirement witness" when she (as did the I&E witness) recommended rejection of the expense claim to pay for Hershey Park tickets and banquet expenditures as being unrelated to providing water service to customers. Columbia Exceptions, p. 30. Interestingly, no reference was made by Columbia in its 2008 base rate case to the undisputable "veteran" status of the OCA witness who's exact same adjustment was adopted by the Commission there. RD, p. 32, also citing to 2008 RD at 23-25.

A review of this, and any other record of a Commission, proceeding will undoubtedly disclose that I&E (and its predecessor, the Office of Trial Staff) consistently presents fair and objective positions pursuant to its charge to act on behalf of the public interest. As such, the Company's characterizations of the straightforward I&E positions on each standard ratemaking issue are both patently untrue and inappropriate. While Columbia is clearly dissatisfied with the I&E recommendations and its staunch advocacy, its imprudent attempts to demonize this Bureau cannot be countenanced as either judicious or cogent.

For the three I&E Reply Exceptions provided herein, I&E Reply Exception No. 1 recommends that Columbia Exception No. 1 [seeking to have the Commission reject the ALJ's sound adoption of the I&E- recommended 50/50 capital structure and 7.07% overall rate of return] be denied. I&E Reply Exception No. 2 recommends that Columbia's Exception No. 2 [seeking to have the Commission not adopt the ALJ's rejection of a total 50 basis point adjustment to the cost of common equity for premiums for alleged superior management performance and acquisitions incentives] also be denied. I&E Reply Exception 3 recommends that Columbia's Exception No. 5 [to the ALJ's proper rejection of an expense claim for Hershey Park tickets and a banquet] should also be denied.

For the reasons provided here and in both the I&E Main and Reply Briefs, I&E respectfully requests that the Commission recognize the legitimacy of the

instant I&E Reply Exceptions and reject each of the three Columbia Exceptions addressed herein in its Final Order resolving this base rate proceeding.

B. REPLY EXCEPTIONS

I&E REPLY EXCEPTION NO. 1

Columbia's Exception No. 1 To The ALJ's Recommended Adoption Of The I&E Recommended 50/50 Capital Structure and 7.07% Overall Rate Of Return Should Be Denied.

Columbia Exceptions pp. 6-15
Recommended Decision, pp. 43-46
I&E Main Brief, pp. 37-55
I&E Reply Brief, pp. 25-47

At pages 43 through 46 of the Recommended Decision, the ALJ addresses the issue of the appropriate overall rate of return and begins by stating that “[F]or the reasons that I will explain below, I&E has provided the most reasonable resolution of this issue.” RD pp. 43-46. Columbia excepts to the ALJ’s determination and attempts to provide support for its arguments at pages 6 through 15 of its Exceptions. Columbia Exception No. 1, pp. 6-15.

We first note that the appropriate cost of debt was not a disputed issue by the close of the evidentiary record, as I&E’s debt cost rate of 5.00% was accepted by the Company during the course of the proceeding and was, therefore, not a

subject of the Company's Exceptions to the ALJ's use of that figure in his overall rate of return determination.⁴

As to the details of his determination, the ALJ summarized the I&E overall rate of return position and his adoption of each of its components, where he states at page 44 of the Recommended Decision:

I&E recommends a 7.07% overall rate of return derived from the use of the I&E recommended debt cost rate of 5.00%, the I&E recommended 50/50 capital structure, and the I&E-recommended 9.15% cost of common equity. I&E MB at 37-54; I&E St. No. 1, pp. 7, 24, 35 & 45; I&E Ex. No. 1, Sch. 1. See also: I&E MB, Appendix A, Table III. Consistent with this recommended 7.07% overall weighted cost of capital, I&E asserts that Columbia's proposed overall return should be disallowed because it is based upon an inappropriate capital structure and overstated faulty return on common equity calculation. I&E RB at 25. I agree.

RD, p. 44.

A review of Columbia's Exception No. 1 at pages 6 through 15 discloses that it is divided first into several paragraphs of introduction and then three numbered subsections that will be addressed in order in this I&E Reply Exception No. 1.⁵ The first numbered subsection is entitled "1. Capital Structure" and is found on pages 7 through 10; the second subsection is entitled "2. Rate of Return" and is found at pages 10 through 14, and the third subsection is entitled "3.

⁴ See I&E Main Brief, pages 43-44, referencing Company Stmt. No. 3R, page 3, lines 15-16, wherein Company Witness D'Ascendis states, "After reviewing Company long-term debt cost rate data, I concede to the 5.00% debt cost rate presented by Ms. Maurer." I&E MB, pp. 43-44.

⁵ As the Company's Exceptions did not provide a Table of Contents, the numbered pages of the subsections comprising their Exception No. 1 are identified in these I&E Reply Exceptions.

Summary of Exception No. 1 on capital structure and equity return rate” and is located on pages 14 through 15 of the Company’s Exceptions. Columbia Exceptions, pp. 7-10, 10-14 & 14-15.

Capital Structure

The first subsection of Columbia Exception No. 1 is entitled “1. Capital Structure” at pages 7 through 10, and consists of a chart showing the revenue effect of adopting the ALJ’s recommendation, then a reference to the Company’s capital structure used in its last base rate case and finally a discussion comparing the Company’s actual capital structure between rate cases to the I&E-recommended 50/50 capital structure adopted by the ALJ here. Columbia Exceptions, pp. 6-10.

Conspicuously not addressed or otherwise argued by Columbia in its Exception No. 1 discussing capital structure is a response to the I&E arguments contained in language from the I&E Reply Brief that was included verbatim on pages 44 and 45 of the Recommended Decision.⁶ A reading of the excerpt there,

⁶ The Recommended Decision specifically references the ALJ’s agreement with the I&E argument that Columbia’s proposal is “heavily weighted” towards equity so as to maximize the overall rate of return. And the referenced quotation from the I&E Reply Brief is shown below exactly as portrayed at pages 44 and 45 of the Recommended Decision:

As to any comparison between the capital structure approved in Columbia’s last base rate case and the current claim, I&E Witness Maurer investigated the Company’s capital structure in the five intervening years between the two cases and revealed that the average for that period was 42.45% debt and 57.55% equity. I&E MB, pp. 42-43; I&E St. No. 1, p. 14.

along with an elaboration of those points made in both the I&E Main and Reply Briefs will disclose that the ALJ obviously relied upon the valid I&E contentions that the use of Columbia's actual capital structure is (1) not in line with the industry average and (2) places an unfair and unnecessary financial burden upon customers when compared to the I&E recommended 50/50 capital structure. RD, pp. 44-45. I&E MB, pp. 41-43. I&E RB, pp. 26-28.

Of further significance and support for the ALJ's adoption of the I&E capital structure, the record reflects that the I&E selected water proxy barometer group had a five year average capital structure of 50.99% long term debt, 0.25% preferred stock, and 48.77% equity - or approximately 50% long-term debt and 50% common equity – almost exactly at the I&E-recommended capital structure. I&E MB, p. 42.

Further eroding the validity of Columbia's Exception No.1 advocating that the Commission not adopt the ALJ's recommendation and instead use the Company's actual capital structure of 36%/64% is the fact emphasized by I&E

As such, Columbia's utilized capital structure is not in line with their historical capital structure but is in fact more heavily weighted toward equity than the Company has been in any of the past five years. I&E MB, pp. 43-43; I&E St. No. 1, p. 14. Coincidentally then, the Company's capital structure is more heavily skewed towards the higher priced equity around the time of the rate cases. *The fact that the Company's capital structure from 2008 to 2012 is more in line with I&E Witness Maurer's barometer group's indicates that a capital structure of 50% long-term debt and 50% common equity is a more accurate representation of the capital structure that the Company normally holds and is more representative of the industry norm than the Company's current claim of 35.60% long-term debt and 64.40% common equity.* I&E St. No. 1-SR, p. 7. I&E Reply Brief at 27-28 (emphasis added).

that the use of such a skewed capital structure shifts approximately 20% of lower cost debt to the higher cost equity, thus providing for an unreasonably and unnecessary higher level of rates than is just and reasonable. I&E MB, p. 42.⁷

As to any direct Company refutation of this I&E rationale for the use of the hypothetical 50/50 capital structure in its Exceptions, we find only the bald assertions that, “the RD forces the Company to take an unnecessary risk ...” and that adoption of the Company’s actual capital structure allows for “minimizing financial risk to the extent possible.” *Columbia Exceptions*, pp. 6-7. Nothing in the remaining language of either that subsection or other portions of Columbia Exception No. 1 provide any convincing support for those blanket assertions. And apparently, the actual capital structures that existed in the interval between this and the previous rate case filing, that were less skewed towards equity than the present ratio, did not arouse the same concerns now expressed by Columbia

⁷ A chart provided in the I&E Main Brief provides the breakdown disclosing that the Company’s estimated actual capital structure at December 31, 2013, is even more heavily weighted toward the higher price equity than the Company’s capital structure has been in any of the past five years. I&E MB, p. 42

The Company’s capital structure from 2008-2012 is as follows:

	Long Term Debt	Common Equity
2008	45.32%	54.68%
2009	44.27%	55.73%
2010	40.61%	59.39%
2011	37.47%	62.53%
2012	44.56%	55.44%
5 Year Average	42.45%	57.55%
Estimated 2013	35.60%	64.40%

regarding alleged financial risks of a capital structure; particularly ones that I&E had already identified as being closer to the industry norm.

As such, I&E asserts that the Columbia Exception No. 1 provides no convincing basis for the Commission to overturn the ALJ's fully justified and supported determination that the use of the I&E-recommended 50/50 capital structure was both valid and appropriately applied in this proceeding.

Common Equity

The second subsection of Columbia Exception No. 1 is entitled "2. Rate of Return" at pages 10 through 15 and leads off with completely unsupported assertions [reprinted below] that were not offered into the evidentiary record by Columbia at any point during this proceeding. I&E is compelled to bring to the Commission's attention that such an introduction of unsupported assertions *beyond the close of the instant record is completely inappropriate and merits any and all appropriate sanctions.* Specifically, the Company's Exception No. 1 at page 10, when referencing the ALJ's adoption of the I&E cost of common equity ["ROE"], states as follows: "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." Company Exceptions, p. 10. In response, I&E would first point out that the Company was well aware of the I&E recommended 9.15% cost

of common equity figure upon receipt of service of the distributed I&E direct testimony and exhibits back on August 2nd of this year. Had such assertions been made by any Company witness in this proceeding between that time and the close of the record, I&E would have most assuredly sought to confirm whether such contentions were both accurate and relevant through both discovery and cross examination of Company witnesses. The right of due process to respond to such unsubstantiated and suspect avowals has been denied here to I&E. The sole remedy now available is to request that the Commission give no weight whatsoever to these late and unsubstantiated assertions. As to the remainder of the Company's arguments put forth in their Exception No. 1 regarding the ALJ's adoption of the I&E recommended cost of common equity, I&E responds that the Recommended Decision specifically and appropriately references the applicable sections of the I&E Main and Reply Briefs that provide the calculations, rationale and reasonableness for the use of a 9.15% equity cost rate. RD, pp. 44-46.

The basic structure of Columbia's Exception No. 1 is to first simply show the revenue effect of the application of the ALJ's overall rate of return; and then devote the remaining four pages of the subsection on this equity cost rate issue to a discussion on their contention on page 11 of their Exception No. 1, that, "[T]he RD on ROE is solely based on the result of I&E's discounted cash flow (DCF) model" and their contention on page 14 that, "... it is against basic financial

precepts to exclusively rely upon one cost of common equity model,...” Company Exceptions, pp. 11 & 14.

Here, the Company provides yet another misstatement. The I&E Main Brief directly refutes this Company contention where it made clear that its rate of return witness, Ms. Maurer used the DCF and CAPM analyses to determine the cost of common equity, with the DCF method as the primary method to determine the cost of common equity and the CAPM as a comparison to the DCF results. I&E MB, pp. 47-48. Importantly, the I&E Main Brief referenced that the Commission has traditionally relied primarily on the DCF and informed judgment in determining the cost of common equity for utilities, while citing full support for that representation. *Pa. P.U.C. v. Consumers Pennsylvania Water Company - Roaring Creek Division*, 87 PA PUC 826 (1997); *Pa. P.U.C. v. Roaring Creek Water Company*, 81 PA PUC 285, 323, 150 PUR 4th 449, 483-488 (1994); *Pa. P.U.C. v. York Water Co.*, 75 PA PUC 134, 153-167 (1991); *Pa. P.U.C. v. Equitable Gas Company*, 73 PA PUC 345-346 (1990); *Pa. P.U.C. v. Philadelphia Suburban Water Company*, 71 PA PUC 593, 623-632 (1989). Therefore, the Company’s mischaracterization of the I&E methodology to derive its recommended cost of common equity as exclusively relying upon the DCF analysis is inaccurate and represents another misstatement of fact or argument that is endemic in Columbia’s Exceptions.

Also in Columbia Exception No. 1, the Company make another assertion that merits scrutiny here, where it states at page 14, “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).” Columbia Exceptions, p. 14. This contention is both misleading and erroneous. In point of fact, the I&E Main Brief points to I&E Witness Maurer’s extensive analysis and criticism a number of the methodologies employed by Company Witness D’Ascendis to arrive at his overstated cost of common equity. Ms. Maurer’s use of the DCF as the primary method is indeed appropriate as it is based upon the concept that the receipt of dividends plus expected appreciation is the total return requirement determined by the market, it uses the utilities’ own stock prices and growth rates which are directly employed in a formalistic calculation, it recognizes the time value of money and is forward-looking, and it has the most wide-spread regulatory acceptance. I&E MB, p. 48.

On this matter, the I&E Main Brief also expressly references I&E Witness Maurer’s inclusion of a CAPM analysis as a comparison due to the Commission’s expressed interest in confirming the DCF results submitted in base rate cases by the use of a second method. I&E MB, p. 48. She further provided her professional opinion that out of the three commonly used methods, other than the

DCF, the CAPM should be used as the second method. I&E MB, p. 48. While she also noted that CAPM is based on the concept of risk and return; that the betas of the companies being analyzed allow the CAPM to be company-specific, that it has widespread use in the financial investment community, and that it is forward-looking - she also referenced the several disadvantages to using the CAPM, which is why it is not used as a primary method. I&E MB, p. 48.

I&E Witness Maurer further asserted that among the disadvantages of the use of CAPM is the fact that the relevancy of the CAPM [and therefore, the Risk Premium (“RP”) method] does not carry over from the investment decision making process into the regulatory process. I&E MB, p. 48-49. And, as she continued, the CAPM and RP method give results that indicate to an investor what the equity cost rate should be if current economic and regulatory conditions are the same as those present during the historical period in which the risk premiums were determined. By comparing CAPM and RP results with the current expected equity returns (DCF results), she stated that an investor can make rational buy and sell decisions within their portfolio. I&E St. No. 1, pp. 20-21. I&E MB, pp. 48-49.

For those reasons, I&E Witness Maurer provided her definitive opinion that the DCF method is the superior method for determining the rate of return for the current economic market and measuring the cost of equity directly. She stated that the CAPM and the RP method are less reliable indicators because they measure the cost of equity indirectly and risk premiums vary depending on the debt and

equity being compared. Also, as she opined, regulators can never be certain that economic and regulatory conditions during the historical period from which the risk premiums were calculated are the same today or in the future. I&E MB, p. 49.

Such analysis and criticism by the I&E rate of return witness provided above therefore directly contradicts Columbia's claim in its Exception No. 1 that the DCF method was exclusively used by I&E and also completely refutes the Company's later assertion in their Exception No. 1 that the Company's rate of return witness's use of a variety of methodologies went unchallenged by either I&E or OCA during the proceeding. *See: Columbia Exceptions, p. 14.*

Additionally, the Company's Exception No. 1 fails to reference in any fashion that the I&E cost of common equity recommendation adopted by the ALJ took into consideration the matter of selecting a barometer group of companies representative of Columbia Water Company. The accuracy of this selection is crucial as it represents a fundamental component of assuring the applicability and accuracy of cost of common equity methodology results. And in fact, the I&E Main Brief referenced I&E Witness Maurer's explicit criticism of Columbia Witness D'Ascendis' creation and use of two barometer groups, one containing regulated companies in the water utility industry and the other comprised of

unregulated companies, as not being properly representative of Columbia.⁸ I&E MB, pp. 45-46.

For the foregoing reasons and those presented in the I&E Main and Reply Briefs, the Commission should adopt the Recommended Decision to use the full extent of the I&E overall rate of return position and reject the Company's Exception No 1 in its entirety.

I&E REPLY EXCEPTION NO. 2

Columbia's Exception No. 2 To The ALJ's Recommended Rejection of Sought After Equity Cost Premiums for Management Performance and Acquisitions Incentives Should Be Denied.

Columbia Exceptions pp. 15-24
Recommended Decision, pp. 46-48
I&E Main Brief, pp. 45-55
I&E Reply Brief, pp. 43-47

⁸ The I&E Main Brief makes particular note of the fact that I&E Witness Maurer selected a barometer group consisting of six (6) utilities: American States Water Company, Aqua America, Inc., California Water Services Group, Connecticut Water Service, Inc., Middlesex Water Co, and SJW Corporation; while providing the criteria she used to create her single:

1. 50% or more of the company's revenues must be generated from the water industry;
2. The company's stock must be publicly traded;
3. Investment information for the company must be available from more than one source;
4. The company must not be currently involved/targeted in an announced merger or acquisition;
5. The company must have five years of historic earnings data.

I&E MB, pp. 45-46.

Further, Schedules 1 and 7-10 in I&E Witness Maurer's I&E Exhibit No. 1 will confirm that use of data from this single proxy group consisting only of water companies is fundamentally sound since those companies represent the most similar risk enterprises necessary to produce a benchmark for comparison when establishing an appropriate return on common equity for Columbia in this case. I&E MB, pp. 45-46.

At page 46 of the Recommended Decision, the ALJ references that Company Witness D'Ascendis' recommended return on equity for Columbia includes the Company's request for a total 50 basis point premium to reflect Columbia's management efficiency, a 1998 acquisition of a neighboring water system, and a 2012 acquisition of an affiliate water system. RD, p. 46. The ALJ then provides his discussion of the issues at pages 46 through 48 of the Recommended Decision. On these issues, Finding of Fact No. 48 on page 11 of the Recommended Decision presents the ALJ's conclusion that, "[A]n additional 50 basis point premium to reflect Columbia's management efficiency, a 1998 acquisition of a neighboring water system, and a 2012 acquisition of an affiliate water system is not supported by the evidence of record or reasonable." RD, p. 11.

Columbia excepts to this recommendation by the ALJ in the Recommended Decision and attempts to provide support for its arguments at Columbia Exception No. 2, at pages 15 through 24. This Columbia Exception No. 2 is divided into two numbered subsections that will be addressed in order herein. The first numbered subsection is entitled "1. Performance Factor Consideration" and is found on pages 15 through 21 and the second subsection is entitled "2. Acquisition Incentive" and is found at pages 21 through 24. It is within these pages that we find the Company's exhortation to have the Commission recognize "... its history of doing these good things instead of *adopting I&E's punitive recommendations of*

its first time rate of return witness.” [Italics added here]. Columbia Exceptions, p. 15. Interestingly, the ALJ’s own actions to reject these very same rate of return premiums have apparently not elicited the same Company characterization that he is being similarly motivated by vindictiveness and a lack of experience dealing in depth with rate of return issues.

Properly Rejected Performance Factors Claim

In an effort to support its position that it is entitled to a separate and additional 25 basis point boost in its cost of common equity for its alleged superior management performance, the Company in this subject Exception No. 2 cites to the 22 basis point adjustment granted by the Commission in Aqua Pennsylvania’s base rate case at Docket No. R-00072711. Such reference is followed by Columbia’s contention that the present case qualifies as a similar circumstance that justifies granting Columbia a performance factor adjustment in this case. Company Exception No. 2, p. 20.

In response, I&E submits that the situation presented to the Commission in the Aqua case is not analogous and the Company argument should be rejected for that and the other valid reasons identified in the Recommended Decision. RD, pp. 46-48. As specifically referenced in the I&E Reply Brief in response to the Company’s claim in their testimonies to an entitlement to an equity cost rate bonus for managerial excellence, the 2011 Management Audit of Columbia found them in need of minor improvement for all assessed areas except customer service,

where they met expected performance levels. I&E RB, p. 44. Also illuminated in the I&E Reply Brief was the fact that, in the Aqua case cited in Company testimony and now this Columbia Exception No. 2, the Commission awarded Aqua 22 basis points based both on management performance and in recognition of Aqua's acquisition of troubled water systems. I&E RB, pp. 44.

Importantly, it must be noted that the Commission rejected this very type of claim in Columbia's last base rate proceeding, docketed at R-2008-2045157, determining that Columbia's management performance was adequate, but did not warrant a basis point adjustment to the return on equity. In that proceeding, the Commission addressed essentially the same arguments put forth here by Columbia and adopted the recommendation of the ALJ that rejected Columbia's request for a twenty-five basis point rate of return adjustment for management efficiency. Order at R-2008-2045157, p. 93. Referring to the Company arguments in the last case, the I&E Reply Brief also referenced that the Commission stated there that, "[T]he ALJ pointed out that these all point to adequate, reasonable service, and this is not sufficient to warrant a rate of return premium of 0.25%. R.D. at 60-61." Order at R-2008-2045157, p. 91. I&E RB, pp. 44-45.

Properly Rejected Acquisition Incentive Claim

As part of the discussion in the Recommended Decision regarding the Company sought after total of 50 basis point adjustments to its common equity cost rate, the ALJ addressed the claim for an upward adjustment of 25 basis points

based upon the Company witnesses testimony seeking equity cost rate recognition for two Columbia acquisitions of other utilities. RD, pp. 47-48. As the ALJ correctly concluded in the Recommendation Decision, Columbia failed to demonstrate a track record of acquiring and improving the service provided to the customers of smaller and less viable water systems that would justify an upward adjustment to the cost of common equity. RD, p. 48.

Specifically, Columbia argues in its Exception No. 2 at pages 21 through 24, that it has demonstrated the necessary “track record” of acquiring less viable water systems, citing its acquisition of the Mountville municipal system in 1998 and the Marietta Gravity Water Company (“Marietta”) in 2012. Columbia therefore contends that its “acquisition strategy is responsible and prudent and should be rewarded by the Commission at this time.” Columbia Exception No. 2, pp. 22-23.

In response I&E submits that the ALJ in the Recommended Decision had appropriately rejected such a Company claim, emphasizing that the Company’s rationale for such an adjustment was based on stale and insufficient data, as the 1998 acquisition of the Mountville Municipal System occurred some 15 years ago. I&E RB, p. 46. Further, the Company has filed at least four base rate cases (not including the instant proceeding) since that time and has more than sufficient opportunity to request an acquisition adjustment. As such, the request for an

adjustment to the claimed return on equity based upon the acquisition of the Mountville Municipal System is no longer timely. I&E RB, pp. 45-47.

As to the Company's reference to the acquisition of Marietta as a reason to be awarded an acquisition adjustment, the ALJ properly determined that Columbia has not established that the Marietta was a less viable system or that Columbia had improved service to those customers. RD, p. 48. As such, while Columbia in its Exception No. 2 at page 22 accurately refers to the fact that the Commission found both acquisitions to be in the public interest and was beneficial to Marietta's customers, Columbia has failed to demonstrate that they should be awarded an additional 25 basis points for such actions. I&E RB, pp. 45-47.

Given the soundness of the ALJ's recognition of the lack of support and evidence for the acquisition adjustment bonus, coupled with the solid foundation for his determination that the Company also failed to demonstrate its entitlement to an upward adjustment to the cost of common equity for management performance, I&E recommends that the Commission appropriately deny Columbia Exception No. 2 in its entirety.

I&E REPLY EXCEPTION NO. 3

Columbia's Exception No. 5 To The ALJ's Recommended Rejection Of An Expense Claim For Hershey Park Tickets and A Banquet Should Be Denied.

Columbia Exceptions pp. 30-31
Recommended Decision, pp. 32
I&E Main Brief, pp. 35-36
I&E Reply Brief, pp. 23-24

At page 32 of the Recommended Decision, the ALJ appropriately recommends the complete disallowance the Company's expense claim of \$6,051, styled in the Company's filing as "Employee Recognition." The total claim results from two expenditures, \$2,779 for a Hershey Park outing and \$3,272 for an annual banquet. I&E MB, p. 35.

In response, the Company provides its Exception No. 5 to the ALJ's determination, alleging that "[B]oth OCA and I&E exaggerate this claim as some frolic or detour" Columbia Exceptions, pp. 30-31. Such a characterization is again hyperbole as a review of the I&E Main Brief will disclose that the objectively presented I&E position is that "... disallowance is appropriate as entertainment expenditures are not an operational cost necessary to provide safe and reliable water service to customers." and that "[T]he Company may indeed make such expenditures, but should not recoup the monies from ratepayers as a legitimate ratemaking expense." I&E MB, pp. 35-36. Not content to only disparage I&E and its position, the Company's Exception No. 5 also refers to a purported limitation in the OCA witness' business background that undermines the legitimacy of her opposition to the granting of such a claim, where the Company states that, "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 ..." Columbia Exceptions, p. 30. Presumably then, the exact same accusation of a dearth of water utility business

acumen can thus also be lodged against the Commission by the Company, since the I&E Main Brief explicitly references that a remarkably similar entertainment expense claim was expressly disallowed in the Commission's Final Order in Columbia's last base rate case, docketed at R-2008-2045157. I&E MB, p. 36. The I&E Main Brief also emphasized that a review of that previous Order at R-2008-2045157, pages 10-11, discloses that the Commission agreed with the ALJ that, consistent with previous Commission decisions, Columbia's employee entertainment expenses should not be included in either expenses or rate base. R-2008-2045157 R.D. at 7. R-2008-2045157 Order, pp. 10-11. I&E MB, p. 36.

In this present Recommended Decision, the ALJ agreed with this I&E citation, where he states that "In Columbia's last rate case Columbia made similar arguments with regard to a Hershey Park outing and a Christmas party only to have those expenses removed. See 2008 RD at 23-25. Further, I agree with the OCA that the Commission has consistently disallowed these types of entertainment expenses as they are not necessary to the provision of public utility service. See *Pa. PUC v. Pennsylvania-American Water Co.*, 1993 Pa. PUC LEXIS 79, *121-23 (PAWC 1993)." RD, p. 32.

As such, I&E asserts that the Company's Exception provides absolutely no valid reason or rationale for the Commission to overturn the ALJ's rejection of the instant entertainment expense claim and the Commission should correspondingly reject the Company's Exception No. 5 in its final Order.

C. CONCLUSION

For the reasons stated here and in the I&E Main and Reply Briefs, the Bureau of Investigation and Enforcement respectfully requests that the Commission grant each of these three I&E Reply Exceptions, and correspondingly deny each of the three identified Columbia Water Company Exceptions to the Recommended Decision, as part of its Final Order concluding this fully litigated proceeding.

Respectfully submitted,



Charles Daniel Shields
Senior Prosecutor
PA Attorney I.D. No. 29363

Richard A. Kanaskie
Deputy Chief Prosecutor
PA Attorney I.D. No. 80409

Johnnie E. Simms
Chief Prosecutor
PA Attorney I.D. No. 33911

RECEIVED
2013 DEC 16 PM 2:10
PA-PEC
SECRETARY'S BUREAU

Bureau of Investigation and Enforcement
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, Pennsylvania 17105-3265
(717) 787-1976

Dated: December 16, 2013

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

CERTIFICATE OF SERVICE

I hereby certify that I am or will serve the foregoing **Reply Exceptions** on
December 16, 2013, either personally, by first class mail, electronic mail, express mail
and/or by fax upon the persons listed below, in accordance with the requirements of 52
Pa. Code § 1.54 (relating to service by a party):

Thomas J. Sniscak, Esquire
William E. Lehman, Esquire
Hawke McKeon & Sniscak, LLP
100 North Tenth Street
Harrisburg, PA 17105

Daniel G. Asmus, Esquire
Office of Small Business Advocate
300 North Second Street
Suite 1102
Harrisburg, PA 17101

Christine M. Hoover, Esquire
Erin L. Gannon, Esquire
Office of Consumer Advocate
555 Walnut Street
5th Floor Forum Place
Harrisburg, PA 17101



Charles Daniel Shields
Senior Prosecutor
Bureau of Investigation and Enforcement
PA Attorney I.D. No.29363

SECRETARY'S BUREAU
PA PUC

2013 DEC 16 PM 2:09

RECEIVED