**COMMONWEALTH OF PENNSYLVANIA**

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November 29, 2016

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

Re: Pa. Public Utility Commission
v.
City of Dubois – Bureau of Water
Docket No. R-2016-2554150

Dear Secretary Chiavetta:

Attached for electronic filing is the Office of Consumer Advocate's Main Brief in the above-referenced proceeding.

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

Respectfully submitted,

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Attachment
cc: Honorable Mark A. Hoyer
Certificate of Service
227556

CERTIFICATE OF SERVICE

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| Re: Pennsylvania Public Utility Commission | : | |
| | : | |
| v. | : | Docket No. R-2016-2554150 |
| | : | |
| City of Dubois – Bureau of Water | : | |

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate's Main Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 29th day of November, 2016.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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| Pennsylvania Public Utility Commission | : | |
| | : | |
| v. | : | Docket No. R-2016-2554150 |
| | : | |
| City of DuBois – Bureau of Water | : | |

<u>MAIN BRIEF OF THE</u>
<u>OFFICE OF CONSUMER ADVOCATE</u>


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DATED: November 29, 2016

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## I. INTRODUCTION

### A. Case History

The Office of Consumer Advocate (OCA) hereby submits this Main Brief regarding the rate increase proposed by the City of DuBois – Bureau of Water (City of DuBois, or the City). On June 30, 2016, City of DuBois filed Supplement No. 22 to Tariff Water - Pa. PUC No. 4, with the Public Utility Commission (PUC or Commission) to become effective August 29, 2016 at Docket No. R-2016-2554150. In its original filing, City of DuBois proposed an annual increase in base rate revenues of $257,604. This represents an approximate 33.6% increase in the City's rates to its PUC-jurisdictional ratepayers who reside outside of the City. In rejoinder, the City revised its proposed PUC-jurisdictional annual revenue requirement increase to $229,551. City Exh. CEH-3RJ.

If the Company's entire request is approved, the total bill for an outside-city residential customer using 3,800 gallons of water per month with a 5/8-inch meter would see an increase in their bill from $25.57 to $34.17, or approximately 33.6% per month. The City serves approximately 697 customers outside the City in Sandy Township, Clearfield County, Pennsylvania.

On July 13, 2016, the Office of Small Business Advocate (OSBA) filed a Formal Complaint at Docket No. C-2016-2556342. The OCA filed a Formal Complaint at Docket No. C-2016-2556376 and Notice of Appearance on July 14, 2016, and Sandy Township also filed a Formal Complaint on July 20, 2016, at Docket No. C-2016-2557459. The Bureau of Investigation and Enforcement (I&E) filed a Notice of Appearance on July 25, 2016.

Pursuant to the Commission's Order entered August 11, 2016, the Commission initiated an investigation into Supplement No. 22 to Tariff Water-Pa. PUC No. 4 and the filing was suspended for a seven-month period until March 29, 2016. The matter was then assigned to the Office of Administrative Law Judge for hearings.

A prehearing conference was held on September 9, 2016. By Order dated September 14, 2016, Administrative Law Judge (ALJ) Mark A. Hoyer established a procedural schedule calling for the Hearings to be concluded on November 10, 2016 and Main and Reply Briefs to be filed on November 29 and December 12, 2016, respectively.

The OCA submitted the Direct and Surrebuttal Testimony of Ashley E. Everette[1] and, Terry L. Fought[2] in this proceeding. Evidentiary Hearings were held in Harrisburg on November 10, 2016.

As discussed herein, the OCA proposes adjustments pertaining to the City's proposed rate base, including plant additions, and cash working capital, cost of capital, including capital structure, the cost of debt, and cost of equity, depreciation expense, operations and maintenance expenses, including administrative and general expenses, chemicals and rate case expense. The OCA's adjustments to the City's updated rejoinder position result in the OCA's recommended revenue requirement of no more than $50,418. See Tables I and II, attached to this Main Brief as Appendix A. The OCA also makes recommendations regarding unaccounted for water calculations and estimates, customer complaint logs, and exercising isolation valves that are

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[1] Ms. Everette is a Regulatory Analyst employed by the OCA since 2012. She received a Master's degree in Business Administration and a Bachelor's degree in Economics both from the University of Illinois. She has testified in numerous proceedings before the Commission with a primary specialty in accounting and finance issues. Ms. Everette's qualifications are attached as Appendix A to OCA Statement 1.

[2] Mr. Fought has been a licensed engineer in Pennsylvania since 1975, is licensed in New Jersey and Virgina and has been a consulting engineer since 1983. He received his Bachelor of Civil Engineering from Cleveland State University. He has been involved in the design, construction and operation of water and wastewater facilities for over 40 years. He has also served as a consultant to the OCA for water and wastewater rate cases, complaint proceedings, investigations, and applications since 1984. Mr. Fought's background and qualifications are attached as Appendix A to OCA Statement 2.

necessary to provide safe and reasonable service. These recommendations were addressed in the City/OCA Stipulation.

The OCA respectfully submits this Main Brief in support of its specific adjustments and recommendations.

B. Burden of Proof

The City of DuBois bears the burden of proof to establish the justness and reasonableness of every element of its requested rate increase. As set forth in Section 315(a) of the Public Utility Code:

> Reasonableness of rates – In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceedings upon the complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. § 315(a). The Commonwealth Court has stated:

> Section 315(a) of the Public Utility Code, 66 Pa. C.S. § 315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial.

Lower Frederick Twp. v. Pa. PUC., 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980) (citations omitted). See also, Brockway Glass v. Pa. PUC, 63 Pa. Commw. 238, 437 A.2d 1067 (1981).

The Pennsylvania Supreme Court has stated that the party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. Even where a party has established a prima facie case, the party with the burden of proof must establish that "the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary." Burleson v. Pa. PUC, 461 A.2d 1234, 1236 (Pa. 1983). Furthermore, it is well-established that the "degree of proof before administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of the evidence." Lansberry v. Pa. PUC, 578 A.2d 600, 602 (Pa. Commw. 1990). Additionally, the evidence must be substantial and legally credible, and cannot be mere "suspicion" or a "scintilla" of evidence. Lansberry, 578 A.2d at 602. Thus, a utility has an affirmative burden to establish the justness and reasonableness of every component of its rate request.

The OCA notes that Pennsylvania law is clear that there is no similar burden for a party proposing an adjustment to a utility base rate filing. See, e.g., Berner v. Pa. PUC, 382 Pa. 622, 116 A.2d 738 (1955). In Berner, the Pennsylvania Supreme Court stated:

> [T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations and that is the burden which the utility patently failed to carry.

Berner, 382 Pa. at 631, 116 A.2d at 744. The Commission recognizes this standard in its rate determinations. Pa. PUC v. Equitable Gas Co., 57 Pa. PUC 423, 471 (1983). See also University of Pennsylvania v. Pa. PUC, 86 Pa. Commw. 410, 485 A.2d 1217 (1984); Pa. PUC v. PPL Elec. Util. Corp., 237 PUR4th 419 (Pa. PUC 2004). Thus, it is unnecessary for the OCA (or any challenger) to prove that City of DuBois's proposed rates are unjust, unreasonable, or not in the public interest. To prevail in its challenge, Pennsylvania law requires only that the OCA show how the City of DuBois failed to meet its burden of proof. While subtle, this critical distinction shows that parties opposing a utility in a rate proceeding need only to shift the burden of going forward to prevail. The burden of proof will not shift to an intervener that is challenging the requested rate increase. Pa. PUC v City of Bethlehem, 2011 Pa. PUC LEXIS 190, *11 (2011).

In conclusion, the City of DuBois must affirmatively demonstrate the reasonableness of every element of its claims and demonstrate that its proposed rates are just, reasonable, and in the public interest. The OCA will show that the City of DuBois has failed to satisfy its statutory burden in the manner set forth below.

## II. SUMMARY OF ARGUMENT

The OCA recommends an increase of no more than $50,418 in annual PUC-jurisdictional revenues rather than the increase of $229,551 in PUC-jurisdictional revenues the City has requested. See OCA Table I.

As discussed herein, the OCA proposes adjustments pertaining to the City's proposed capital structure, the cost of equity, rate base including proposed rate base plant additions and corresponding depreciation adjustments, cash working capital, and net operating income claims, contractual services expenses, administrative and general expenses and rate case expense. These adjustments result in the OCA's recommended revenue increase for PUC-jurisdictional customers of no more than of $50,418. The OCA respectfully submits this Main Brief in support of the individual adjustments that underlie the recommended revenue increase. There are a number of revenue requirement issues that have been resolved over the course of the proceeding as will be discussed *infra*. Finally, the OCA and the City were able to reach a stipulation (City/OCA Stipulation) that addresses the issues raised in the testimony provided by Mr. Fought. Those issues were related to unaccounted for water calculations, complaint log, and isolation valves, as discussed *infra*.

Based on the evidence the City has provided to support its revenue claim and the applicable law, it is clear that the City's PUC-jurisdictional revenues should increase by no more than $50,418.

The Tables reflecting the OCA's adjustments and a complete set of schedules supporting the OCA's recommendation are attached to this Brief as Appendix A. Relevant portions of unpublished Commission Orders and Recommended Decisions cited in this brief are provided in Appendix D.

The OCA now submits this Main Brief in support of the positions set forth in the testimony of its witnesses in this case.

III. RATE BASE

In testimony, the OCA recommended 5 adjustments to the additions to rate base and one adjustment to remove plant that is not used and useful from rate base. These adjustments are all a result of OCA regulatory expert Everette's testimony. These adjustments are reflected in OCA Exh. AEE-1 and AEE-1S, which are attached to OCA St. 1 and OCA St. 1S, and in Tables I and II, and are discussed in sections A thru C *infra*. The one remaining adjustment addresses cash working capital and is addressed in Section B.6, *infra*.

Under the Pennsylvania Code, "Rate Base" is defined as: "The value of the whole or any part of the property of a public utility which is used and useful in the public service." 66 Pa. C. S. § 102. The U.S. Supreme Court has held that "a state scheme of utility regulation does not 'take' property simply because it disallows recovery of capital investments that are not 'used and useful in service to the public.'" Under Pennsylvania law, only plant that is used and useful is entitled to be included in rate base. Duquesne Light Co. v. Barasch, 488 U.S. 299, 301-302 (1989) (Duquesne Light); Pa. PUC v. Roaring Creek Water Co., 87 Pa. PUC 826, 844 (1997) (Roaring Creek 1997).

A. Plant in Service

The City initially calculated a total rate base of $15,622,314 as of December 31, 2016, which is the future test year in this case. OCA St. 1 at 3; City Exh. CEH-1 at 13. Of this initial total rate base, $4,493,848 is attributable to jurisdictional customers. OCA St. 1 at 3; City Exh. CEH-1 at 12. In rejoinder, City witness Heppenstall made a total adjustment to rate base of $642,060. City Exh. CEH-3RJ. This results in a revised rate base claim of $14,980,254.[3] City

[3] The revised rate base calculation is $15,622,314 (initially calculated total rate base) - $642,060 (total adjustment to rate base made in rejoinder) = $14,980,254.

Exh. CEH-1 at 10; City Exh. CEH-3RJ. The City's updated jurisdictional rate base claim is $4,317,704. City Exh. CEH-3RJ. The OCA reflects this updated position in Table I.

B. Additions to Rate Base

1. Heating and Air Conditioning

City of DuBois claimed a rate base addition of $75,000 for a new heating and air conditioning system in its initial filing. City Exh. JJS-2; OCA St. 1 at 4; I&E-RB-7 (attached to OCA St. 1). Ms. Everette found that the City has neither started the project, nor spent any money on the project. OCA St. 1 at 4; I&E-RB-7 (attached to OCA St. 1); OCA-V-3 (attached to OCA St. 1). When the City of DuBois was asked what time frame would be required from project start date to the system being in-service, the City of DuBois answered only that it "expects to have this completed by the end of 2016." OCA St. 1 at 4. While the City was asked to provide all of the information concerning this project, City witness Spanos stated that requiring information which would establish that the plant additions would be in service by the end of the future test year is "an unreasonable expectation." City St. 3R at 3.

When a City is not able to establish that an expense is "known and measurable", it is not appropriate to include the expense in rates. Pa PUC v. City of Lancaster - Sewer Fund. 2005 Pa. PUC LEXIS 44, *102-103. (Lancaster Sewer) The OCA submits that only costs that are known and measurable should be included in rates and only projects that are used and useful within the chosen test year should be reflected in the calculation of revenue requirement. OCA St. 1 at 4. The end of the Future Test Year is less than two months away and the City has not provided a start date and an estimated time-frame for the project's completion. Moreover, the City has not selected a vendor to complete this project. Despite City witness Spanos' assertions that the projects will take less than three months to complete, City Manager and witness Suplizio provided no further updates or documentation when asked for “the estimated time from the start date until the in-service date.” OCA St. 1S at 4; OCA-V-1 (attached to OCA St. 1). Since the City is unable to show that this project will be bid, started, completed or used and useful within the future test year, Ms. Everette made a rate base adjustment of $17,352 which has a jurisdictional component of $5,204. Table II; OCA Exh. AEE-1S at line 2. The associated depreciation expense adjustment of $309 with a $93 jurisdictional component has also been reflected by Ms. Everette. Table II; OCA St. 1S at 4; OCA Exh. AEE-1 at line 17.

2. <u>Mains Additions</u>

City of DuBois’ initial filing included a rate base addition of $807,500 of Mains additions and replacements in 2016. OCA St. 1 at 5. In a later response to interrogatories dated September 28, 2016, the City updated the list of projected projects for 2016 to include $288,630 of additions to Mains and Accessories rather than the previously claimed $807,500. OCA St. 1 at 5; I&E-RB-8 (attached to OCA St. 1). Therefore, as Ms. Everette testified, it appeared that the City was no longer planning to install the remaining $518,870 of additions within the test year. OCA St. 1 at 5. An adjustment to remove the $518,870 of Mains and Accessories, with a jurisdictional component of $134,585 was made by Ms. Everette. OCA St. 1 at 5. The associated depreciation expense adjustment of $1,287 with a jurisdictional component of $386 was also made by Ms. Everette. OCA St. 1 at 5-6.

City witness Spanos subsequently made updates to planned capital improvements relating to additions to rate base to reflect the removal of the Mains additions of $518,870 ($134,854 jurisdictional). OCA St. 1S at 1-2; City Exh. JJS-1 R. As a result of the updates, OCA witness Everette removed the adjustments that she made in her direct testimony to Mains and Fire Hydrants. OCA St. 1S at 2; OCA Exh. AEE-1S. The associated depreciation expense adjustments were also removed because the amounts were removed in the City's updated claim. OCA St. 1S at 2.

Ms. Everette further explained as follows:

> It should be noted that I have only removed the cost of the Mains and Accessories project which the City has not begun. While I have not made an adjustment to remove partially-completed projects from the revenue requirement, proper ratemaking principles dictate that those projects should be completed before the end of the FTY in order to be properly included in rates.

OCA St. 1 at 6.

a. <u>High Street Mains Additions Project</u>

The High Street Mains and Accessories project was not specifically included in the City's original filing. In a response to an interrogatory, however, the City specified that the High Street mains project would be $55,911. I&E-RB-8 (attached to OCA St. 1). The City claimed that it planned to complete the project during the future test year. OCA St. 1S at 2. Subsequently, the City claimed that the project would be delayed until 2017. OCA St. 1S at 2. The City changed its position a third time, claiming that the project will be in service in 2016. OCA St. 1S at 2; OCA-V-2. In rebuttal, City witness Spanos stated "[t]his project will be completed in November." City St. 3R at 3-4.

While testifying that the project would be completed in November, the City has not provided a start date for the project, an answer as to the amount of time the project will take before it is placed into service, the percentage of the project that has been completed, or that any amount for the project has been expended to date. OCA St. 1S at 2-3. No support for this November completion month was provided and there have been no further updates to interrogatories or data requests that address the High Street project and its anticipated completion. OCA St. 1S at 2.

The City has not yet begun work on its High Street project and this project should not be reflected in rate base in this proceeding. As the City has not supported these proposed rate base additions, OCA witness Everette recommended that an adjustment be made to remove the $55,911 of Mains and Accessories for this project, with a jurisdictional component of $14,531. Table II; OCA St. 1S at 3; OCA Exh. AEE-1S at line 4. The associated depreciation expense of $475, with a jurisdictional component of $124, has also been removed by Ms. Everette. Table II; OCA St. 1S at 3; OCA Exh. AEE-1S at line 19.

3. Fire Hydrants

The City's initial filing included a rate base addition of $120,000 for Fire Hydrant additions and replacements in 2016. OCA St. 1 at 7. In updated responses, the City stated that it "does not have an exact anticipated start date for these projects" and provided an updated list of projected projects for 2016 which included $56,421 of additions to Fire Hydrants rather than $120,000 of additions to Fire Hydrants. OCA St. 1 at 7. Since the City is no longer planning to install the other $63,759 of additions within the test year, they should not be included for ratemaking purposes and an adjustment should be made to remove the $63,759 of Mains and Accessories with a jurisdictional component of $11,800. OCA St. 1 at 7. The associated $903 adjustment to depreciation expense, and the jurisdictional portion of $168 has also been adjusted by Ms. Everette. OCA St. 1 at 7. City witness Spanos subsequently made updates to planned capital improvements relating to additions to rate base to reflect the removal of the $63,759 of Fire Hydrants additions. OCA St. 1S at 1-2; City Exh. JJS-1 R. The OCA, however, does not accept that the revised amount of $56,421 of additions to the fire hydrant expense is supported.

a. High Street Fire Hydrants Project

The High Street mains project, discussed above, also includes the proposed installation of fire hydrants. As discussed above, work on the High Street mains project has not begun and costs for the project were removed. In rebuttal, the City witness Spanos stated the High Street mains project will be completed in November. City St. 2R at 3-4. However, City witness Spanos did not provide any support that the project will be completed in November. OCA St. 1S at 2. While the City updated its claims to reflect $56,421 of fire hydrant additions, City Exh. JJS-1R p. 2, this updated amount is not supported for ratemaking purposes because it includes projects at various stages, including some projects that have not even been started. OCA St. 1 at 8. Specifically, an adjustment should be made to remove the $5,769 of fire hydrants additions related to the High Street mains project, with a jurisdictional component of $1,071. Table II; OCA St. 1S at 3; OCA Exh. AEE-1S at line 6. The associated $82 adjustment to depreciation expense with a jurisdictional portion of $15 has also been removed by Ms. Everette. Table II; OCA St. 1 at 8; OCA Exh. AEE-1S at line 21. It should be noted that this adjustment only removes costs of the Fire Hydrant projects which the City has not begun. OCA St. 1 at 8. While adjustments were not made to remove partially-completed projects from the revenue requirement, proper ratemaking principles dictate that those projects should be completed before the end of the future test year in order to be properly included in rates. OCA St. 1 at 8.

4. Billing, Payroll and Accounting Software

The City's filing included a rate base addition of $13,341 for Office Furniture and Equipment for new billing, payroll, and accounting software. OCA St. 1S at 4; OCA. Exh. AEE-1S at line 7. The City has not yet confirmed a provider for this purchase. OCA St. 1 at 9.

Moreover, the City has spent nothing on the project and the project has not been started. OCA St. 1 at 9.

In rebuttal, the City provided no evidence that the project would be completed by the end of the FTY. Instead, City witness Spanos merely claimed that requiring information that would establish that the plant addition will be in service by the end of FTY is "an unreasonable expectation." City St. 2R at 3. The City has the burden of proof to establish that additions to rate base are made within the FTY. See, Section I.B, *supra*. The City has not provided any milestones which would tend to show that the additions will be completed by the FTY and the FTY has almost reached a conclusion.

Since the City has not demonstrated that this project will be completed within the FTY, the $13,341 claim should be excluded from rate base. OCA St. 1S at 4. A rate base adjustment of $13,341, with a jurisdictional component of $1,426, has been recommended by Ms. Everette since the City has not demonstrated that this software will be installed prior to the end of the future test year. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 7. The associated depreciation expense adjustment of $890, with a jurisdictional component of $254, has also been removed by Ms. Everette. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 22.

5. Phone System

The City's filing included a rate base addition of $5,833 for Office Furniture and Equipment in regards to a new phone system. OCA St. 1S at 4; OCA Exh. AEE-1S at line 8. The City has spent nothing on the project, and the project has not been started. OCA St. 1S at 3. Moreover, the City has not confirmed a provider for this project. OCA St. 1S at 3. The $5,833 claim should be excluded from rate base since costs have not yet been incurred and the future test year ends in less than 2 months. OCA St. 1S at 3-4. OCA submits that an adjustment in the amount of $5,833, with a $1,663 jurisdictional component, should be made to reflect that fact that no costs have been incurred for a phone system. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 8. The associated depreciation expense adjustment of $389, with a jurisdictional component of $111, should also be adopted. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 23.

6. <u>Cash Working Capital</u>

The City's rate base claim includes a Cash Working Capital claim of $252,385. City Exh. CEH-3RJ. As explained by OCA witness Everette, "[t]he cash working capital claim was calculated using the formula method, or 1/8 of Future Test Year (FTY) expenses." OCA St. 1 at 11. OCA witness Everette made a jurisdictional adjustment to Cash Working Capital, of $9,264, in order to reflect an adjustment equal to 1/8, or 12.5%, of the adjustments she made to expenses. Table II. The OCA's updated Cash Working Capital adjustment totals $9,264 for jurisdictional customers. Table II. While City witness Heppenstall does not agree with all of OCA's expense adjustments and therefore does not agree with OCA's adjustment to Cash Working Capital, she agrees that "any modification to O&M expense should result in a modification of the Cash Working Capital as the rule of thumb method of calculating Cash Working Capital is based on 12.5% of O&M." City St. 2R at 5.

C. <u>Deductions from Rate Base</u>

The City has included in rate base a home owned by the City which was previously used for the Water Treatment Plant Superintendent but is now vacant. OCA St. 1 at 28. Currently, the vacant home is in rate base with a net book value of $11,116. OCA St. 1S at 13. Ms. Everette removed the rate base claim because the home "is vacant and is not used or useful for the provision of water service." OCA St. 1S at 29. In rebuttal, City witness Heppenstall stated that she was rejecting OCA witness Everette's adjustments regarding the vacant home because the home has only recently become vacant due to the death of the City's Water Treatment Plant Superintendent, that the property is being held for future use, and that "[t]he City is considering the best use of this property going forward." City St. 2R at 14. On cross examination, however, City witness Suplizio acknowledged that as City Manager his recommendation to City Council was to "go ahead to begin planning for demolition of the caretaker's house at the City reservoir." Tr. at 43:23-45:20.

In Pa. PUC v. West Penn Power Co., a utility sought to include in rate base plant held for future use which did not have a definite plan for being put into service. 1979 Pa. PUC LEXIS 37, 37. The company argued that the Commission in the past included measures of value amounts for plant held for future use when a public utility made expenditures to acquire property when it knows the property will be needed in the future and when the property is of a unique character insofar as the acquisition of such property, in advance of its being put into actual use, is prudent. Id. The Commission determined that "the evidence establishes that the company has frequently revised 'in-service dates,' thus failing to meet our requirement that **plant held for future use must have a definite plan of use within a specific period of time**." Pa. PUC v. West Penn Power Co., 1979 Pa. PUC LEXIS 37, *38-39 (emphasis added). This affirms the principle that "[t]he utility will recover the entire cost of the plant over the life of the plant; the customer will be required to pay only for the plant which serves it." Id. at 23; See also, Application of Duquesne Light Co., 1998 Pa. PUC LEXIS 167, *149 (Plant that is used and useful today could become not used or not useful tomorrow).

The vacant home fails to meet the requirement that plant held for future use must have a definite plan of use within a specific time frame because there are no current plans regarding the vacant home and no specific time-frame has been offered by the City for the vacant home being put into use to serve ratepayers. OCA St. 1S at 13. Further, the City Manager has recommended that the vacant home be demolished and is waiting for City Council to take action regarding his recommendation. Tr. at 43:23-45:20. Since this home is vacant, has no specific time-frame in which it will be put into use, and is not currently used or useful for the provision of water service, the vacant home should be removed from the City's rate base. OCA St. 1 at 29; OCA St. 1S at 13. The OCA submits that the $11,116 net book value of the home should be removed from rate base. Table II; OCA Exh. AEE-1S at line 9.

D. Conclusion

The OCA made specific adjustments to the City's claims for additions to rate base that are neither going to be in service, nor used and useful, by 12/31/16, the end of the future test year. For these projects, the City has not expended any money, does not have vendors or providers and does not have any specific plans to complete the projects.

The City's unsupported statements that the projects will be completed and its failure to make any attempt to provide such information highlights the lack of evidence for its claims and supports the OCA's adjustments.

## IV. REVENUES

The City has made adjustments to outside-city revenues at present rates. OCA St. 1 at 28; City Exh. CEH-1 at 19, 21. The City corrected the average annual bill at present from $103.55 to $310.64 for residential customers and from $397.70 to $1,193.11 for commercial customers. OCA St. 1 at 28; OCA-I-31 (attached to OCA St. 1). Since the City has reflected a net customer gain in both 2015 and in 2016, this correction increases the amount of revenues at present rates by $2,920. OCA St. 1 at 28; OCA Exh. AEE-1 at line 16. The City has made this revenue adjustment and it is reflected in the City's current position. City Exh. CEH-3RJ. The OCA reflects this updated position in Table I.

## V. EXPENSES

### A. Introduction

The expenses at issue in this case include expenses associated with 1) a vacant home, 2) transmission and distribution contractual services, 3) water treatment contractual services, 4) administrative and general expense, including the City Manager's salary, administrative expense, and city buildings: computer parts/supplies/software and, 5) rate case expense. The expenses which the City and OCA are in agreement include 1) chemicals, 2) engineering, 3) engineering contracted services, 4) postage, and 5) pensions.

### B. Vacant Home Expenses

The City claimed $3,592 in expenses associated with the vacant property discussed above in Section III.C. OCA St. 1 at 28-29. These expenses included $828 for electricity, $1,668 for heat, $240 for building repairs and maintenance, $856 of telephone expense, and $572 of depreciation. OCA St. 1 at 28; I&E-RE-15 (attached to OCA St. 1); OCA-V-12 (attached to OCA St. 1); OCA-VII-4 (attached to OCA St. 1); and OCA-VII-5 (attached to OCA St. 1). As discussed above, the City Manager has acknowledged that his recommendation to City Council was to plan for the demolition of the vacant home. Tr. at 43:23-45:20. As discussed above, only plant that is used and useful is entitled to be included in rate base. See, 66 C.S. § 102; Roaring Creek Water Co., 87 Pa. PUC at 844. Since the home is vacant and is not used or useful for the provision of water service, the expenses related to this home should be removed. OCA St. 1 at 29. Accordingly, a $3,592 reduction for the vacant home's expense and a $572 adjustment to depreciation expense should be made, which include jurisdictional components of $1,077 and $172 respectively. See Table II; OCA Exh. AEE-1 at lines 24-25; OCA St. 1 at 29.

C. Transmission and Distribution Contractual Services

The City claimed a pro forma expense of $132,771 for Transmission and Distribution Contractual Services, which is equal to the historical test year expense. See, City Exh. CEH-1 at 16; OCA St. 1 at 29. As OCA witness Everette testified, there has been a significant fluctuation in this expense from 2013 to 2015. Ms. Everette illustrated the fluctuation as follows:

2013: $129,587
2014: $14,087
2015: $132,771

OCA St. 1 at 29.

Given the significant fluctuation in this expense over the last 3 years, Ms. Everette recommended a normalization of the expense for ratemaking purposes. OCA St. 1 at 29.

It is axiomatic that "[t]he test year concept is a basic tenet of ratemaking that forms a sound and reasonable basis for establishing a representative level of prospective rates. It allows for a reasonable measure of predictability and semi-permanence in ratemaking." Pa. PUC v. Philadelphia Gas Works, 2007 Pa. PUC LEXIS 45, *27. Moreover, "[i]t is well established that rates in Pennsylvania are set using a test year concept. The object of using a test year is to reflect typical conditions." Id. at 26-27 (internal citations omitted).

As explained by Ms. Everette:

> Expenses included in the annual revenue requirement should represent the normal, annual level of expense. As demonstrated above, the City does not experience the same level of expense for this account every year. Normalization allows fluctuations in the account to be smoothed so that the expense included in the revenue requirement represents a normal annual level of expense.

OCA St. 1 at 30.

In rebuttal, City witness Heppenstall testified that the expense should not be normalized because the expenses relate to unaccounted for water (UFW) and "because if the City is expected to lower its percentage of unaccounted for water it must be given the revenue requirement to combat the problem." City St. 2R at 12. Ms. Everette explained in her testimony that:

> First, I would note that OCA witness Fought's recommendations focused on ways to improve the estimated non-revenue water, which would not require additional revenues. Second, utilities are not "given" revenues in rates to incentivize them to do work that needs to be done in order to comply with Commission policies. Expenses included in the revenue requirement must be known and measurable and based on normal, ongoing levels of expense. The City has not demonstrated that it is reasonable to use the 2015 level of expense as the pro forma level of expense when it is more than nine times the prior year expense. Accordingly, using a normalized level of expense is appropriate.

OCA St. 1S at 16.

Accordingly, Ms. Everette has recommended an adjustment of $40,623 with a jurisdictional portion of $11,216. Table II; OCA St. 1S at 15; OCA St. 1 at 30; OCA Exh. AEE-1S at line 26.

D. Water Treatment Contractual Services

The City incurred $101,288 of Water Treatment Plant Contractual Services expense in 2015 and made a pro forma 2016 expense claim of $51,138. OCA St. 1S at 15; City Exh. CEH-1R at 6, 10. The City identified $70,300 of the 2015 as recurring over a 2 to 5 year period and made the appropriate normalization adjustment. OCA St. 1S at 15. Moreover, in response to an OCA interrogatory, the City identified an additional $8,665 as recurring annually. OCA St. 1S at 15; OCA-I-16.

The City's $51,138 claim can be summarized as follows:

| | | | |
|---|---|---|---|
| 2 year normalization | $40,300 | = | $20,150 annually |
| Non-recurring expense removed | $30,000 | = | $0 annually |
| Expense identified as recurring | $8,665 | = | $8,665 annually |
| Other expenses | $22,323 | = | $22,323 |
| | $101,288 | | $51,138 annually |

OCA St. 1S at 15.

OCA witness Everette recommended that the expense be allowed as follows:

| | | | |
|---|---|---|---|
| 2 year normalization | $40,300 | = | $20,150 annually |
| Non-recurring expense removed | $30,000 | = | $0 annually |
| Expense identified as recurring | $8,665 | = | $8,665 annually |
| Normalization of other expenses of | $22,323 | = | $8,338 annually |
| | $101,288 | | $37,153 annually |

OCA St. 1S at 16. The only component of the City's claim which is at issue is the $22,323 expense, which is the normalization of other expenses. The City uses the 2015 level of expense while the OCA submits that a three year annualization period is appropriate as described below.

After adjusting the Watershed Inventory Management Plan and Herbicide Application that were identified and normalized, the expense in 2015 was still significantly higher than in previous years and were as follows:

2013: $1,825
2014: $865
2015: $22,323

OCA St. 1 at 31; OCA St. 1S at 16.

Ms. Everette explains that:

> Invoices and the general ledger provided in response to OCA-V-15 and I&E-RE-18 (both attached) show that the additional expenses in 2015 were for the programming of a new SCADA computer, pump maintenance, etc., that would not be expected to recur on an annual basis. The two prior years of expenses indicate that the 2015 level of expense was not normal. Accordingly, I recommend that a normalized level of expense be used for ratemaking purposes in order to represent a normal annual level of expense.

OCA St. 1 at 31.

The City's original expense claim, based on the 2015 expense level, has been revised to update the $8,665 Watershed Inventory Management Plan and Herbicide Application expense to

$1,200. OCA St. 1S at 16; City Exh. CEH-1 at Adjustment E6. This adjustment is reflected in the City's updated rejoinder testimony. City Exh. CEH-3RJ.

Therefore, the expenses which OCA witness Everette normalizes does not include the herbicide application expense and the portion of the Watershed Inventory Management Plan that is an annual expense which have been appropriately normalized by City witness Heppenestall. OCA St. 1 at 32.

The two prior years of expenses indicate that the 2015 level of expense was not normal and for this reason OCA witness Everette recommended that a three year normalization period be used for ratemaking purposes. OCA St. 1 at 31-32. Due to the extremely large fluctuation for this expense, Ms. Everette recommended that this expense be normalized and used a three year period from 2013 to 2015 to arrive at her recommended expense level of $8,338, instead of the City's position of $22,323, which results in an adjustment of $13,985. OCA St. 1 at 32.

In rebuttal, City witness Heppenstall disagreed that the expense should be normalized and stated that "the history of expense in this account is not the best indication of future expense" City St. 2R at 11. Instead of using the historical expense trend, Ms. Heppenstall recommended that the FTY 2016 expenses be annualized in order to demonstrate the ongoing level of expense. City St. 2R at 11. Ms. Heppenstall suggests that the expense as of September 30, 2016 can be annualized by assuming the expenses for the last three months of the year will be the same as the average monthly expense for the first months of the year. OCA St. 1S at 17.

OCA witness Everette explained the problem with Ms. Heppenstall's approach. Ms. Everette testified as follows:

> There are some circumstances in which annualization can appropriately reflect a whole year of expense, such as when an expense does not vary significantly on a monthly basis. For example, a change in salary can be reflected for the whole year using annualization, or the annual effect of a change in insurance rates that are

> billed monthly could be reflected by an annualization calculation. However, the Water Treatment Contractual Services expense is not one that is incurred on a level basis throughout the year.

OCA St. 1S at 17.

One hundred percent of the 2013 expense was recorded in one month, September 2013. OCA St. 1S at 17. One hundred percent of the 2014 expense was recorded in one month, May 2014. OCA St. 1S at 17. In 2015, seven percent of the expense was recorded in the first five months of the year, 93% of the expenses were recorded in the last three months of the year. OCA St. 1S at 17.

OCA witness Everette testified as to the problems with animalization based on this evidence:

> Annualizing the 2013 or 2014 expense on September 30 of those years would have overstated the annual expenses by one-third. Annualizing the 2015 expense on September 30 of that year would have understated the expense as only 45% of the expense was incurred through September. Annualizing an expense that fluctuates significantly month-to-month can produce an unrealistic picture of the annual level of the expense.

OCA St. 1S at 17-18.

A review of the monthly expenses for this account were as follows:

| | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|
| January | - | - | - | - |
| February | - | - | - | - |
| March | - | - | 4,427 | 1,044 |
| April | - | - | - | 1,181 |
| May | - | 865 | 3,074 | 1,311 |
| June | - | - | - | 2,075 |
| July | - | - | - | 7,052 |
| August | - | - | - | 5,313 |
| September | 1,825 | - | - | 1,591 |
| October | - | - | 5,492 | n/a |
| November | - | - | 7,263 | n/a |
| December | - | - | 2,067 | n/a |
| | 1,825 | 865 | 22,322 | 19,568 |

OCA St. 1S at 18.

Using a normalized level based on the actual expenses over three years is a reasonable approach given the expenditures. OCA St. 1S at 18. OCA witness Everette recommends a total expense of $29,688[4] rather than the City's claim of $43,673.[5] The resulting adjustment is $13,985 with a jurisdictional component of $4,194.[6] Table II; OCA St. 1 at 32; OCA St. 1S at 18; OCA Exh. AEE-1S at line 28.

E. Chemicals

The City initially claimed a pro forma expense for Chemicals of $78,107. OCA St. 1 at 32; City Exh. CEH-1 at 16. The City provided invoices showing that an additional chemical in the amount of $6,400 should be added to the annual chemical expense. OCA St. 1 at 32; I&E-RE-12. The OCA and the City are in agreement in regards to a positive adjustment of $6,400 with a jurisdictional portion of $1,985. OCA St. 1 at 32; OCA Exh. AEE-1 at line 29; City St. 2R at 10; City Exh. CEH-3RJ. This adjustment is reflected in both OCA Table I under adjusted pro forma present rates, and in the City's revised position. OCA Exh. AEE-1S; City Exh. CEH-1R.

F. Administrative and General Expense

1. Introduction

City witness Heppenstall testified that the City's A&G expense is appropriate because it is comparable to the percentage of A&G to total O&M experienced by other Pennsylvania utilities. Ms. Everette testified as to the overall appropriateness of comparing the level of comparing the City's Administrative and General (A&G) expense to the percentage of A&G

[4] The OCA reached this final calculation by taking the previously recommended total expense of $37,153 and subtracting $7,465 to which the City agreed to. See, OCA St. 1S at 16; Tr. at 62.
[5] The City subtracted $7,465 from its claim of $51,138. See, City Exh. CEH-1R; City Exh. CEH-1RJ.
[6] This adjustment was calculated by taking the City's claim of $51,138 and subtracting the annual expense of $37,153, which is calculated above.

expense to total Operating and Maintenance (O&M expense experienced by other Pennsylvania water utilities as follows:

> The amount of an expense of one water company has no bearing on the allowable expense of another water company. The Commission does not set rates by comparing one Company's costs to another. There are numerous factors that may influence both what a company's A&G costs are and what a company's O&M costs are. For example, if a company had relatively high O&M costs, its percentage of A&G costs to total O&M could appear relatively small. The reverse could also be true. Comparing one company's ratio of expenses to another is simply not a useful tool in determining the reasonableness of an expense. Instead, it is necessary to consider each A&G expense to determine what portion, if any, is appropriate to charge to jurisdictional water ratepayers.

OCA St. 1S at 19.

As discussed below, the City has failed to support numerous A&G expenses and the OCA's adjustments should be adopted.

2. <u>City Manager's Salary</u>

In the City's prior rate case settlement, the City agreed that in its next rate filing "Administrative and General expenses shall be allocated to the Water Fund on the basis of actual and measureable costs attributable to the Water Fund." City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 5. "Given that allocation issues were an issue of significant contention in the last case, the City certainly had notice that support would be needed for allocated expenses in this case." OCA St. 1S at 20. The City Manager could have kept timesheets but did not. OCA St. 1S at 20. As such, the OCA submits that because the City Manager oversees financial matters, in addition to numerous other responsibilities, a 24% allocation of the City Manager's salary, which reflects the verified allocation for treasury and finance employees to the Water Fund is a reasonable allocation based on the limited information provided by the City. OCA St. 1 at 35.

a. Legal Standard for Allocations

The Commonwealth Court has affirmed a PUC determination to disallow a utility's entire claim for fees for management expenses. Popowsky v. Pa. PUC, 674 A.2d 1149 (Pa. Commw. 1996). When no supporting information is provided, the Commonwealth Court, in upholding the PUC decision, found: "[a]lthough there is no dispute that some managerial services were provided by LPDC, the record is devoid of time records and wage information concerning managerial personnel." 674 A.2d at 1153. The Court agreed with the PUC's finding that the utility had failed to present actual evidence of managerial expenses. Id. The Court noted that not only does the utility bear the burden of proof in a rate increase request; it must also meet the requirements of Section 2106 of the Public Utility Code for affiliate expenses. Id.; 66 Pa. C.S. § 2106. Section 2106 requires that the utility establish the reasonableness of the payment or compensation paid to an affiliate. Section 2106 specifically requires that:

> "In any proceeding, upon the commission's own motion, or upon application or complaint, involving rates or practices of any public utility, the commission may disallow, in whole or in part, any payment or compensation to an affiliated interest for any services rendered or property or service furnished, or any property, right, or thing received by such public utility, or donation given or received, under existing contracts or arrangements with such affiliated interest unless such public utility shall establish the reasonableness thereof. In such proceeding no payment shall be approved or allowed by the commission, in whole or in part, unless satisfactory proof is submitted to the commission of the cost to the affiliated interest of rendering the service or furnishing the service, property, security, right or thing to the public utility. No proof shall be satisfactory, within the meaning of the foregoing sentence, unless it includes the original (or verified copies) of the relevant cost records and other relevant accounts of the affiliated interest, or such abstract thereof or summary taken therefrom as the commission may deem adequate, properly identified and duly authenticated. The commission may, where reasonable, approve or disapprove such contracts or arrangements without the submission of such cost records or accounts."

66 Pa. C.S. § 2106.

In Pa. PUC v. LP Water and Sewer Co., 1993 Pa. PUC LEXIS 149, *31 (1993), the case underlying the Commonwealth Court decision, LP claimed a management expense from its parent, Lehman Pike Development Corporation (LPD), which was ultimately denied by the Commission. The managerial services included administrative and general functions for LP from LPD. Id. at *29. The ALJ and the Commission found no evidence to support the claim. The Commission stated "there is no dispute that management services were provided. However, we are constrained to agree with the position advocated by the OCA, and shall adopt the same, that the support for the expense is woefully lacking." Id. at *36. Thus, the Commission disallowed the entire claim. Id. at *36. The Commission did require LP to implement a time sheet system prior to the next rate case, which would be subject to scrutiny by all parties and the Commission. Id.

Regarding municipal allocation issues, the Commission has similarly required sufficient evidence to support the allocation methodology. In Pa. PUC v. Borough of Media Water Works, 72 Pa. PUC 144 (1990), a similar allocation situation was presented to the Commission. Borough of Media Water Works (Media) was a municipally owned water system that provided service to the Borough of Media and several area Townships. Id. at 148. Approximately 83% of its customers were located outside the Borough. Id. The outside Townships intervened in the case. Id. at 147.

Media used an allocation factor of 70-80% to allocate the payroll expenses of its administrative and supervisory employees who also perform services for other Borough functions. Id. at 171. OTS and the Townships recommended an adjustment be applied that took the allocation factor down to 50% because Media did not present any evidence as to the reasonableness of the 70-80% allocations. Id. at 171-74. Specifically, Township witness

Kalbarczyk stated that when looking at the administrative employees' job descriptions compared to the allocations the two did not match up. Id. at 172. For example, the Accountant's job description listed several tasks that were performed for the General Fund, but only one task relating to the Water Fund. Id. Yet, the allocation for this position was 80% to the Water Fund and 20% to the Sewer Fund. Id. Therefore, Witness Kalbarczyk concluded that there was no basis for the allocation amounts because without time sheets there is no way to verify the correctness of the allocation. Id.

The Commission agreed with the reasoning set forth above stating that Media did not meet its burden of proof to support the allocation methodology it used. Id. at 174. The Commission stated that formal duty descriptions, written records of actual hours worked, and written records of the type of work conducted would be evidence to support allocation factors. Id. Since Media did not submit any of the above the Commission found its methodology unsupported and adopted the 50%/50% allocation suggested by the Townships and OTS. Id.

In order to support allocation percentages the utility must submit evidence proving the reasonableness of the allocation methodology. The evidence could include formal duty descriptions, written records of actual hours worked and written records of the type of work conducted. Various types of evidence may be submitted so long as it proves that the allocation methodology is reasonable. The City did not submit evidence which would prove that the allocation method it used is reasonable.

b. City Manager Allocation to the Water Fund

In this case, the City has claimed that 55.7% of the City Manager's $124,076 annual salary should be allocated to the Water Fund, which represents a total claim of $69,093[7]. City St.

[7] The City's claim for expenses in City Exh. CEH-1 showed the total-City cost of each expense. The jurisdictional portion of the expense is shown in the City's Cost of Service Study in City Exhibit CEH-2.

2R at 16. City witness Heppenstall determined this allocation figure based on interviews with the City Manager and a review of City Council minutes. OCA St. 1 at 34-35; City Exh. CEH-1 at 25; Tr. at 70:21-71:3. Furthermore, the City states that the allocation of the City Manager's salary is based on the City Manager's projections of how his time is spent. OCA St. 1 at 34. Indeed, in his rebuttal testimony the City Manager states that the City's water operations "easily take up at least 60% of my time." City St. 1R at 9.

The City's allocation of the City Manager's salary to the Water Fund is speculative, unverifiable, and likely inaccurate. The 55.7% figure is not based on timesheets since the City Manager does not maintain timesheets. OCA St. 1 at 34-35. Moreover, Mr. Suplizio contradicted these percentages at the evidentiary hearing when he stated that "I think 60 percent is probably on the low end." Tr. at 26:18-19. Furthermore, Mr. Suplizio stated that despite the lack of time sheets, his estimate of the time he spends on water is "more than accurate, it's a hundred percent accurate." Tr. at 32:20-25, 33:1-2. Neither of Mr. Suplizio's estimates are based on verifiable information. As described below, Mr. Suplizio's duties encompass more than water treatment.

The City Manager's job description is three pages long and notes a wide variety of tasks that the City Manager is responsible to perform. A portion of the City Manager's duties are as follows:

- The Manager shall be responsible to direct, supervise and manage the administration of all departments, offices and agencies of the City, except the Volunteer Fire Department who shall report directly to Mayor and City Council.
- The Manager shall report ALL known information to the Council concerning any action requiring their official decision."

- He/she shall submit a weekly report to Council on all City activities.
- The Manager shall establish and maintain an effective system of communication throughout the City; with the public and with the City's personnel.
- Shall establish current and long-range objectives, plans and policies subject to the approval of the Council.
- [P]resents an annual budget and capital program to the Council and oversees the adequacy and soundness of the City's financial structure.
- The Manager provides recommendations and guidance to the Council regarding Municipal operations, fiscal policy, and the future needs of the City, as necessary.

I&E-RE-30D Part A (emphases in original) (attached to OCA St. 1)

Mr. Suplizio is neither a certified water system operator nor an engineer. Tr. at 36:14-23. Additionally, nowhere in the City Manager's job description is there a requirement that the City Manager have any skill or knowledge specific to water or public utilities.

At multiple points in his rejoinder testimony, City Manager Suplizio states that water is more intense than sewer.[8] See, Tr. at 24:8-9, 24:25-25:2, 39:10-15. In rebuttal, Mr. Suplizio stated that "[t]he sewer system very much runs itself with comparatively minimal staffing, whereas water operations naturally generate more work." City St. 1R at 10. Yet, the sewer department has more employees than the water department. Tr. at 76:18-20. City Manager Suplizio does not physically repair the water leaks Tr. at 37:19-23. Additionally, while City Manager Suplizio stated at the evidentiary hearing that he is with the crew that does leak inspections, he is not with them for the entirety of the leak detection. Tr. at 38: 24-25. Mr. Suplizio stated that the City Engineer prepares DEP reports but that Mr. Suplizio reviews the

[8] The City's sewer operations serve inside-City customers only and are not regulated by the Commission.

reports before they are submitted to DEP. Tr. at 39:25-40:11. Yet, while Mr. Suplizio says that he looks over the reports, he was unable to identify what was contained in the Chapter 110 reports. Tr. at 39:25-40:22.

The City Manager, according to his job description, does not strictly work in tandem with the Public Works Director, as argued by the City.[9] The Public Works Director does not have any of the above-listed responsibilities, but is instead responsible for the distribution and collection lines.[10] Tr. 41:21-42:3. The allocation of the City Manager's salary to the Water Fund should not be allocated on the basis of the Public Work Director's salary since the two jobs are not the same and as there is no verifiable basis to support the City's assertion that this allocation would be reasonable.

City witness Heppenstall's determination of the percentage of time that City Manager Suplizio spends on water further illustrates the speculative nature of the City Manager's salary calculations given that the basis of her testimony regarding the City Manager's salary is interviews with the City Manager. In her direct testimony, City witness Heppenstall states that "[t]he allocation percentage of 60% of the City Manager's salary (*$109,208*) is based on an interview with the City Manager in which he estimates that 60% of his time is spent on matters related to the water system." City St. 2 at 10 (emphasis added). However, in City witness Heppenstall's rebuttal, she states that the City Manager's salary is in fact $124,076 and that

[9] In addition to a Public Works Director, the City employs a Water Treatment Plant Supervisor and a City Engineer, among various other Water Bureau staff. The City allocated 45.6% of the City Engineer's time to the Water Fund. OCA St. 1 at 39. In other words, according to the City, the City Engineer spends less percent of his time on water than the City Manager.

[10] The City states that since the Public Works Director's timesheets produce an approximately 60% allocation to the Water Fund, that supports the City Manager's salary allocation as the two work in tandem to oversee general, sewer, and water operations. OCA St. 1 at 34. City witness Heppenstall states that in regards to the time that the City manager is not spending on finance "it is logical to assume that the balance of his time would be dictated by the same projects/issues that are reflected in the timesheets of the Public Works Director." City St. 2R at 16. The Public Work Director's timesheets shows that he spent 60.7% of his time on water, 20.8% of his time on Wastewater, and 18.5% of his time on "street." OCA St. 1 at 34.

$14,868 of the City Manager's salary is included in finance salaries and is allocated to the Water Fund at 24%. City St. 2R at 16; Tr. at 72. City witness Heppenstall "does not provide the rationale for the two-part allocation or any documentation demonstrating the accuracy of the allocation." OCA St. 1S at 21. During the evidentiary hearing, City witness Heppenstall agreed with OCA witness Everette's position that the financial portion of the City Manager's salary should be allocated to the Water Fund based on the 24% allocation factor for treasury and finance employees. Tr. at 73:5-9. In other words, the City Manager's annual salary is $124,076 and City witness Heppenstall allocates 60% of the portion of the City Manager's salary which is not related to finance issues to the water fund. However, the actual total percentage of time the City Manager spends on water according to City witness Heppenstall is 55.7%, which is less than the amount of time the City Manager testified to and contradicts City witness Heppenstall's initial contention in her direct testimony.

The rates developed in this case apply to PUC jurisdictional customers; customers that reside outside of the City. These customers do not receive any benefit from Mr. Suplizio's work in managing the City besides the time he spends on the water department. OCA St. 1S at 20.

The City has failed to support its claim for the allocation of Mr. Suplizio's salary to the Water Fund. OCA witness Everette recommends a 24% allocation developed for the treasury and finance employees be used to allocate the City Manager's salary as the work of the treasury and finance personnel is relevant to the City as a whole; similar to the City Manager. OCA St. 1 at 35. The City agreed in the most recent 2013 settlement that all Administrative and General expenses would be allocated to the Water Fund on the basis of actual and measureable costs attributable to the Water Fund. City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 5. Ms. Everette also testified that, in the next case, the City should be required to provide documentation, including timesheets, demonstrating the appropriate allocation of the City Manager's time. OCA St. 1 at 34-35. Given that the City Manager oversees financial matters, in addition to numerous other responsibilities, a 24% allocation which reflects the verified allocation for treasury and finance employees to the Water Fund is a reasonable allocation based on the limited information provided by the City. OCA St. 1 at 35. Accordingly, Ms. Everette has recommended an adjustment with a jurisdictional component of $11,209. Table II.

3. Administrative Expense

The City has claimed $58,712 for Administrative Expense and has allocated 60.3%, or $35,403 to the Water Fund. OCA St. 1 at 35. Administrative expense included expenses such as credit card fees, flooring, and expense for unpaid taxes. OCA St. 1 at 36; I&E-RE-67 (attached to OCA St. 1). The City determined this allocation by taking the allocation of the City Manager's and the Public Work Director's salaries, averaging these allocations together, and thereby reaching a conclusion that it would be logical to allocate expenses related to their work in the same manner as their salaries are allocated. OCA St. 1 at 36.

Charging 60.3% of administrative expenses to the Water Fund would be inappropriate. As discussed above, 60% is not an appropriate allocation for the City Manager's salary. Additionally, if 60.3%, or $35,403, of this account were allocated to the Water Fund, it would leave only 39.7%, or $23,309, of administrative expense for all other City functions. OCA St. 1 at 36. The general ledger showing a breakdown of this expense indicates that of the $58,712 expense in 2015, $9,958 was related to the City's fire department, $3,601 was for unpaid taxes on properties that were abandoned or sold by "sheriff sale", and $18,908 was for the removal of a blighted property. OCA St. 1 at 36. As explained by OCA expert witness Everette:

> In other words, $32,467 (55.3%)[11] of this expense account is identifiable as specifically related to non-Water-related functions of the City.[12] These City-level functions such as blighted property removal are completely unrelated to the provision of water service, such that no portion of these expenses should be charged to the Water Fund.
>
> Given that 55.3% of this account should not be charged to the Water Fund even as an allocated expense, it would not be appropriate to charge 60.3% of the total expense to the Water Fund.
>
> OCA St. 1 at 37.[13]

OCA witness Everette reviewed the expenses charged to this account for 2013, 2014, and 2015 and determined that the expenses that appear reasonable and appropriate to allocate a portion to the Water Fund are the credit card and banking fees. OCA St. 1 at 37. In 2015, this expense totaled $11,836. OCA St. 1 at 37. City witness Heppenstall clarified in rebuttal that the credit card fees were only applicable to the Water and Sewer customers and Ms. Everette accepted the clarification. OCA St. 1S at 23. "Therefore, a 54% allocation of these expenses is appropriate." OCA St. 1S at 23.

Part of the claimed expense was for an electric vendor not related the Water fund. City witness Heppenstall made a $2,323 adjustment of the expense related to the electric vendor during her rejoinder. See City Exh. CEH-3RJ. While OCA accepts the dollar amount of the adjustment, the OCA disagrees with the use of a 33% allocation factor. Table II.

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[11] ($9,435 + $2,938 + $18,908 = $31,281. $31,281 / $58,712 = 53.3%)

[12] Stated differently, the total of the fire, taxes, and blighted property removal plus the amount the City claims is water related is more than the total expense the City incurred (55.3% + 60.3% = 115.6%, or $32,467 + $35,403 = $67,870, which is more than the $58,712 expense claimed.)

[13] I&E witness Patel made a similar argument in his testimony, but recommended that after certain expenses were removed, one-third of the expenses be allocated to the Water Department based on a 33% allocation each to the General Fund, the Water Fund, and the Sewer Fund. OCA St. 1S at 22. Ms. Heppenstall accepted this recommendation. See, CEH-1R; OCA St. 1S at 22. The OCA submits that utilizing a 33% allocation factor is unsupported and does not comply with the City's previous settlement of its most recent base rate case.

In the City's settlement of the previous 2013 rate case, the City specifically agreed as follows:
"The City agrees it will not allocate the Administrative and General costs in the same manner proposed in City of DuBois Statement No.2, i.e., by dividing the costs by the number of funds (General, Water, Sewer).
2013 Settlement, Docket No. R-2013-2350509 at 6; OCA St. 1S at 22-23.

Therefore, while the OCA is in agreement with I&E and the City in regards to the dollar amount of the adjustment, the OCA disagrees with the allocation method.

4. Engineering

The City and OCA are in agreement regarding the City's need to adjust its initial claim for Engineering expense. City St. 2R at 21. The City initially claimed total allocated expenses of $60,914 for Engineering, which included salary, health insurance, FICA, unemployment compensation and benefits. OCA St. 1 at 38. The City made two corrections to this expense in response to interrogatories by updating the allocation factor from 47.5% to 45.6%, and by stating that a portion of the expense was erroneously included in Engineering rather than in Finance. OCA St. 1 at 38. Since the allocator for Finance salaries is 24%, the total of this expense was updated from $60,914 to $57,882. OCA St. 1 at 38. OCA witness Everette recommended an adjustment of $3,032, with a jurisdictional portion of $864, to reflect the corrections provided by the City. OCA St. 1 at 39; OCA Exh. AEE-1 at line 33. City witness Heppenstall stated "I accept Ms. Everette's adjustment to Engineering expense which includes the change in the allocation percentage for Engineering Expense and allocates the Finance Officer's miscoded salary at 24%." City St. 2R at 21; City Exh. CEH-1R.

5. Engineering Contracted Services

The City and OCA are in agreement regarding the City's need to adjust its initial claim for Engineering Contracted Services expense. City St. 2R at 21. The City initially claimed an expense of $27,849 for Engineering Contracted Services Expense and allocated 47.5%, or $13,233, to the Water Fund. OCA St. 1 at 39. The initial allocation factor of this expense was the 47.5% allocation factor of the City Engineer. OCA St. 1 at 39. The City subsequently updated this allocation factor to 45.6% in response to an I&E interrogatory. OCA St. 1 at 39. A review of the general ledger provided in response to an I&E interrogatory showed that $17,453 of the $27,859 expense, or 63% of this expense, was for the City's mobility studies, transportation planning, or sewer operations. OCA St. 1 at 39-40. None of these expenses should be allocated in any way to water. OCA St. 1 at 40. Accordingly, OCA witness Everette recommended an adjustment of $10,507, with a jurisdictional portion of $2,996. OCA St. 1 at 40; OCA Exh. AEE-1 at line 34. City witness Heppenstall accepted this adjustment in rebuttal. City St. 2R at 21; City Exh. CEH-1R.

6. <u>Postage</u>

The City and OCA are in agreement regarding the City's need to adjust its initial claim for Postage expense. City St. 2R at 7. The City initially claimed a total Postage expense of $37,321, of which $20,154 was allocated to the Water Fund. OCA St. 1 at 40; City Exh. CEH-1 at 25. This ratio was based on the ratio of Water bills to total Water and Sewer bills. OCA St. 1 at 40; City Exh. CEH-1 at 25, note e. In response to an I&E interrogatory, the City stated that the postage for Water and Sewer bills is $24,000 per year and that "[t]he balance of the postage is for other City purposes." OCA St. 1 at 4; I&E-RE-46 (attached to OCA St. 1). Therefore, OCA witness Everette recommended that "only $24,000 should be allocated using the ratio of Water bills to total Water and Sewer bills." OCA St. 1 at 40. This results in an updated annual expense of $12,960 rather than the initially claimed expense of $20,154. OCA St. 1 at 40. This update results in a $7,194 adjustment with a jurisdictional portion of $1,163. OCA St. 1 at 40; OCA Exh. AEE-1 at line 35. City witness Heppenstall agreed with this adjustment and updated the City's postage expense. City St. 2R at 7; City Exh. CEH-1R.

7. <u>City Buildings: Computer Parts/Supplies/Software</u>

The City calculated a total City Buildings expense of $213,227 based on the 2015 expenses for this account and allocated 24%, or $51,174, to the Water Fund. OCA St. 1 at 41. The expenses in 2013, 2014, and 2015 were $186,119, $175,306, and $213,227, respectively.

OCA St. 1 at 41. The 2015 expense is 22% higher than the 2014 expense and is 15% higher than the 2013 expense. OCA St. 1 at 41. A breakdown of this expense showed that the primary increase in 2015 was to a computer parts account; the expenses for this specific account are listed below:

2013: $17,269
2014: $19,562
2015: $47,202

OCA St. 1 at 41.

Ms. Everette testified that "[t]he 2015 expense was 173% more than the 2013 expense and 141% more than the 2014 expense." OCA St. 1S at 24. The City provided general ledger entries for the computer parts account which showed that the reason for the increase in 2015 was due to the fact that payments to vendor "RAK Computer Associates" increased from $45 in 2013, to $1,127 in 2014, to $23,116 in 2015. OCA St. 1 at 41. As explained by OCA witness Everette, "[c]learly, this is a significant increase, as **the 2015 expense is over 20 times as much** as the 2014 expense." OCA St. 1 at 41 (emphasis added). In rebuttal, City witness Heppenstall provided a list of expenses from 2015 which she testified "clearly show that the expense items in this account related to ongoing computer needs of the City." City St. 2R at 22. However, City witness Heppenstall does not provide any explanation as to why the expense more than doubled in one year. OCA St. 1S at 24. There is no support to indicate that the increased expense in 2015 is an ongoing expense. OCA St. 1S at 24. As such, it is appropriate to normalize the expense as it is significantly higher than a normal year of expense. OCA St. 1 at 41; OCA St. 1S at 24.

For these reasons, OCA witness Everette recommends that a three-year normalization period be used, which results in an annual expense for the Computer Parts Supplies Software account of $28,011; a reduction of $19,191. OCA St. 1 at 41-42; OCA St. 1S at 24. Utilizing the City's 24% allocation factor results in an adjustment of $4,606 to this account with a jurisdictional component of $1,313. Table II; OCA St. 1 at 42; OCA Exh. AEE-1; OCA St. 1S at 24; OCA Exh. AEE-1S at line 36.

8. Pension Expense

The OCA and the City are in agreement in regard to the City's Pension expense. The City initially claimed total pension expense of $225,233, with 15%, or $33,785 allocated to the Water Fund. OCA St. 1 at 42; City Exh. CEH-1 at 25. The 15% allocation was based on the number of Water Fund employees compared to total City employees. OCA St. 1 at 42. This claimed level of pension expense included both police and non-uniform pensions and reflects state and county aid received by the City. OCA St. 1 at 42.

The City's initial total pension expense accounts for the 53 City employees, of which 8 are Water Fund employees, 16 are full-time police officers, and the remaining 29 are other City employees. OCA St. 1 at 43. Combining police pensions with non-uniformed employee pensions distorts the total pension expense for the non-uniformed City employees. OCA St. 1 at 43. The appropriate amount of pension expense is calculated by allocating State and County Aid across the board. OCA St. 1 at 43. OCA witness Everette recommended that 22% of the pension expense, after state and county aid, should be allocated to the Water Fund based on the ratio of 8 Water Fund employees to 37 total City employees provided by the City in a response to an OCA interrogatory. OCA St. 1S at 25. Using the 22% allocation factor, Ms. Everette initially recommended an allocation of $9,207 to the Water Fund, with a jurisdictional portion of $7,078. OCA St. 1 at 44; OCA St. 1S at 25. This represented a $24,758 adjustment to the City's claim of $33,785. OCA St. 1 at 44.

In rebuttal, City witness Heppenstall accepted the premise of this adjustment. OCA St. 1 at 25; City St. 2R at 23-24. City witness Heppenstall, however, stated that the number of water employees shown in the response to an I&E interrogatory should be used which shows 9 water employees rather than the 8 water employees shown in response to an OCA interrogatory. OCA St. 1S at 25; OCA St. 2R at 23. At the evidentiary hearing, City witness Heppenstall confirmed that there are 9 water department employees. Tr at 76:18-20. This increases the percentage of Pension expense to be allocated to the Water Fund to 24% from the originally calculated 22%. OCA St. 1S at 25. The City's revised expense claim is $10,020.[14] OCA St. 1S at 25.

G. Rate Case Expense

The City claims $225,505 of rate case expense normalized over a 2.5 year period, for an annual expense of $90,202. OCA St. 1S at 27. The OCA has not recommended any adjustment to the level of expense claimed, but does recommend an adjustment to the 2.5 year normalization period proposed by the City. The OCA submits that a 5 year normalization period is appropriate.

City witness Heppenstall stated that the 2.5 year normalization period is based on "the recent history of City filings" and "expectations of the City regarding future filings." OCA St. 1 at 45. In addition to the current case filed on June 30, 2016, the City has acknowledged that its three previous cases were filed in March 2013, October 2005, and August 1996. OCA St. 1 at 45. In other words, these cases were filed 3, 9, and 7 years apart respectively, which is not indicative of a 2.5 year normalization period. OCA St. 1 at 45. Indeed, even the most recent case does not support a 2.5 year normalization period as the most recent case and the present filing are separated by 3.25 years. OCA St. 1 at 45.

OCA witness Everette recommends that a 5 year normalization period be used for rate base expense. OCA St. 1 at 45. The City's last rate case was in 2013, three years prior to this case. The case before that was in 2005, or seven years prior, and the case before that was filed nine years before, or in 1996. OCA St. 1 at 45. The average time between City of DuBois's last

[14] $41,750 multiplied by 24% equals $10,020.

three rate filings is more than six years.[15] OCA St. 1 at 45. In fact, the City's average historical filing history in the last three cases is 6.61 years. OCA St. 1 at 45. If the 1996 case is eliminated from the calculation, the average filing frequency is 5.33 years. OCA St. 1 at 45. Thus, Ms. Everette recommended a five year normalization period. Id. Using the estimated total rate case expense of $225,505, the annual normalization amount is $45,101. Table II. As noted above, the final adjustment should be based on the final total estimated rate case expense amount, and normalized over five years. This adjustment includes the full level of rate expense claimed by the City ($225,505), and as of the update provided on August 15, 2016, the City has spent $105,201 on rate case expense.

In rebuttal, City witness Heppenstall stated that if OCA witness Everette's recommended normalization period is accepted, the City "will never be able to recover its rate case expense." City St. 2R at 12. To demonstrate this contention, City witness Heppenstall calculated the percentage of rate case expense from the last case which the City has "recovered." OCA St. 1S at 26; City St. 2R at 12. The previous 2013 rate case, however, was a black box settlement in which particular adjustments, including a rate case normalization period, were not agreed upon. 2013 Settlement, Docket No. R-2013-2350509 at Paragraph 7; OCA St. 1S at 26.

City witness Heppenstall suggests that a 2.5 year normalization period is appropriate because it is the time between when the last rate increase became effective and the filing of the current case. OCA St. 1S at 26; City St. 2R at 13. City witness Heppenstall does not explain why the 9 month suspension period, while rates are still in effect, is excluded from her calculation. OCA St. 1S at 26. Nevertheless, the rates established in the previous case will be

[15] The last three cases were filed on the following dates: 8/27/1996, 10/28/2005, and 3/1/2013. The current case was filed on 6/30/2016.

effective for 3.25 years, which is longer than the normalization period proposed by the City in its previous case or in this case. OCA St. 1S at 27.

As explained by OCA witness Everette:

> There are many reasons that the City may alter the timing of its filing of rate cases. For example, prior to the last rate filing, the City was able to delay filing a case for several years due to the receipt of significant water revenues from a shale gas driller. In this case, my direct testimony discussed the possible addition of the Borough of Falls Creek as a customer, which would provide increased sales to the City. Although Ms. Heppenstall's testimony focused on what percentage of rate case expense the City would recover if it chose to file earlier than the rate case normalization period, it is important to understand that the reverse is also true. If the City waits longer than the normalization period before filing its next rate case, it will continue to collect the annual rate case expense as part of annual revenues.

OCA St. 1S at 27.

The City of DuBois rate case expense must be adjusted to reflect a proper normalization period that is consistent with Commission precedent. The Commission has consistently held that rate case expenses are normal operating expenses, and normalization should, therefore, be based on the historical frequency of the utility's rate filings. Popowsky v. Pa. PUC, 674 A.2d 1149, 1154 (Pa. Commw. 1996); Pa. PUC v. Columbia Water Co., 2009 Pa. PUC LEXIS 1423 (2009); Lancaster Sewer, 2005 Pa. PUC LEXIS *84; Pa. PUC v. National Fuel Gas Distriburtion Corp., 84 Pa. PUC 134, 175 (1995); Pa. PUC v. Roaring Creek Water Co., 73 Pa. PUC 373, 400 (1990); Pa. PUC v. West Penn Power Co., 119 PUR4th 110, 149 (Pa. PUC 1990). In recent cases the Commission reiterated that the normalization period is determined, "by examining the utility's actual historical rate filings, not upon the utility's intentions." Pa. PUC v. City of Lancater – Bureau of Water, 2011 Pa. PUC LEXIS 1685, *56-57 (Lancaster 2011); Pa. PUC v. Metropolitan Edison Co., 2007 Pa. PUC LEXIS 5 (2007); Lancaster Sewer, 2005 Pa. PUC LEXIS *84.

The City's rate case expense must accurately reflect the City's filing history. A 2.5 (two-and-a-half) year normalization period does not accurately reflect the City's filing history. Since the average historical period of time between the City's last three rate cases is more than five years, it is reasonable and appropriate to use a five year normalization period to ensure consistency with past Commission precedent. For these reasons, OCA submits that a 5 year normalization period fairly reflects the City's filing history. Table II.

## VI. TAXES

The City does not claim any taxes for ratemaking purposes.

## VII. RATE OF RETURN

### A. Introduction

The City's cost of capital and rate of return claim is premised on a hypothetical capital structure and high cost of equity. The City's request is contrary to Commission determinations that the use of a hypothetical capital structure needs to be balanced with the impact on ratepayers. The OCA's recommended rate of return and cost of capital are adequate to attract capital and protect the public interest in every sense. The OCA's use of a hypothetical capital structure, based on the City's actual financing, properly provides the City with a fair rate of return. In contrast, the City's proposed hypothetical capital structure, based on the comparable group capital structures is not specific to the City and results in overstating the cost of capital.

The following summarizes the positions of the parties as to capital structure, cost of long term debt and return on equity.[16]

| Type of Capital | **Ratio (%)** | | | **Cost Rate (%)** | | | **Weighted Cost Rate (%)** | | | **Tax Factor Adjustment (%)** | | | **Weighted Cost (%)** | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | OCA | I&E | City | OCA | I&E | City | OCA | I&E | City | OCA | I&E | City | OCA | I&E | City |
| Long-term Debt | 70 | 70 | 50 | 3.02 | 3.02 | 3.02 | 2.11 | 2.11 | 1.51 | | | | 2.11 | 2.11 | 1.51 |
| Common Equity | 30 | 30 | 50[17] | 8.25 | 8.62 | 10.50[18] | 2.48 | 2.59 | 5.25 | 20 | 18.22 | 9 | 1.98 | 2.12 | 4.78 |
| TOTAL | *100* | *100* | *100* | | | | | | *6.76* | | | | *4.09* | *4.23* | *6.29* |

[16] OCA St. 1 at 15; I&E St. 1 at 5; City Exh. 4, Sch. 1.
[17] The City's rate filing was based on a hypothetical capital structure or 50% debt and 50% equity with a 10% return on equity and overall rate of return of 10% . City St. 4 at 3, note 1. However, the City's direct case as presented by witness Walker proposes a 10.5% ROE and 6.56% overall return. See City St. 4 at 3, note 1.
[18] If a tax factor adjustment is not used, City witness Walker's recommended return on equity is 10.5%. City St. 4, Sch. 25.

Through the testimony of Ms. Everette, the OCA recommends a capital structure ratio of 70% debt and 30% equity, based on the City's financing, combined with a 3.02% cost of debt and a 8.25% cost of equity. OCA St. 1 at 15-16. Each of the capital structure components is identifiable and directly relates to the Company's facilities which are included in the rate base upon which the City seeks to earn a return. OCA St. 1 at 13-16; OCA St. 1S at 5-8. The OCA used the 3.02% cost of debt claimed by the City. OCA St. 1 at 12. The 8.25% cost of equity recommended by Ms. Everette is the result of the DCF analysis and is the midpoint of a range of 7.5% to 9.0%. OCA St. 1 at 12-13, 16-23; OCA St. 1S at 9-11. Ms. Everette then applied a tax factor adjustment of 20% based on prior Commission decision, to arrive at a tax factor adjusted cost of equity of 6.60%. OCA St. 1 at 12-13, 23. The OCA's overall cost of capital is 4.09%. OCA St. 1 at 27; OCA Exh. AEE-2. The OCA's recommended 8.25% cost of equity capital and 4.09% overall rate of return, after the tax savings adjustment, when applied to the OCA's recommended rate base will properly provide the City an opportunity to earn a fair rate of return while benefiting consumers with public service at reasonable rates, consistent with Pennsylvania law and public policy as set forth in the Public Utility Code. The Commission should adopt the recommendations of the OCA as to rate of return and cost of capital as explained below.

B. <u>The Legal Framework For Determining What Rate Of Return Is Fair To DuBois Consumers And The City.</u>

As a general matter, cost of capital is the basis for determining a fair rate of return. <u>Pa. PUC v. Philadelphia Suburban Water Co.</u>, 71 Pa. PUC 593, 623 (1989) (<u>PSWC 1989</u>). The Commission has defined an appropriate rate of return as:

> the amount of money a utility earns, over and above operating expenses, depreciation expense and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the 'return' are interest on long-term debt, dividends on preferred stock, and earnings on common stock equity. In other words, the return is the money earned from

> operations which is available for distribution among the capital. In the case of common stockholders, part of their share may be retained as surplus.

EWC 2001, 95 Pa PUC at 196, 208 PUR4th at 507 (quoting Public Utility Economics, Garfield and Lovejoy, 116 (1964)). Further, "[t]he return authorized must not be confiscatory, and must be based upon the evidence presented." PSWC 1989, 71 Pa. PUC at 623 (citing Pittsburgh v. Pa. PUC, 165 Pa. Super. 519, 69 A.2d 844 (1949) (Pittsburgh)).

A public utility with facilities and assets used and useful in the public service is entitled to no more than a reasonable opportunity to earn a fair rate of return on its investment. Roaring Creek 1997 at 844. The United States Supreme Court established the standard with which to evaluate whether a rate of return is fair in Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of West Virginia, 262 U.S. 679 (1923) (Bluefield), stating:

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management. . .to raise the money necessary for the proper discharge of public duties.

Bluefield, 262 U.S. at 693. The Court also said that allowed rates of return should reflect the following:

> [A] return on the value of the [utility's] property which it employs for the convenience of the public equal to that. . .being made at the same time… on investments in other business undertakings which are attended by corresponding risks and uncertainties.

Bluefield, 262 U.S. at 692. Twenty-one years later, the Court reviewed the issue of fair rate of return in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) (Hope). In Hope, the Court held that a fair rate of return "should be commensurate with returns on investments in other enterprises having corresponding risks" while being sufficient "to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital." Hope, 320 U.S. at 603. The Court noted that "[t]he rate-making process under the Act, *i.e.*, the fixing of 'just and reasonable' rates, involves a balancing of the investor and consumer interests . . . and does not insure that the business shall produce revenues." Id. More recently, the Court stated that consumers are obliged to rely upon regulatory commissions to protect them from excessive rates and charges. See Permian Basin Area Rate Cases, 390 U.S. 747, 794-95 (1968) (*citing* Atlantic Refining Co. v. Public Service Comm'n, 360 U.S. 378, 388 (1959)).

Finally, in Duquesne Light Co. v. Barasch, the Court stated "whether a particular rate is 'unjust' or 'unreasonable' will depend to some extent on what is a fair rate of return given the risks under a particular ratesetting, and on the amount of capital upon which the investors are entitled to earn on that return." Duquesne Light Co., 488 U.S. at 310.

The Pennsylvania Public Utility Commission has also stated:

> A fair rate of return for a public utility, however, is not a matter which is to be determined by the application of a mathematical formula. It requires the exercise of informed judgment based upon an evaluation of the particular facts presented in each proceeding. There is no one precise answer to the question as to what constitutes the proper rate of return. The interests of the Company and its investors are to be considered along with those of the customers, all to the end of assuring adequate service to the public at the least cost, while at the same time maintaining the financial integrity of the utility.

Pa. PUC v. Pennsylvania Power Co., 55 Pa. PUC 552, 579 (1982) (emphasis added). See Pa. PUC v. National Fuel Gas Distribution Corp., 73 Pa. PUC 552, 603-605 (1990).

C. A Capital Structure That Reflects The City's Actual Financing Should Be Adopted To Determine A Fair Rate Of Return.

1. The OCA's Recommended Capital Structure Is Appropriate For Ratemaking Purposes And Balances The Interests Of The Ratepayers And The Company.

Capital structure is the type and percentages of capital supplied by investors. There are two basic types of capital used by utilities: debt and equity. The City proposes the use of a hypothetical 50% debt/50% equity capital structure. City St. 4 at 15. City witness Walker recommends that a hypothetical capital structure of 50% debt/50% equity be used because he claims that the Bureau of Water's per books capital structure is 0% debt/100% equity. City St. 4 at 14. The OCA recommends a capital structure of 70% debt/30% equity which reflects the financing used by the City for its future test year level of rate base. OCA St. 1 at 15.

Ms. Everette explained that Mr. Walker's statement that the City's per books capital structure is 0% debt/100% equity reflects the fact that the City is run on a cash basis. In fact, City witness Walker explains in his testimony under cash accounting, the bonds and notes that are used for Bureau of Water do not exist as "cash" at the end of the future test year, because they would have been reported as "cash" only on the day they were issued. See City St. 4 at 19; OCA St. 1 at 14. Thus, City witness Walker's position regarding the City's actual capital structure is not relevant for ratemaking purposes.

Ms. Everette explained that the outstanding debt for the Bureau of Water at December 31, 2016 is $10,738,268 and the fund equity, according to the most recent audited financial statement is $46,488. OCA St. 1 at 14. Using those figures would result in a 99.6% debt/0.4% equity capital structure. OCA St. 1 at 14-15. Ms. Everette looked at the City's claimed total rate base in rebuttal of $14,981,586 at December 31, 2016 and subtracted from it the total debt at December 31, 2016 of $10,738,268. Id. The resulting $4,243,318 (OCA St. 1S at 6) could be considered "equity", i.e., the amount of rate base that was not funded by debt, which would result in a capital structure of 71.7% debt/28.3% equity. Id. After considering the actual capital structure of 99.6% debt/0.4%equity and the capital structure of 71.7% debt/28.3% equity which reflect the financing of the City's rate base, Ms. Everette concluded that a capital structure of 70% debt/30% equity is appropriate for ratemaking purposes. Id.

Given that the actual capital structure is almost entirely debt, it is important to carefully select a hypothetical capital structure because any hypothetical capital structure will contain more equity than the actual capital structure and equity costs are higher than debt costs.

Ms. Everett explained why it is not appropriate to treat debt as equity:

> Debt is generally considered to be a lower-cost source of capital than equity. This is particularly true in a municipal situation when low-cost bonds are available for financing. This is demonstrated by the fact that the Bureau of Water's debt has an average cost of 3.02%, while the claimed cost of equity is 10.5% (more than three times the cost of debt). It is not appropriate to treat debt as if it were equity as this would force ratepayers to pay a higher cost than the Bureau of Water is actually incurring for its financing needs because the cost of equity claimed is approximately three times the cost of debt.

OCA St. 1 at 14.

It is important to understand the impact of choosing a hypothetical capital structure that has an unsupported level of equity, such as that proposed by City witness Walker. Specifically, the achieved return using the overall rate of return of 6.76% claimed by the City and applied to its pro forma capital structure, with its cost rates, would result in an excessive 14.98% return on equity (ROE). OCA St. 1 at 15-16 (Table 2). This illustrates the problem with the City's proposal to receive an equity return of 10.50% on half of its low cost debt.

The OCA submits the capital structure of 70% debt/30% equity that represents the actual financing used by the City to fund its rate base is appropriate and reasonable to use to balance fairly the interests of consumers and the City.

2. The Actual Capital Structure Is Consistent With The Commission Orders And Case Law.

The Commission considers a utility's capital structure when developing an appropriate cost of capital. The Commission has used the actual capital structure of utilities in a number of cases.

The Commission also addressed a claim for a hypothetical capital structure in Lancaster 2011. Lancaster proposed a hypothetical capital structure of 50% debt/50% equity while its actual capital structure was 83.8% debt/16.20% equity. The Commission approved the use of the actual capital structure finding that it must be used for ratemaking purposes to achieve a fair balance between consumers and the City. Lancaster 2011 at 77. The Commission found that the City was able to obtain low cost debt and that it should not be shifted to higher cost equity at the expense of the City's customers. Id. at 81-82. The Commission also noted that the actual capital structure represents the City's decision, in which it has full discretion, on how to capitalize the Water Bureau's rate base. Id. at 82. The Commission rejected the argument that the City's capital structure needed to be the same as the comparison group because the utilities in the comparison group were publicly traded companies that need to meet market norms for capital structure ratios. Id. at 82. The overall return granted to the City was 5.21%. Id. at 122. see also Pa. PUC v. National Utilities, Inc., 1996 Pa. PUC LEXIS 208, Docket No. R-00953416, RD (Nov. 18, 1996). [19]

In Pa. PUC v. Emporium Water Co., Docket No. R-00061297, Order at 54 (Dec. 28 2006) (EWC 2006), (attached as Appendix D) *aff'd*. Emporium Water Co. v. Pa. PUC, 955 A.2d 456, 464-65 (Pa. Commw. 2008) petition for allowance of appeal denied Emporium Water Co. v.

[19] The Commission adopted the ALJ's primary recommendation and denied the rate increase in its entirety due to inadequate service. It did not address the individual adjustments addressed by the ALJ however. NUI 1997 Order at 9-10, 12.

Pa. PUC, 599 Pa. 702, 961 A.2d 860 (Pa. 2008) (EWC 2006 Appeal);the Commission found that there were several factors supporting the use of Emporium's actual capital structure. EWC 2006,Order at 52. The Commission enumerated those factors, as follows:

> First, it would be consistent with the Commission's precedent in *Western Utilities*, *Emporium*, and the distinguishing factors of *City of Lancaster*. Second, use of the actual capital structure would recognize the ratepayers' interest in not paying a high return on publicly-funded PennVest plant. Third, a cost of equity adjustment could be used to make up for the difference between the principal due on the loan and the depreciation expense related to the PennVest-funded plant, adjusting the unbalanced capital structure, thereby recognizing the Company's needs and securing timely repayment of the PennVest loan. Fourth, this result would be consistent with an interpretation of *Lower Paxton*, *Carnegie* and *Riverton* that emphasizes the Commission's use of discretion, the necessity of balancing both the utility's and the ratepayers' interest and recognition of the special public nature of PennVest financing.

EWC 2006, Order at 52-53. In its decision affirming the Commission's Order, the Commonwealth Court stated that the issue is whether the Commission properly used the utility's actual capital structure in calculating the utility's proper rate of return. EWC 2006 Appeal, 955 A. 2d at 460. The Commonwealth Court found that there was a rational basis for the Commission's methodology, the Order was supported by substantial evidence, the Order did not conflict with the law and the Order was rationally derived from the application of the law to the facts of the case. EWC 2006 Appeal, 955 A.2d at 464. The Court found that the Commission, in its decision, addressed complex financial determinations and the weighing and interpreting of evidence. Id.

The Commission also addressed the issue of an actual versus hypothetical capital structure in Pa. PUC v. Emporium Water Co., 95 Pa. PUC 191, 198-99, 208 PUR4th 502, 509 (2001) (EWC 2001). In EWC 2001, the Commission found that the use of a hypothetical capital structure was improper because it would require Emporium's customers to pay an equity return on nearly 18 percent of its rate base that was financed by PennVest debt that cost only 1%. EWC 2001, 95 Pa. PUC at 198-99; 208 PUR 4th at 509. The Commission found that would be unfair to the ratepayers. Id. In the 2001 rate order, the Company's actual capital structure was 76.35% debt/23.65% equity. EWC 2001, 95 Pa. PUC at 197; 208 PUR4th at 507. In its 2001 case, Emporium argued that the use of the hypothetical capital structure was necessary because it was consistent with an industry average and that the use of the actual capital structure would produce an insufficient return (4.09%) to allow it to provide safe, adequate, continuous and reasonable service to its customers. EWC 2001, 95 Pa. PUC at198; 208 PUR4th at 508. The Commission rejected Emporium's arguments finding that the actual capital structure properly accounts for the portion of the capital structure financed by 1 percent debt. Id.

The Commission addressed a claim for a hypothetical capital structure in Pa. PUC v. Western Utilities, Inc., 88 Pa. PUC 124 (1998) (Western Utilities). In Western Utilities, the Commission rejected the use of the hypothetical capital structure finding that the utility had a very high percentage of the rate base financed by very low interest PennVest loans. Western Utilities, 88 Pa. PUC at 130. The Commission adopted the actual capital structure that separately identified the components of the total debt ratio of 77.70% which consisted of PennVest debt (59.12% at a 1% cost rate), and the remaining debt (18.56% at a 9.74% cost rate) and common equity of 22.32% for an overall return of 5.01%. 88 Pa. PUC at 128, 130-31, 134. The Commission found that using the hypothetical capital structure would be improper because it would require Western Utilities' customers to pay a return of 11.7% on nearly 20% of the Company's rate base, when that rate base was financed by debt that cost only 1%. Id. The Commission rejected the Company's argument that it would not have sufficient cash flow to cover its PennVest obligation if the actual capital structure was used. Id.

The Commission has used a hypothetical capital structure in certain limited circumstances. For example, in a Big Run telephone case, the Commission adopted a hypothetical capital structure to offset abuses of managerial discretion where the actual capital structure would impose an unfair cost burden on ratepayers. Big Run Telephone Co. v. Pa. PUC, 449 A.2d 86, 89 (Pa. Commw. 1982). See Lower Paxton Township v. Pa. PUC, 317 A.2d 917 (Pa. Commw. 1974) (utility as wholly owned subsidiary had 100% equity capital structure) (Lower Paxton); see also Carnegie Natural Gas Co. v. Pa. PUC, 433 A.2d 938 (Pa. Commw. 1981) (gas utility was subsidiary of U.S. Steel and had a capital structure of 100% equity) (Carnegie).

A hypothetical capital structure such as that claimed by the City in this case, designed to provide a utility with more revenues than actual expenses incurred would violate a "basic ratemaking maxim that only expenses which are actually paid or payable by the utility may be included for the purposes of ratemaking." Barasch v. Pa. PUC, 493 A.2d 653, 656 (Pa. 1985). "There is no legal or equitable reason for a supplemental return in the guise of an allowance for taxes or other expenses which are not incurred." Id., quoting Pittsburgh, *supra*.

3. The City's Criticisms Of The OCA's Recommended Capital Structure Are Without Merit.

City witness Walker criticizes Ms. Everette's capital structure recommendation by claiming that it is based on two unrelated items. City St. 4-R at 7. Specifically, he states that the equity amount is from the audited financial statement that is reported on a cash basis and the debt amount is estimated on an accrual basis. Id. Ms. Everette responded by noting that although the information does not provide a perfect picture it is the best information that the City made available. OCA St. 1S at 5.

She also noted that the City does not calculate equity on an accrual basis, so the equity amount shown in the audited financial statements is the only available amount. OCA St. 1S at 5. In looking at the debt in the financial statement, the City shows $0 actual debt at 12/31/14 which does not represent the actual debt of the City. Id. Thus, the debt level as shown by City witness Walker, on an accrual basis, is the best information to establish the actual debt level. City witness Walker shows $8,458,809 of debt in 2014. OCA St. 1S at 6; City Exh. _HW-1.[20]

Ms. Everette explained that her 70% debt/30% equity recommendation was not based solely on the use of the debt and equity figures contained in the City's audited financial statements. She also looked at the funding of the City's rate base. OCA St. 1 at 15; OCA St. 1S at 6. She reviewed that recommendation in light of the updated rate base claims provided by City witness Heppenstall in rebuttal and the result was very similar to her calculation in direct:

| | | |
|---|---|---|
| Total Rate Base at 12/31/2016: | $14,981,586 | (100%) |
| Total Debt at 12/31/2016: | $10,738,268 | (71.7%) |
| Equity Amount at 12/31/2016: | $4,243,318 | (28.3%) |

OCA St. 1S at 6. Thus, looking at either source of information, there is support for Ms. Everette's recommended equity ratio of 30% while City witness Walker's proposed 50% equity ration is not supported by any of the City's actual financial information.

4. Summary

The City's actual capital structure is appropriate of ratemaking purposes, is consistent with prior Commission decisions. The City's actual capital structure of 70% debt / 30 % equity should be adopted in this proceeding as recommended by Ms. Everette.

[20] Ms. Everette noted that correcting for the time period discrepancy in her direct testimony, and using debt and equity data as of 12/31/14, the actual capital structure would be 99.5% debt/0.5% equity. OCA St. 1S at 6.

D. The City's Request For Adoption Of A Hypothetical Capital Structure Should Be Denied.

1. Introduction

As explained above, the use of the City's actual capital structure in this case is consistent with prior Commission decisions regarding similarly capitalized utilities. In addition evidence shows that the use of the actual capital structure is fair to ratepayers because it does not require them to pay an equity return on low interest debt. A review of the City's support for its proposed hypothetical capital structure shows that there is ample evidence to reject that claim and use the actual capital structure.

2. The City's Hypothetical Capital Structure Is Not Supported By The Record.

In this case, the City's proposed hypothetical capital structure is 50% debt and 50% equity. City St. 4 at 16. City witness Walker claims that the actual capital structure is atypical compared to the 3/31/16 average capital structure maintained by the water utilities in his proxy group, thus, the hypothetical capital structure is appropriate. Id. Similar arguments were made and rejected in Lancaster 2011. Specifically, the Commission found that reliance on the comparable groups' capital structures is inappropriate because those utilities are publicly traded and need to meet market norms for capital structure ratios which Lancaster did not need to meet. Lancaster 2011, 2011 Pa. PUC at 82-83. See also Emporium 2006; Order at 48-54 and EWC 2001, 95 Pa. PUC at 197, 198, 208 PUR4th at 507, 508.

City witness Walker also testified that the hypothetical capital structure is consistent with Commission precedent. City St. 4S at 10. The precedent he cites to is Carnegie, which, as explained above, used a hypothetical capital structure to **decrease** the costs to ratepayers, not increase the costs as he proposes. City witness Walker failed to address more recent decisions in which the Commission did not adopt a hypothetical capital structure and Commonwealth Court affirmed those order. Specifically, he did not address the Commission's finding that the use of the hypothetical capital structure (which is the same as what he proposed here) would produce an inflated overall rate of return that would adversely affect customers. Lancaster 2011, 2011 Pa. PUC at 77.

He also did not distinguish his recommendation in this case from the Commonwealth Court decision affirming the use of the actual capital structure in the 2006 Emporium rate case or from the Commission's use of the actual capital structure in the 2001 Emporium rate case.

As explained above, the Commission has rejected arguments similar to the City's in Lancaster 2011, EWC 2006 and EWC 2001. Lancaster 2011, 2011 Pa. PUC at 77-83; EWC 2006, Order at 509; EWC 2001, 95 Pa. PUC at 198-99, 208 PUR4th at 509. The OCA submits that the bounds of the Commission's discretion are well-defined. The Commission has a "duty to regulate utilities in a manner which provides customers with reliable service at reasonable cost." Pa. PUC v. Carnegie Natural Gas Co., 54 Pa. PUC 381, 392-93 (1980) (Carnegie), *aff'd* Carnegie Natural Gas Co. v. Pa. PUC, 433 A.2d 938, 941 (Pa. Commw. 1981).

3. Conclusion

The OCA submits that the City has provided no sound reasons or evidence to require the Commission to depart from its decision in similar cases where it found that the actual capital structure is reasonable and appropriate for determining a fair rate of return. The City's arguments cannot overcome the clear evidence that use of a hypothetical capital structure would increase costs unreasonably to consumers. Additionally, a hypothetical capital structure would unreasonably provide the City with a return on equity which does not exist. Use of the City's actual capital structure will properly balance the interests of the City and consumers and protect ratepayers from excessive rates or charges for costs which the City does not incur.

E. Cost of Debt

The OCA accepted the City's 3.02% cost of debt. OCA St. 1 at 12.

F. Cost of Equity

1. Introduction

The City proposes a common equity cost rate of 10.50%, I&E 8.62% and the OCA 8.25%.

Ms. Everette explained that she used the Discounted Cash Flow (DCF) method to estimate the cost of equity for the Bureau of Water. OCA St. 1 at 16. As explained in more detail below, she derived a DCF equity cost rate range of 7.50%-9.00% and recommended the midpoint of the range, 8.25% as appropriate for the Bureau of Water. OCA Exh. AEE-2, Sch. 1.

The Commission should adopt an 8.25% cost of equity over the City's recommendation of 10.5% because the 8.25% cost is in line with results of the DCF analysis and with current economic conditions, as explained in further detail below.

2. Proxy Group

The Bureau of Water, as a municipal utility, is not a publicly traded company, thus it is necessary to use a group of proxy companies as a substitute for the City to determine the City's cost of equity. OCA St. 1 at 16. Ms. Everette noted that capital attraction needs for municipal utilities are not subject to the same market forces as investor owned utilities. Id. at 17. She noted two significant differences. First, the income from municipal bonds is not taxable which affects the return that an investor requires, compared to the return required on an investor-owned utility's financing. Id. Second, "unlike investor-owned utility bonds, general obligation bonds issued by a municipality are generally backed by the taxing power of the municipality, which decreases risk to the investor." OCA St 1 at 17.

Ms. Everette's proxy group consists of nine water companies from the group of water utility companies covered by Value Line. Id.; OCA Exh. AEE-2, Sch. 2. Her proxy group is the same as the proxy group used by Company witness Walker with one difference-he did not include Artesian Water. See City St. 4 at 10.

3. The Commission Should Adopt The 8.25% Equity Cost Rate Proposed By The OCA As Appropriate For The City.

The Pennsylvania Public Utility Commission relies primarily on the use of the DCF analysis. The Commission has relied on the DCF approach for setting returns on equity for many years. See, e.g. Lancaster 2011, 2011 Pa. PUC at 118; EWC 2006, Order at 55-56; EWC 2001, 95 Pa. PUC at 201, 208 PUR4th at 512; Pa. PUC v. York Water Co., 75 Pa. PUC 134, 159-69 (1991); PSWC 1989, 71 Pa. PUC at 631-32; Pa. PUC v. Pennsylvania-American Water Co., 71 Pa. PUC 210, 279-82 (1989); Pa. PUC v. The Peoples Natural Gas Co., 69 Pa. PUC 1, 167-68 (1989); Pa. PUC v. Pennsylvania Power, 67 Pa. PUC 91, 164, 93 PUR4th 189, 266 (1988) (Penn Power 1988); Pa. PUC v. National Fuel Gas Distribution Corp., 67 Pa. PUC 264, 332 (1988). Moreover, the Commission has preferred the DCF approach to several other methods. Pa. PUC v. Roaring Creek Water Co., 81 Pa. PUC 285, 150 PUR4th 449 (1994) (Roaring Creek 1994). Concerning the DCF method, the Commission has stated:

> In considering the issues and arguments raised regarding the appropriate return on common equity for RCW, we note the following. We have, in recent years, relied primarily on the DCF methodology in arriving at our authorized return on common equity. As correctly observed by the ALJ, we rejected the use of the risk premium and the CAPM methods in the company's last rate case at Roaring Creek 1994, supra, as well as in Pennsylvania Power Company, supra. There is no evidence of record in the proceeding before us, which convinces us that such

> methodologies should be used in this proceeding. Accordingly, we will continue to rely primarily on the DCF methodology and informed judgment.

Pa. PUC v. Roaring Creek Water Co., 84 Pa. PUC 438, 462 (1995). Ms. Everette's DCF evaluation, which is consistent with the Commission's approach for determining cost of capital, shows a required cost of capital between 7.5%-9.0% for the proxy group. OCA Exh. AEE-2, Sch. 1.

Ms. Everette used the quarterly compounding version of the DCF model:

$$Yield = \frac{D_o(1+0.5g)}{P_o}$$

> The $P_o$ in my yield calculation is the average daily closing stock price for each company for the most recent three month period (June 2016-August 2016). The $D_o$ is the current annualized dividend rate for each company.

OCA St. 1 at 17-18.

a. Dividend Yield

As noted above, Ms. Everette used the average daily closing price over a 3-month period to smooth the day to day fluctuations in the market to determine $P_o$. OCA Exh. AEE-2, Sch. 4, p. 1. The dividend yield calculation is shown on Schedule 4, p. 4. The average is 2.3% for the proxy group, while the median adjusted yield is 2.2%. OCA St. 1 at 18.

b. Growth Rate

The growth rate component of the DCF is the most crucial and controversial element involved in using the DCF methodology. The growth rate attempts to estimate the growth expected by investors. OCA St. 1 at 18. Ms. Everette explained that investors do not all use the same growth rate or apply the same weight to the various growth estimates. Id. She explained that she used five indicators of growth, as follows:

1. historical (five-year average) earnings retention, or fundamental growth;
2. five-year average historic growth in earnings per share (“EPS”), dividends per share (“DPS”), and book value per share (“BVPS”);
3. projected earnings retention growth;
4. projections of EPS, DPS, and BVPS; and,
5. five-year projections of EPS growth as reported by Thomson First Call (formerly I/B/E/S).

OCA St. 1 at 19. Ms. Everette noted that analyst projections of growth may be overstated, while historical growth may not equal future growth rates. Id. Thus, Ms. Everette’s analysis considered both historic and projected growth rates to develop her DCF based cost of equity range.

Historical growth rates for the proxy group are shown on pages 2 and 3 of Schedule 4. As shown there, the five year average historical retention growth rate is 3.8%. OCA St. 1 at 19. The five year average historical growth rate of earnings per share, dividends per share and book value per share is 6.2%. Id.

Projected growth rates are shown on pages 2 and 3 of Schedule 4. The five year average projected retention growth rate is 4.8% and the average projected growth rate for the period 2013-2015 to 2019-2021 is 5.5%. OCA St. 1 at 20. The average projected earnings per share growth rate for the proxy group is 6.5%. Id.; OCA Exh. AEE-2, Sch. 4, p. 4.

Ms. Everette summarized her analysis of the five different growth rate indicators, as follows:

> The average of each of the five growth analyses are in the range of 3.8% to 6.5% (Exhibit AEE-2, Sch. 4, page 4). The median of each of the five growth analyses are in the range of 3.5% to 6.8% (Exhibit AEE-2, Sch. 4, page 4). Given these results, I have found an appropriate growth rate range of 5.2% to 6.7%.

OCA St. 1 at 20. Based on the range of results in both historic and projected growth rates when added to her average adjusted dividend yield, Ms. Everette determined that a proper DCF cost of equity is in the range of 7.5% to 9.0%. Id., Exh. AEE-2, Sch. 4, p. 4.

### 4. Tax Factor Adjustment

Investors in investor-owned utilities have income taxes associated with dividends and capital gains, and thus require a higher equity return than if the dividends and capital gains were tax exempt. OCA St. 1 at 21. Thus, the equity returns required by investors in investor-owned utilities "implicitly reflect a provision for the income taxes that the investor pays." Id.

City witness Walker recommended a 9% tax factor adjustment if an adjustment is made by the Commission. OCA St. 1 at 22. However, he calculated an average 13% tax rate by comparing the yields of similarly rate general obligation municipal bonds to investor-owned pubic utility bonds for a two year period (May 2014 to May 2016). Id. The resulting comparison resulted in effective tax rates ranging from -1% to +30%, with the average being 13%. Id.

Ms. Everette noted that the 9% tax factor recommended by City witness Walker has numerous flaws. OCA St. 1 at 22. He did not consider that there are multiple other reasons for differences in yields between general obligation bonds and similarly rate investor-owned public utility bonds. Id. She concluded that it is not reasonable to calculate the income tax effect by comparing the yields of the two types of bonds. Id.

In Lancaster 2011, the Commission adopted a tax factor of 20% based on the marginal tax rate of the largest block of municipal investors. 2011 Pa. PUC LEXIS *121. The Commission adjusted the market based common equity by the 20% tax factor. Id.

Ms. Everette concluded that the 20% tax factor adjustment was still appropriate because income tax rates have not changed materially since the Commission's Order in Lancaster 2011. OCA St. 1 at 23. She adjusted her cost of equity range by the 20% tax factor which results in an adjusted cost of equity range of 4.8% to 5.76% for the City. Id.

The total cost of capital recommended by Ms. Everette, including the pro forma capital structure is as follows:

> For purposes of establishing revenue requirements, I recommend the mid-point of my after-tax adjustment cost of equity range such that the following reflects my recommended overall cost of capital for this case.

TABLE 4
City of DuBois – Bureau of Water
OCA Total Cost of Capital

| Item | Percent | Cost | Weighted Cost |
|---|---|---|---|
| Long Term Debt | 70.00% | 3.02% | 2.11% |
| Equity | 30.00% | 6.60% | 1.98% |
| Total | 100.00% | -- | 4.09% |

OCA St. 1 at 27. The OCA submits that its recommended capital structure, and tax factor adjusted common equity cost rate and overall return should be adopted in this proceeding.

5. <u>The Commission Should Reject The City's Overstated 10.5% Equity Cost Rate Which Is Based On Multiple Costing Methods With Biased Inputs</u>.

a. <u>Introduction</u>

City witness Walker applied three cost rate models to an eight company proxy group. He used the DCF model, the Risk Premium (RP) model and the CAPM. City St. 4 at 40. From the results of all of these models, City witness Walker identified an indicated equity cost range of 10%-11%. City St. 4 at 59. He selected 10.25% as the indicated cost of common equity before adjustments. <u>Id.</u> at 60. To this range, he added 25 basis points to reflect a size risk-adjusted equity cost rate of 10.5% for the City. <u>Id.</u> at 61.

As explained below, the City's risk adjusted return of 10.5% overstates the appropriate cost of equity for the City through the blending of results of flawed valuation analyses plus a risk adjustment for size. Nor can an inflated equity return be justified as necessary to generate a higher overall return. Established rate making principles and the law of Hope, Bluefield, Barasch, and established Commission practice do not support the City's claim.

b. Mr. Walker's Cost of Equity Analyses Are Not Reasonable For Ratemaking Purposes.

City witness Walker's application of the DCF model is flawed because he relies only on projected growth rates and does not consider historical growth rates. OCA St. 1 at 24. Mr. Walker admitted that investors have access to information about historical growth rates that shows negative growth rates, yet he does not consider that in his DCF analysis. Moreover he misstates the published historical earnings growth rate, stating that it is 10.9% but provides no citation for this statement. City St. 4 at 43. In fact, the average historical earnings growth rate for the proxy group is 4.7%. OCA St. 1 at 24.

Mr. Walker's DCF results produce a cost rate of 9.3%. OCA St. 1 at 25. He then adjusted his DCF results by 70 basis points for a leverage adjustment (City St. 4 at 50) and then by an additional 25 basis points for risk differential (City St. 4 at 60). These adjustments result in his 9.3% DCF result increasing to 10.25%. He then compared that to the results of his CAPM and RP analyses which were also increased by the leverage and risk differential adjustments and recommended a cost of equity of 10.5%. OCA St. 1 at 25.

Regarding the leverage adjustment, Ms. Everette noted that City witness Walker did not adjust his recommendation for the fact that his return on equity recommendation "already accounts for the City's leveraged position by imputing 50% equity when the City in fact is only 0.4% equity." OCA St. 1 at 24-25.

Regarding City witness Walker's risk adjustment, he provides a discussion regarding characteristics of the water business that increase the risk and required return of water utilities in his opinion. This discussion, however, has no bearing on a reasonable return on equity because each of his cost of equity models are market-based as is Ms. Everette's DCF analysis. Thus, the various analyses of specific water utilities reflect the market's assessment and reaction to all risks confronted in the water utility industry.

In Lancaster 2011, the Commission rejected similar analyses by City witness Walker. The Commission rejected the 25 basis point risk adjustment that was proposed by Mr. Walker and is proposed here. Lancaster 2011, 2011 Pa. PUC LEXIS *118. The Commission also rejected any market to book or leverage adjustment. Id.

Individually or jointly, OCA submits that results of City witness Walker's cost methods, as applied to his proxy group, are not appropriate to determine a cost of common equity for the City.

6. Summary

The Commission should adopt the City's specific actual capital structure ratio of 70% debt and 30% equity and overall rate of return of 4.09%, based on the OCA's tax factor adjusted return on equity of 6.6% to determine base rates for the City's PUC-jurisdictional customers. The OCA's cost of capital recommendation is based on consideration of the amount and particular characteristics of the City's capital, consistent with Barasch and Lower Paxton. The OCA's cost of capital recommendation will provide the City with a fair rate of return. The Commission should adopt the OCA's cost of capital recommendation.

## VIII. MISCELLANEOUS ISSUES

The miscellaneous issues in this case are limited to a response to an evidentiary motion to strike and the stipulations entered into between the City and OCA.

### A. Stipulations

At the evidentiary hearing, stipulations between the City and OCA was identified for the record and received into evidence. Tr. at 140:8-12. The following provides a brief discussion of the agreed upon stipulations.

#### 1. Annual PUC Report Format

City/OCA Stipulation 1 provides:

> In future rate cases, the City will provide UFW[21] Calculations in the format shown on Exhibit TLF-1 that is used by water utilities in submission of their Annual PUC Reports.

Stipulation Between the City of DuBois and the Office of Consumer Advocate (City/OCA Stipulation) at ¶ 1.

OCA witness Fought recommended that the City provide UFW calculations in the format shown in Exhibit TLF-1 which is used by water utilities in submission of their Annual PUC Reports. OCA St. 2 at 7; OCA St. 2S at 5. The City was not using the PUC procedure in section 500 of the PUC Annual Report forms for public water utilities for calculating UFW. OCA St. 2 at 3. The OCA and the City are in agreement that in future rate cases, the City will provide UFW Calculations in the format shown in Exh. TLF-1 which is used by water utilities in the submission of their Annual PUC Reports. City OCA Stipulation at ¶ 1. The City/OCA stipulation 1 addresses this concern.

[21] Unaccounted for Water (UFW).

2. Installation of water meters on all services lines connected to the municipal buildings

City/OCA Stipulation 2 provides:

> Within six months of a final order in this case, the City will install water meters on all water service lines connected to the Public Works Garage, City Municipal Building, Waste Water Treatment Plant, Public Library, City Pool, and the five Fire Halls. The Water Treatment Plant may not need metering if the water is withdrawn prior to the metering of the flow into the distribution system.

City/OCA Stipulation at ¶ 2.

Mr. Fought recommended that the City install water meters in the city facilities. OCA St. 2 at 8; OCA St. 2S at 5. In response to an OCA interrogatory, the City stated that the volume of water used for the category "other" was estimated by assuming that each of the eleven municipal buildings used 500 gallons per day. OCA St. 2 at 7; OCA Exh. TLF-9; OCA-IV-7. OCA expert witness Fought raised concerns regarding the City's estimates. OCA St. 2 at 3-5. During the OCA's site visit on October 3, 2016, the City Manager and the City Engineer explained that, to the best of their knowledge, there is not any unusual construction problem that would prevent the metering of all of the City buildings. OCA St. 2 at 7. Mr. Fought recommended the following:

> I recommend that the City meter water service to all of its buildings in according with § 65.7. Metered service.
>
> > (d) *Universal metering.* A public utility shall provide a meter to each of its water customers except fire protection customers and shall furnish water service, except fire protection service, exclusively on a metered basis; except that flat rate service may continue to be provided pending implementation of a reasonable metering program or under special circumstances as may be permitted by the Commission for good cause.

OCA St. 2 at 7.

The City/OCA stipulation 2 addresses this concern.

3. The Submission of Written Monthly Estimates of Unmetered Water Use from Fire Companies

City/OCA Stipulation 3 provides:

> Within two months of the final order in this case, the City should require each of the Fire Companies to submit a monthly written estimate of the unmetered water used and what it was used for.

City/OCA Stipulation at ¶ 3.

OCA witness Fought recommended that the Fire companies should submit monthly written estimates to the City in order to properly measure UFW. OCA St. 2 at 8; OCA St. 2S at 5. Mr. Fought raised concerns regarding how the City estimated and accounted for unmetered water use to the nearest 1 million gallons. See, OCA St. 2 at 3-5. Mr. Fought noted as follows regarding the use of estimations:

> [O]n Exhibit TLF-4, the City has estimated the *Accounted For Water (Unmetered) Use* to the nearest 1 million gallons per year for 'Fire Department Use', 'Water Line Construction' and 'Other'. In some cases, the estimated volumes are the same for more than one year…In my experience such rounding and consistency of using the same numbers for more than one year is unusual in UFW calculations. This indicates that some of the City's volumes of unmetered uses may be educated guesses instead of reasonably accurate estimates taken at the time the use occurred.

OCA St. 2 at 3-4.

Additionally, "the City Manager explained that in addition to cleaning their own parking lots, the Fire Department sometimes cleans private parking lots as part of fireman training exercises." OCA St. 2 at 4. OCA witness Fought was concerned that "[i]t appears that the City does not have information from the fire companies that would provide a reasonable estimate of the unmetered water used by each company." OCA St. 2 at 5.

The City/OCA stipulation 3 addresses this concern.

4. <u>Estimation of Water Loss at the Time Repair is Made</u>

City/OCA Stipulation 4 provides

> Upon entry of a final order in this case, the City will estimate (at the time the repair is made) the water loss of each waterline/service line leak or break that was repaired.

City/OCA Stipulation at ¶ 4.

OCA witness Fought recommended that the City estimate water loss for line breaks and repairs. OCA St. 2 at 8; OCA St. 1S at 5. This recommendation was based on OCA witness Fought's concerns regarding the City's estimation of UFW discussed above and is intended to lead to greater accuracy in measuring the level of UFW. <u>See generally</u>, OCA St. 2 at 2-7. The City/OCA stipulation 4 addresses OCA's concerns regarding the calculation of UFW.

5. <u>Metered Locations for Street Sweepers and Fire Companies</u>

City/OCA Stipulation 5 provides:

> Upon entry of a final order in this case, the City will provide metered location(s) for use by the street sweeper and fire companies for their non-firefighting uses.

City/OCA Stipulation at ¶ 5.

As mentioned above, OCA witness Fought expressed concerns regarding UFW in relation to the City's Fire Companies. <u>See</u>, OCA St. 2 at 4 ("the Fire Department sometimes cleans private parking lots as part of fireman training exercises"). OCA witness Fought also expressed concern that the City claimed its one street sweeper used 250,000 gallons per year for street cleaning and 200,000 gallons per year for parking lot cleaning. OCA St. 2 at 5. OCA witness Fought stated that "using almost as much water for parking lot cleaning as street cleaning seems unusual because the area covered by the streets is much larger than the area of the parking lots. OCA St. 2 at 5. Moreover, parking lot cleaning was also included in the Fire

Deparment usage. OCA St. 2 at 5. The City/OCA stipulation 5 addresses OCA's concerns regarding the calculation of UFW.

6. Complaint Logs

City/OCA Stipulation 6 provides:

> The City will prepare a script for customer service complaints made via telephone, requiring the responding City representative to obtain the customer name, customer address, and a description of the service issue.

City/OCA Stipulation at ¶ 6.

City/OCA Stipulation 7 provides:

> The City will preserve a record of customer service complaints received via telephone. The Complaint logs should include the names and addresses of the complainants, the date and character of the complaint, and the final disposition of the complaint.

City/OCA Stipulation at ¶ 7.

In his direct testimony, OCA witness Fought expressed concerns regarding the City's lack of a complaint log. OCA St. 2 at 8. At the time of Mr. Fought's direct testimony, the City did not keep a record of complaints from jurisdictional customers. OCA St. 2 at 8. Mr. Fought testified that "[t]herefore, the number of water quality and service complaints received by the City from jurisdictional customers by phone calls or other non-written methods during the years 2013, 2014, 2015 and 2016 to date is unknown." OCA St. 2 at 8; OCA Exh. TLF-10. OCA witness Fought explained in his direct testimony that ongoing records are important information since they show whether customers have quality of service issues and because they would show what steps the City took to remedy customer complaints and whether the City responded in a timely manner. OCA St. 2 at 8. Mr. Fought had the following recommendations in his direct testimony:

> First, the City should keep records of complaints as required by the Commission in accordance with 52 Pa. Code § 65.3. The City should maintain a written log of all complaints received from jurisdictional customers. The complaint logs should include the names and address of the complainants, the date and character of the complaint and the final disposition of the complaint. Second, the phone number listed on the City's bills should be used to log complaints by the jurisdictional customers.

OCA St. 2 at 9.

Subsequent to the filing of OCA witness Fought's direct testimony, Mr. Fought was made aware of complaints made to OCA by jurisdictional customers via telephone. OCA St. 2S at 3-4. The reported existence of complaints being made to the City was in contradiction to what OCA witness Fought was told by City witness Suplizio during OCA witness Fought's site visit. OCA St. 2 at 3-4.

In his rebuttal, City witness Suplizio stated that:

> [O]f course, some residents at times approach known City employees informally to address minor service inquiries. Such is the nature of life in a small city like DuBois. However, if a resident sent a written Complaint to the City, the City would certainly keep original correspondence with a record of the ensuing investigation. But the **City should not be expected to track every phone call or record every instance of a customer flagging down a City employee in public spaces.** To the contrary, the City's customer service record should be referenced as a justification for providing the City with sufficient revenue to continue providing customers with exemplary service and high quality water.

City St. 1R at 11 (emphasis added).

In surrebuttal, OCA witness Fought re-iterated the importance of keeping complaint logs. OCA St. 2 at 4. "The City should not disregard a consumer complaint regarding water quality because the complaint was made in-person or over the telephone as opposed to in a formal writing." OCA St. 2 at 4. The stipulations require the City to keep complaint logs for all forms of contact with the city. The OCA accepts the City's stipulations relating to consumer compliant logs being kept for all consumer contact with the City regarding water service issues.

7. Isolation Valves

City/OCA Stipulation 8 provides:

> The City will exercise all isolation valves in the jurisdictional area prior to October 2017 and subsequently submit a schedule to the OCA and other parties for repairing or replacing all isolation valves that could not be exercised.

City/OCA Stipulation at ¶ 8.

In response to OCA interrogatories, the City indicated that there are 105 isolation valves installed in the jurisdictional areas but that none of the isolation valves have been exercised in the past 5 years. OCA St. 2 at 9. The City does not know if any of these isolation valves need to be repaired or replaced. Id.; OCA Exh. TLF-11. In his direct testimony, OCA witness Fought testified as to the importance of exercising isolation valves to prevent the valves from seizing-up and getting stuck from corrosion or other deposits adjacent to the valves. OCA St. 2 at 9-10. Mr. Fought testified: "An isolation valve that cannot be fully closed will increase the water loss during a water main break and increase the number of customers affected." Mr. Fought recommended that isolation valves be exercised in a routine manner as part of a maintenance program. OCA St. 2 at 10; OCA St. 2S at 6.

B. Sales To Shale Gas Companies

In 2013, a settlement was entered into between the City and the OCA regarding rate base. In this 2013 Settlement, which was previously the City's most recent base rate case before the immediate case, the City agreed to "include any and all revenues from water service contracts received from shale gas exploration or drilling companies (and volumes delivered thereto), during a given year, in future annual reports filed with the Commission." 2013 Settlement, Docket No. R-2013-2350509 at 6.

Reporting gas driller sales separately does not impose an additional burden on the City because the City will already be filing its Annual Report with the Commission, and volumes and sales revenues for any such sales in the prior year are available to the City at the time the annual report is filed. OCA St. 1S at 28. The volumes and sales revenues for the driller sales is relevant because the City charges above-tariff rates for these sales.[22] OCA St. 1S at 28.

At the evidentiary hearing Mr. Suplizio stated that the City will continue to report sales of water to shale gas companies in its annual reports. Tr. at 22-23, 32. The sales information should be available and publicly recorded for review in future rate cases, as was previously agreed upon in the previous settlement.[23] For these reasons, OCA submits that the City should continue to report sales to shale gas companies in its annual reports.

C. Sales of Water to the Borough of Falls Creek

The City initially included a rate base claim for the addition of a waterline intended to be used to serve Falls Creek. OCA St. 1 at 46; I&E-RB-8 (attached to OCA St. 1). In response to a Sandy Township interrogatory, the City stated that it "planned a line extension to serve the Borough of Fall [sic] Creek…However, this extension will not be completed as originally anticipated and the expense will be removed from rate base." OCA St. 1 at 46. Although the City initially included the cost of this main extension in its filing, the City did not include any revenues from sales to Falls Creek. OCA St. 1 at 46.

[22] The City's highest tariff rate since 2013 was $5.15. In its 2013 Annual Report, the City had an average rate of $8.65 per thousand gallons for driller sales. In its 2014 Annual Report, the City had an average rate of $9.11 per thousand gallons for driller sales. In its 2015 annual report, the City had an average rate of $7.38 per thousand gallons for driller sales.

[23] The City should continue to comply with the terms of the previous 2013 Settlement and continue to report all revenues received from shale gas exploration or drilling companies. The Settlement neither states a specific end date nor contains a provision stating that the Settlement remains in effect only until the next base rate case. See generally, 2013 Settlement, Docket No. R-2013-2350509.

If the extension of sales for resale service to Falls Creek occurs after the end of the FTY, neither costs nor revenue would be included for ratemaking purposes in this case. OCA St. 1S at 47. As service to Falls Creek would potentially create additional revenue, the OCA recommends that the City be required to inform the Commission when it connects Falls Creek and begins service. OCA St. 1S at 47. The OCA recommends that the City be required to provide the following:

1. The date service began
2. The annual number of gallons to be sold to Falls Creek
3. The rate to be charged per thousand gallons
4. The expected annual customer charge revenue and
5. A copy of the contract with Falls Creek

OCA St. 1 at 47.

D. Evidentiary Motion

At the evidentiary hearing, the City made an oral Motion to Strike testimony in OCA Statement Number 2S from page 3, line 19 to page 4, line 17. This testimony contains information that Mr. Fought received regarding customer complaints to OCA and forms part of his basis for his recommendation regarding the necessity of complaint logs.

A statement is hearsay only if it is offered to prove the truth of the matter asserted in the statement. Pa.R.E. 801(c). It is well settled that "any out of court statement offered not for its truth but to explain the witness's course of conduct is not hearsay" Commonwealth v. Johnson, 615 Pa. 354, 386, 42 A.3d 1017, 1035 (2012) (internal citations omitted). Additionally, under Rule 703:

> "An expert may base an opinion on facts or data in the case that the expert has been made aware of or personally observed. If experts in the particular field

> would reasonably rely on those kinds of facts or data in forming an opinion on the subject, they need not be admissible for the opinion to be admitted."
>
> Pa.R.E. 703.

Moreover, as stated in an evidentiary treatise by Professors Leonard Packel and Anne Poulin, "[a]n expert witness may also base an opinion on facts which he or she has perceived." *L. Packel & A.B. Poulin, Pennsylvania Evidence, 4th Addition,* §703-1 at 758 (2013).

In the disputed testimony, OCA expert Fought is asked "[c]an you provide an example of why it is important to have the information you described above [referencing a complete log of complaint which includes telephonic complaints]?" OCA St. 2S at 3: 19-21. In response, Mr. Fought states that he was made aware of complaints regarding water quality. This information is not hearsay because this portion of Mr. Fought's testimony is not being offered to prove that the City in fact has any water quality issues. Tr. at 141:6-24. Mr. Fought includes the disputed answer in his testimony as a part of his basis as to why a complaint log which accounts for telephonic complaints to the City is necessary for the City to maintain high water quality standards. All of Mr. Fought's statements in this section of his surrebuttal testimony regarding customer contact specifically state that he received reports or was informed by customers of water quality issues. At no point in this section does Mr. Fought state that the City of DuBois in fact has water quality issues.

Additionally, even if Mr. Fought's testimony were to be construed as hearsay, under Rule 703, the statement remains admissible. Mr. Fought was made aware of information that contributed to his expert opinion regarding the need for complaint logs, specifically, the need for complaint logs for telephonic complaints. In this section of his testimony, Mr. Fought is explaining one of the bases of his opinion as to why a consumer complaint log which tracks all complaints, including telephonic complaints, is necessary and proper. Experts in the field of engineering and quality of service can reasonably rely on reports of consumer complaints regarding water quality in forming their expert opinions.

When Mr. Fought spoke to Mr. Suplizio during his site visit on October 3, 2016, he was assured that no water quality issues exist. OCA St. 2S at 3. However, Mr. Fought was made aware of jurisdictional customers who claim that they have contacted the City with water quality issues. OCA St. 2S at 3-4. Mr. Fought should be permitted to explain one of the bases of his opinion as an OCA expert.

In the alternative, lines 19-26 on page 3 of OCA Statement Number 2S should not be stricken. Lines 19-20 is merely a question posed to the expert. Lines 21-22 of the disputed testimony merely states what Mr. Fought was told by Mr. Suplizio at the October 3, 2016 site visit. If these lines are construed as hearsay, it meets the exception of a statement by a party opponent and Mr. Fought was available for cross-examination at the time of the evidentiary hearing. See Pa.R.E. 803(25). Lines 24-25 merely reports that the OCA was notified by two jurisdictional customers of water quality problems. OCA St. 2S at 3. Lines 25-26 states that the customers indicated that the City did not do an on-site inspection or evaluation. OCA expert witness Fought is not making any substantive assessment of the City's water quality, but is relaying in his testimony that the customers reported that there was no on-site inspection/evaluation, not that an on-site inspection or evaluation was never performed.

## IX. RATE STRUCTURE

The OCA did not take any position regarding the City's proposed rate structure, cost of service, revenue allocation or tariff issues.

## X. CONCLUSION

As the OCA demonstrated above, the City of Dubois, Bureau of Water has not shown that it is entitled to the claimed increases and awarding the level of revenue proposed by the City would produce unjust and unreasonable rates. For all the above reasons the Office of Consumer Advocate respectfully requests that the Commission approve an increase in annual revenue requirement of no more than $50,418 for PUC-jurisdictional customers.

Respectfully submitted,

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Date: November 29, 2016

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Appendix A
OCA Tables I and II

City of DuBois - Bureau of Water
Docket No. R-2016-2554150
Table I

Income Summary

| | Pro Forma Present Rates (Revised)[1] | OCA Recommended Adjustments | Adjusted Present Rates | Revenue Adjustment | Total Recommended Revenue |
|---|---|---|---|---|---|
| Operating Revenues | $ 800,242 | $ - | $ 800,242 | $ 50,418 | $ 850,660 |
| Deductions: | | | | | |
| O&M Expenses | 643,422 | (74,110) | 569,312 | - | 569,312 |
| Depreciation | 107,126 | (768) | 106,358 | - | 106,358 |
| Assessments | | - | - | - | - |
| Other Taxes | | - | - | - | - |
| Income Taxes | | - | - | - | - |
| Total Deductions | 750,548 | (74,878) | 675,670 | - | 675,670 |
| Net Income Available for Return | $ 49,694 | $ 74,878 | $ 124,572 | $ 50,418 | $ 174,990 |
| Rate Base | $ 4,317,704 | $ (38,870) | $ 4,278,834 | | $ 4,278,834 |
| Rate of Return | 1.15% | | 2.91% | | 4.09% |

[1] City Exhibit CEH-1R and City Exhibit CEH-3RJ.

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City of DuBois - Bureau of Water
Docket No. R-2016-2554150

Table II

Summary of Adjustments

| Recommended Adjustment | Reference | (A) Rate Base Effect | (B) Revenue Effect | (C) Expense Effect | (D) Effect Upon Other Taxes | (E) Depreciation Expense Effect | (F) Income Tax |
|---|---|---|---|---|---|---|---|
| Heating and Air Conditioning System | OCA Statement 1S | (5,204) | | | | | |
| Mains and Accessories - High Street | OCA Statement 1 | (14,531) | | | | | |
| Fire Hydrants - High Street | OCA Statement 1 | (1,071) | | | | | |
| Software | OCA Statement 1S | (3,804) | | | | | |
| Telephone | OCA Statement 1S | (1,663) | | | | | |
| Vacant Home | OCA Statement 1 | (3,334) | | | | | |
| Cash Working Capital | 12.5% of Column C | (9,264) | | | | | |
| Depreciation Expense for Heating and A/C System | OCA Statement 1S | | | | | (93) | |
| Depreciation for Mains and Accessories - High St. | OCA Statement 1 | | | | | (124) | |
| Depreciation Expense for Fire Hydrants - High St. | OCA Statement 1 | | | | | (15) | |
| Depreciation Expense for Software | OCA Statement 1S | | | | | (254) | |
| Depreciation Expense for Telephone | OCA Statement 1S | | | | | (111) | |
| Depreciation Expense for Vacant Home | OCA Statement 1 | | | | | (172) | |
| Vacant Home Expenses | OCA Statement 1 | | | (1,077) | | | |
| T&D Contractual Services Expense | OCA Statement 1 | | | (11,216) | | | |
| Water Treatment Contractual Services | OCA Statement 1 | | | (4,194) | | | |
| City Manager | OCA Statement 1 | | | (11,209) | | | |
| City Buildings/Computer Parts/Supplies/Software | OCA Statement 1 | | | (1,313) | | | |
| Rate Case Expense | OCA Statement 1S | | | (45,101) | | | |
| Total Adjustments | | $ (38,870) | $ - | $ (74,110) | $ - | $ (768) | $ - |

Appendix B
List of OCA Sponsored Testimony,
Exhibits and Appendices

OCA - Sponsored Testimony, Exhibits and Appendices

The following OCA Testimony and Exhibits were admitted into the record at the Evidentiary Hearing on November 10, 2016:

Direct Testimony of Ashley E. Everette, OCA Statement 1
OCA Appendix A - Background and Qualifications of Ashley E. Everette
OCA Exhibits – AEE-1, AEE-1a, AEE-2, and attachments.

Surrebuttal Testimony of Ashley E. Everette, OCA Statement 1S
OCA Exhibit - AEE-1S

Direct Testimony of Terry L. Fought, OCA Statement 2
OCA Appendix A - Background and Qualifications of Terry L. Fought, P.E.
OCA Exhibits – TLF-1 – TLF-12

Surrebuttal Testimony of Terry L. Fought, OCA Statement 2S

Stipulation between the City of DuBois and the Office of Consumer Advocate

The following OCA Cross-Examination Exhibits were admitted into the record at the Evidentiary Hearing on November 10, 2016.

OCA Cross Exam Exhibit 1: City of DuBois response to I&E-RE-58-D

OCA Cross Exam Exhibit 2: September 2016 AUS Monthly Utility Report (Excerpt)

Appendix C
Proposed Findings of Fact,
Proposed Conclusions of Law,
and Proposed Ordering Paragraphs

## PROPOSED FINDINGS OF FACT

### RATE BASE

1. The City initially calculated a total rate base of $15,622,314 as of December 31, 2016, which is the future test year in this case. OCA St. 1 at 3; City Exh. CEH-1 at 13.

2. Of this initial total rate base, $4,493,848 is attributable to jurisdictional customers. OCA St. 1 at 3; City Exh. CEH-1 at 12.

3. In rejoinder, City witness Heppenstall made a total adjustment to rate base of $642,060. CEH-3RJ.

4. This results in a revised rate base claim of $14,980,254. City Exh. CEH-1 at 10; CEH-3RJ.

5. The City's updated jurisdictional rate base claim is $4,317,704. City Exh. CEH-3RJ.

<u>Additions to Rate Base</u>

6. City of DuBois claimed a rate base addition of $75,000 for a new heating and air conditioning system in its initial filing. City Exh. JJS-2; OCA St. 1 at 4; I&E-RB-7 (attached to OCA St. 1).

7. Ms. Everette found that the City has neither started the project, nor spent any money on the project. OCA St. 1 at 4; I&E-RB-7 (attached to OCA St. 1); OCA-V-3 (attached to OCA St. 1).

8. When the City of DuBois was asked what time frame would be required from project start date to the system being in-service, the City of DuBois answered only that it "expects to have this completed by the end of 2016." OCA St. 1 at 4.

9. While the City was asked to provide all of the information concerning this project, City witness Spanos stated that requiring information which would establish that the plant additions would be in service by the end of the future test year is "an unreasonable expectation." City St. 3R at 3.

10. The end of the Future Test Year is less than two months away and the City has not provided a start date and an estimated time-frame for the project's completion. OCA St. 1S at 4.

11. The City has not selected a vendor to complete this project. OCA St. 1S at 4.

12. Despite City witness Spanos' assertions that the projects will take less than three months to complete, City Manager and witness Suplizio provided no further updates or documentation when asked for "the estimated time from the start date until the in-service date." OCA St. 1S at 4; OCA-V-1 (attached to OCA St. 1).

13. Ms. Everette made a rate base adjustment of $17,352 which has a jurisdictional component of $5,204. Table II; OCA Exh. AEE-1S at line 2. The associated depreciation expense adjustment of $309 with a $93 jurisdictional component has also been reflected by Ms. Everette. Table II; OCA St. 1S at 4; OCA Exh. AEE-1 at line 17.

Mains Additions

14. City of DuBois' initial filing included a rate base addition of $807,500 of Mains additions and replacements in 2016. OCA St. 1 at 5.

15. In a later response to interrogatories dated September 28, 2016, the City updated the list of projected projects for 2016 to include $288,630 of additions to Mains and Accessories rather than the previously claimed $807,500. OCA St. 1 at 5; I&E-RB-8 (attached to OCA St. 1).

16. It appears that the City was no longer planning to install the remaining $518,870 of additions within the test year. OCA St. 1 at 5.

17. An adjustment to remove the $518,870 of Mains and Accessories, with a jurisdictional component of $134,585 was made by Ms. Everette. OCA St. 1 at 5. The associated depreciation expense adjustment of $1,287 with a jurisdictional component of $386 was also made by Ms. Everette. OCA St. 1 at 5-6.

18. City witness Spanos subsequently made updates to planned capital improvements relating to additions to rate base to reflect the removal of the Mains additions of $518,870 ($134,854 jurisdictional). OCA St. 1S at 1-2; City Exh. JJS-1 R.

19. As a result of the updates, OCA witness Everette removed the adjustments that she made in her direct testimony to Mains and Fire Hydrants. OCA St. 1S at 2; OCA Exh. AEE-1S. The associated depreciation expense adjustments were also removed because the amounts were removed in the City's updated claim. OCA St. 1S at 2.

20. The High Street Mains and Accessories project was not specifically included in the City's original filing. In a response to an interrogatory, however, the City specified that the High Street project would amount to $55,911. I&E-RB-8 (attached to OCA St. 1). The City claimed that it planned to complete the project during the future test year. OCA St. 1S at 2.

21. Subsequently, the City claimed that the project would be delayed until 2017. OCA St. 1S at 2. The City changed its position a third time, claiming that the project will be in service in 2016. OCA St. 1S at 2; OCA-V-2. In rebuttal, City witness Spanos stated "[t]his project will be completed in November." City St. 3R at 3-4.

22. While testifying that the project would be completed in November, the City has not provided a start date for the project, an answer as to the amount of time the project will take before it is placed into service, the percentage of the project that has been completed, or that any amount for the project has been expended to date. OCA St. 1S at 2-3. No support for this November completion month was provided and there have been no further updates to interrogatories or data requests that address the High Street project and its anticipated completion. OCA St. 1S at 2.

23. As the City has not supported these proposed rate base additions, OCA witness Everette recommended that an adjustment be made to remove the $55,911 of Mains and Accessories for this project, with a jurisdictional component of $14,531. Table II; OCA St. 1S at 3; OCA Exh. AEE-1S at line 4. The associated depreciation expense of $475,

with a jurisdictional component of $124, has also been removed by Ms. Everette. Table II; OCA St. 1S at 3; OCA Exh. AEE-1S at line 19.

Fire Hydrants

24. The City's initial filing included a rate base addition of $120,000 for Fire Hydrant additions and replacements in 2016. OCA St. 1 at 7.

25. In updated responses, the City stated that it "does not have an exact anticipated start date for these projects" and provided an updated list of projected projects for 2016 which included $56,421 of additions to Fire Hydrants rather than $120,000 of additions to Fire Hydrants. OCA St. 1 at 7.

26. Since the City is no longer planning to install the other $63,759 of additions within the test year, they should not be included for ratemaking purposes and an adjustment should be made to remove the $63,759 of Mains and Accessories with a jurisdictional component of $11,800. OCA St. 1 at 7. The associated $903 adjustment to depreciation expense, and the jurisdictional portion of $168 has also been adjusted by Ms. Everette. OCA St. 1 at 7.

27. City witness Spanos subsequently made updates to planned capital improvements relating to additions to rate base to reflect the removal of the $63,759 of fire hydrants additions. OCA St. 1S at 1-2; City Exh. JJS-1 R. The OCA, however, does not accept that the revised amount of $56,421 of additions to the fire hydrant expense is supported.

28. The High Street Project, discussed above, includes the proposed installation of fire hydrants.

29. As discussed above, work on the High Street mains project has not begun and costs for the project were removed.

30. In rebuttal, the City witness Spanos stated the High Street mains project will be completed in November. City St. 2R at 3-4.

31. City witness Spanos did not provide any support that the project will be completed in November. OCA St. 1S at 2.

32. While the City updated its claims to reflect $56,421 of fire hydrant additions, this updated amount is not supported for ratemaking purposes because it includes projects at various stages, including some projects that have not even been started. OCA St. 1 at 8.

33. Specifically, an adjustment should be made to remove the $5,769 of fire hydrants additions for the High Street mains project, with a jurisdictional component of $1,071. Table II; OCA St. 1S at 3; OCA Exh. AEE-1S at line 6. The associated $82 adjustment to depreciation expense with a jurisdictional portion of $15 has also been removed by Ms. Everette. Table II; OCA St. 1 at 8; OCA Exh. AEE-1S at line 21.

Billing, Payroll, and Accounting Software

34. The City's filing included a rate base addition of $13,341 for Office Furniture and Equipment for new billing, payroll, and accounting software. OCA St. 1S at 4; OCA. Exh. AEE-1S at line 7.

35. The City has not yet confirmed a provider for this purchase. OCA St. 1 at 9.

36. Moreover, the City has spent nothing on the project and the project has not been started. OCA St. 1 at 9.

37. The City provided no evidence that the project would be started by the end of the FTY. Instead, City witness Spanos merely claimed that requiring information that would establish that the plant addition will be in service by the end of FTY is "an unreasonable expectation." City St. 2R at 3.

38. A rate base adjustment of $13,341, with a jurisdictional component of $1,426, has been recommended by Ms. Everette since the City has not demonstrated that this software will be installed prior to the end of the future test year. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 7. The associated depreciation expense adjustment of $890, with a jurisdictional component of $254, has also been removed by Ms. Everette. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 22.

Phone System

39. The City's filing included a rate base addition of $5,833 for Office Furniture and Equipment in regards to a new phone system. OCA St. 1S at 4; OCA Exh. AEE-1S at line 8.

40. The City has spent nothing on the project, and the project has not been started. OCA St. 1S at 3.

41. The City has not confirmed a provider for this project. OCA St. 1S at 3.

42. The $5,833 claim should be excluded from rate base since costs have not yet been incurred and the future test year ends in less than 2 months. OCA St. 1S at 3-4.

43. An adjustment in the amount of $5,833, with a $1,663 jurisdictional component, should be made to reflect that fact that no costs have been incurred for a phone system. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 8. The associated depreciation expense adjustment of $389, with a jurisdictional component of $111, should also be adopted. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 23.

Cash Working Capital

44. The City's rate base claim includes a Cash Working Capital claim of $252,385. City Exh. CEH-3RJ.

45. The cash working capital claim was calculated using the formula method, or 1/8 of Future Test Year (FTY) expenses. OCA St. 1 at 11.

46. OCA witness Everette made a jurisdictional adjustment to Cash Working Capital of $9,264, in order to reflect an adjustment equal to 1/8, or 12.5%, of the adjustments she made to expenses. Table II.

47. The OCA's updated Cash Working Capital adjustment totals $9,264 for jurisdictional customers. Table II.

Deductions from Rate Base-Vacant Home

48. The City has included in rate base a home owned by the City which was previously used for the Water Treatment Plant Superintendent but is now vacant. OCA St. 1 at 28.

49. Currently, the vacant home is in rate base with a net book value of $11,116. OCA St. 1S at 13.

50. The home is vacant and is not used or useful for the provision of water service. OCA St. 1S at 29.

51. City Manager Suplizio's recommendation to City Council was to "go ahead to begin planning for demolition of the caretaker's house at the City reservoir." Tr. at 43:23-45:20.

52. The vacant home fails to meet the requirement that plant held for future use must have a definite plan of use within a specific time frame because there are no current plans regarding the vacant home and no specific time-frame has been offered by the City for the vacant home being put into use to serve ratepayers. OCA St. 1S at 13.

53. Since this home is vacant, has no specific time-frame in which it will be put into use, and is not currently used or useful for the provision of water service, the vacant home should be removed from the City's rate base. OCA St. 1 at 29; OCA St. 1S at 13.

54. The OCA submits that the $11,116 net book value of the home should be removed from rate base. Table II; OCA Exh. AEE-1S at line 9.

**REVENUES**

55. The City has made adjustments to outside-city revenues at present rates. OCA St. 1 at 28; City Exh. CEH-1 at 19, 21.

56. The City corrected the average annual bill at present from $103.55 to $310.64 for residential customers and from $397.70 to $1,193.11 for commercial customers. OCA St. 1 at 28; OCA-I-31 (attached to OCA St. 1).

57. Since the City has reflected a net customer gain in both 2015 and in 2016, this correction increases the amount of revenues at present rates by $2,920. OCA St. 1 at 28; OCA Exh. AEE-1 at line 16.

58. The City has made this revenue adjustment and it is reflected in the City's current position. City Exh. CEH-3RJ. The OCA reflects this updated position in Table I.

**EXPENSES**

Vacant Home Expenses

59. The City claimed $3,592 in expenses associated with the vacant home discussed above. OCA St. 1 at 28-29.

60. These expenses included $828 for electricity, $1,668 for heat, $240 for building repairs and maintenance, $856 of telephone expense, and $572 of depreciation. OCA St. 1 at 28; I&E-RE-15; OCA-V-12; OCA-VII-4; and OCA-VII-5 (all attached to OCA St. 1).

61. The City Manager has acknowledged that his recommendation to City Council was to plan for the demolition of the vacant home. Tr. at 43:23-45:20.

62. A $3,592 reduction for the vacant home's expense and a $572 adjustment to depreciation expense should be made, which include jurisdictional components of $1,077 and $172 respectively. See, Table II; OCA Exh. AEE-1 at lines 24-25; OCA St. 1 at 29.

Transmission and Distribution Contracting Services

63. The City claimed a pro forma expense of $132,771 for Transmission and Distribution Contractual Services, which is equal to the historical test year expense. See, Exh. CEH-1 at 16; OCA St. 1 at 29.

64. There has been a significant fluctuation in this expense from 2013 to 2015. OCA St. 1 at 29.

65. Given the significant fluctuation in this expense over the last 3 years, Ms. Everette recommended a normalization of the expense for ratemaking purposes. OCA St. 1 at 29.

66. An adjustment of $40,623 with a jurisdictional portion of $11,216 should be made. Table II; OCA St. 1S at 15; OCA St. 1 at 30; OCA Exh. AEE-1S at line 26.

Water Treatment Plant Contractual Services

67. The City incurred $101,288 of Water Treatment Plant Contractual Services expense in 2015 and made a pro forma 2016 expense claim of $51,138. OCA St. 1S at 15; City Exh. CEH-1R at 6, 10.

68. The City identified $70,300 of the 2015 expenses as recurring over a 2 to 5 year period and made the appropriate normalization adjustment. OCA St. 1S at 15.

69. The City identified an additional $8,665 as recurring annually. OCA St. 1S at 15; OCA-I-16.

70. The only component of the City's claim which is at issue is the $22,323 expense, which is the normalization of other expenses.

71. The City uses the 2015 level of expense while the OCA submits that a three year annualization period is appropriate as described below.

72. After adjusting the Watershed Inventory Management Plan and Herbicide Application that were identified and normalized, the expense in 2015 was still significantly higher than in previous years.

73. The City's original expense claim, based on the 2015 expense level, has been revised to update the $8,665 Watershed Inventory Management Plan and Herbicide Application expense to $1,200. OCA St. 1S at 16; City Exh. CEH-1 at Adjustment E6. This adjustment is reflected in the City's updated rejoinder testimony. City Exh. CEH-3RJ.

74. The expenses which OCA witness Everette normalizes do not include the herbicide application expense and the portion of the Watershed Inventory Management Plan that is an annual expense which have been appropriately normalized by City witness Heppenestall. OCA St. 1 at 32.

75. The two prior years of expenses indicate that the 2015 level of expense was not normal and for this reason OCA witness Everette recommended that a three year normalization period be used for ratemaking purposes. OCA St. 1 at 31-32.

76. Due to the extremely large fluctuation for this expense, Ms. Everette recommended that this expense be normalized and used a three year period from 2013 to 2015 to arrive at her recommended expense level of $8,338, instead of the City's position of $22,323, which results in an adjustment of $13,985. OCA St. 1 at 32.

77. There are some circumstances in which annualization can appropriately reflect a whole year of expense, such as when an expense does not vary significantly on a monthly basis.

78. The Water Treatment Contractual Services expense is not one that is incurred on a level basis throughout the year.

79. One hundred percent of the 2013 expense was recorded in one month, September 2013. OCA St. 1S at 17.

80. One hundred percent of the 2014 expense was recorded in one month, May 2014. OCA St. 1S at 17.

81. In 2015, seven percent of the expense was recorded in the first five months of the year, 93% of the expenses were recorded in the last three months of the year. OCA St. 1S at 17.

82. Using a normalized level based on the actual expenses over three years is a reasonable approach given the expenditures. OCA St. 1S at 18.

83. OCA witness Everette recommends a total expense of $29,688 rather than the City's claim of $43,673. The resulting adjustment is $13,985 with a jurisdictional component of $4,194. Table II; OCA St. 1 at 32; OCA St. 1S at 18; OCA Exh. AEE-1S at line 28.

<u>Chemicals</u>

84. The City initially claimed a pro forma expense for Chemicals of $78,107. OCA St. 1 at 32; City Exh. CEH-1 at 16.

85. The City provided invoices showing that an additional chemical in the amount of $6,400 should be added to the annual chemical expense. OCA St. 1 at 32; I&E-RE-12.

86. The OCA and the City are in agreement in regards to a positive adjustment of $6,400 with a jurisdictional portion of $1,985. OCA St. 1 at 32; OCA Exh. AEE-1 at line 29; City St. 2R at 10; City Exh. CEH-3RJ. This adjustment is reflected in both OCA Table I under adjusted pro forma present rates, and in the City's revised position. OCA Exh. AEE-1S; City Exh. CEH-1R.

City Manager's Salary

87. In the City's prior rate case settlement, the City agreed that in its next rate filing "Administrative and General expenses shall be allocated to the Water Fund on the basis of actual and measureable costs attributable to the Water Fund." City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 5.

88. Given that allocation issues were an issue of significant contention in the last case, the City had notice that support would be needed for allocated expenses in this case. OCA St. 1S at 20.

89. The City Manager could have kept timesheets but did not. OCA St. 1S at 20.

90. Since the City Manager oversees financial matters, in addition to numerous other responsibilities, a 24% allocation of the City Manager's salary, which reflects the verified allocation for treasury and finance employees to the Water Fund, is a reasonable allocation based on the limited information provided by the City. OCA St. 1 at 35.

91. The City has claimed that 55.7% of the City Manager's $124,076 annual salary should be allocated to the Water Fund, which represents a total claim of $69,093. City St. 2R at 16.

92. The City determined this allocation figure based on interviews with the City Manager and a review of City Council minutes. OCA St. 1 at 34-35; City Exh. CEH-1 at 25; Tr. at 70:21-71:3.

93. The City states that the allocation of the City Manager's salary is based on the City Manager's projections of how his time is spent. OCA St. 1 at 34.

94. The 55.7% figure is not based on timesheets since the City Manager does not maintain timesheets. OCA St. 1 at 34-35.

95. Mr. Suplizio contradicted these percentages at the evidentiary hearing when he stated that "I think 60 percent is probably on the low end." Tr. at 26:18-19.

96. Mr. Suplizio stated that despite the lack of time sheets, his estimate of the time he spends on water is "more than accurate, it's a hundred percent accurate." Tr. at 32:20-25, 33:1-2.

97. Neither of Mr. Suplizio's estimates are based on verifiable information.

98. Mr. Suplizio's duties encompass more than water treatment.

99. The City Manager's job description is three pages long and notes a wide variety of tasks that the City Manager is responsible to perform.

100. Mr. Suplizio is neither a certified water system operator nor an engineer. Tr. 36:14-23.

101. Additionally, nowhere in the City Manager's job description is there a requirement that the City Manager have any skill or knowledge specific to water or public utilities.

102. At multiple points in his rejoinder testimony, City Manager Suplizio states that water is more intense than sewer. See, Tr. 24:8-9, 24:25-25:2, 39:10-15.

103. In rebuttal, Mr. Suplizio stated that "[t]he sewer system very much runs itself with comparatively minimal staffing, whereas water operations naturally generate more work." City St. 1R at 10.

104. The sewer department has more employees than the water department. Tr. 76:18-20.

105. City Manager Suplizio does not physically repair the water leaks Tr. 37:19-23.

106. Additionally, while City Manager Suplizio stated at the evidentiary hearing that he is with the crew that does leak inspections, he is not with them for the entirety of the leak detection. Tr. 38: 24-25.

107. Mr. Suplizio stated that the City Engineer prepares DEP reports but that Mr. Suplizio reviews the reports before they are submitted to DEP. Tr. at 39:25-40:11.

108. While Mr. Suplizio says that he looks over the reports, he was unable to identify what was contained in the Chapter 110 reports. Tr. 39:25-40:22.

109. The City Manager, according to his job description, does not strictly work in tandem with the Public Works Director, as argued by the City. The Public Works Director does not have any of the above-listed responsibilities, but is instead responsible for the distribution and collection lines. Tr. 41:21-42:3.

110. The allocation of the City Manager's salary to the Water Fund should not be allocated on the basis of the Public Work Director's salary since the two jobs are not the same and as there is no verifiable basis to support the City's assertion that this allocation would be reasonable.

111. City witness Heppenstall's determination of the percentage of time that City Manager Suplizio spends on water further illustrates the speculative nature of the City Manager's salary calculations given that the basis of her testimony regarding the City Manager's salary is interviews with the City Manager. In her direct testimony, City witness Heppenstall states that "[t]he allocation percentage of 60% of the City Manager's salary (*$109,208*) is based on an interview with the City Manager in which he estimates that 60% of his time is spent on matters related to the water system." City St. 2 at 10 (emphasis added).

112. In City witness Heppenstall's rebuttal, she states that the City Manager's salary is in fact $124,076 and that $14,868 of the City Manager's salary is included in finance salaries and is allocated to the Water Fund at 24%. City St. 2R at 16; Tr. at 72.

113. City witness Heppenstall "does not provide the rationale for the two-part allocation or any documentation demonstrating the accuracy of the allocation." OCA St. 1S at 21.

114. During the evidentiary hearing, City witness Heppenstall agreed with OCA witness Everette's position that the financial portion of the City Manager's salary should be allocated to the Water Fund based on the 24% allocation factor for treasury and finance employees. Tr. at 73:5-9.

115. The City Manager's annual salary is $124,076 and City witness Heppenstall allocates 60% of the portion of the City Manager's salary which is not related to finance issues to the water fund. However, the actual total percentage of time the City Manager spends on water according to City witness Heppenstall is 55.7%, which is less than the amount of time the City Manager testified to and contradicts City witness Heppenstall's initial contention in her direct testimony.

116. The rates developed in this case apply to PUC jurisdictional customers; customers that reside outside of the City.

117. These customers do not receive any benefit from Mr. Suplizio's work in managing the City besides the time he spends on the water department. OCA St. 1S at 20.

118. OCA witness Everette recommends a 24% allocation developed for the treasury and finance employees be used to allocate the City Manager's salary as the work of the treasury and finance personnel is relevant to the City as a whole; similar to the City Manager. OCA St. 1 at 35.

119. The City agreed in the most recent 2013 settlement that all Administrative and General expenses would be allocated to the Water Fund on the basis of actual and measureable costs attributable to the Water Fund. City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 5.

120. In the next case, the City should be required to provide documentation, including timesheets, demonstrating the appropriate allocation of the City Manager's time. OCA St. 1 at 34-35.

121. Given that the City Manager oversees financial matters, in addition to numerous other responsibilities, a 24% allocation which reflects the verified allocation for treasury and finance employees to the Water Fund is a reasonable allocation based on the limited information provided by the City. OCA St. 1 at 35.

122. Ms. Everette has recommended an adjustment with a jurisdictional component of $11,209. Table II.

Administrative Expense

123. The City has claimed $58,712 for Administrative Expense and has allocated 60.3%, or $35,403 to the Water Fund. OCA St. 1 at 35.

124. Administrative expense included expenses such as credit card fees, flooring, and expense for unpaid taxes. OCA St. 1 at 36; I&E-RE-67 (attached to OCA St. 1).

125. The City determined this allocation by taking the allocation of the City Manager's and the Public Work Director's salaries, averaging these allocations together, and thereby reaching a conclusion that it would be logical to allocate expenses related to their work in the same manner as their salaries are allocated. OCA St. 1 at 36.

126. Charging 60.3% of administrative expenses to the Water Fund would be inappropriate. As discussed above, 60% is not an appropriate allocation for the City Manager's salary.

127. If 60.3%, or $35,403, of this account were allocated to the Water Fund, it would leave only 39.7%, or $23,309, of administrative expense for all other City functions. OCA St. 1 at 36.

128. The general ledger showing a breakdown of this expense indicates that of the $58,712 expense in 2015, $9,958 was related to the City's fire department, $3,601 was for unpaid taxes on properties that were abandoned or sold by "sheriff sale", and $18,908 was for the removal of a blighted property. OCA St. 1 at 36.

129. $32,467 (55.3%) of this expense account is identifiable as specifically related to non-Water-related functions of the City. These City-level functions such as blighted property

removal are completely unrelated to the provision of water service, such that no portion of these expenses should be charged to the Water Fund.

130. Given that 55.3% of this account should not be charged to the Water Fund even as an allocated expense, it would not be appropriate to charge 60.3% of the total expense to the Water Fund.

131. OCA witness Everette reviewed the expenses charged to this account for 2013, 2014, and 2015 and determined that the expenses that appear reasonable and appropriate to allocate a portion to the Water Fund are the credit card and banking fees. OCA St. 1 at 37.

132. In 2015, this expense totaled $11,836. OCA St. 1 at 37.

133. City witness Heppenstall clarified in rebuttal that the credit card fees were only applicable to the Water and Sewer customers and Ms. Everette accepted this clarification. OCA St. 1S at 23.

134. Part of the claimed expense was for an electric vendor not related the Water fund. City witness Heppenstall removed $2,323 of the expense related to the electric vendor during her rejoinder. City Exh. CEH-3RJ.

135. While OCA accepts the dollar amount of the adjustment, the OCA disagrees with the use of a 33% allocation factor. Table II.

Engineering

136. The City and OCA are in agreement regarding the City's need to adjust its initial claim for Engineering expense. City St. 2R at 21.

137. The City initially claimed total allocated expenses of $60,914 for Engineering, which included salary, health insurance, FICA, unemployment compensation and benefits. OCA St. 1 at 38.

138. The City made two corrections to this expense in response to interrogatories by updating the allocation factor from 47.5% to 45.6%, and by stating that a portion of the expense was erroneously included in Engineering rather than in Finance. OCA St. 1 at 38.

139. Since the allocator for Finance salaries is 24%, the total of this expense was updated from $60,914 to $57,882. OCA St. 1 at 38.

140. OCA witness Everette recommended an adjustment of $3,032, with a jurisdictional portion of $864, to reflect the corrections provided by the City. OCA St. 1 at 39; OCA Exh. AEE-1 at line 33.

Engineering Contracted Services

141. The City and OCA are in agreement regarding the City's need to adjust its initial claim for Engineering Contracted Services expense. City St. 2R at 21.

142. The City initially claimed an expense of $27,849 for Engineering Contracted Services Expense and allocated 47.5%, or $13,233, to the Water Fund. OA St. 1 at 39.

143. The initial allocation factor of this expense was the 47.5% allocation factor of the City Engineer. OCA St. 1 at 39.

144. The City subsequently updated this allocation factor to 45.6% in response to an I&E interrogatory. OCA St. 1 at 39.

145. A review of the general ledger provided in response to an I&E interrogatory showed that $17,453 of the $27,859 expense, or 63% of this expense, was for the City's mobility studies, transportation planning, or sewer operations. OCA St. 1 at 39-40.

146. None of these expenses should be allocated in any way to water. OCA St. 1 at 40.

147. Accordingly, OCA witness Everette recommended an adjustment of $10,507, with a jurisdictional portion of $2,996. OCA St. 1 at 40; OCA Exh. AEE-1 at line 34. City witness Heppenstall accepted this adjustment in rebuttal. City St. 2R at 21; City Exh. CEH-1R.

Postage

148. The City and OCA are in agreement regarding the City's need to adjust its initial claim for Postage expense. City St. 2R at 7.

149. The City initially claimed a total Postage expense of $37,321, of which $20,154 was allocated to the Water Fund. OCA St. 1 at 40; City Exh. CEH-1 at 25. This ratio was based on the ratio of Water bills to total Water and Sewer bills. OCA St. 1 at 40; City Exh. CEH-1 at 25, note e.

150. In response to an I&E interrogatory, the City stated that the postage for Water and Sewer bills is $24,000 per year and that "[t]he balance of the postage is for other City purposes." OCA St. 1 at 4; I&E-RE-46 (attached to OCA St. 1).

151. OCA witness Everette recommended that "only $24,000 should be allocated using the ratio of Water bills to total Water and Sewer bills." OCA St. 1 at 40. This results in an updated annual expense of $12,960 rather than the initially claimed expense of $20,154. OCA St. 1 at 40.

152. This update results in a $7,194 adjustment with a jurisdictional portion of $1,163. OCA St. 1 at 40; OCA Exh. AEE-1 at line 35.

<u>City Buildings: Computer Parts/Supplies/Software</u>

153. The City calculated a total City Buildings expense of $213,227 based on the 2015 expenses for this account and allocated 24%, or $51,174, to the Water Fund. OCA St. 1 at 41.

154. The expenses in 2013, 2014, and 2015 were $186,119, $175,306, and $213,227, respectively. OCA St. 1 at 41.

155. The 2015 expense is 22% higher than the 2014 expense and is 15% higher than the 2013 expense. OCA St. 1 at 41.

156. A breakdown of this expense showed that the primary increase in 2015 was to a computer parts account. OCA St. 1 at 41.

157. The 2015 expense was 173% more than the 2013 expense and 141% more than the 2014 expense. OCA St. 1S at 24.

158. The City provided general ledger entries for the computer parts account which showed that the reason for the increase in 2015 was due to the fact that payments to vendor "RAK Computer Associates" increased from $45 in 2013, to $1,127 in 2014, to $23,116 in 2015. OCA St. 1 at 41.

159. This is a significant increase, as the 2015 expense is over 20 times as much as the 2014 expense. OCA St. 1 at 41.

160. In rebuttal, City witness Heppenstall provided a list of expenses from 2015 which she testified "clearly show that the expense items in this account related to ongoing computer needs of the City." City St. 2R at 22. However, City witness Heppenstall does not provide any explanation as to why the expense more than doubled in one year. OCA St. 1S at 24.

161. There is no support to indicate that the increased expense in 2015 is an ongoing expense. OCA St. 1S at 24. As such, it is appropriate to normalize the expense as it is significantly higher than a normal year of expense. OCA St. 1 at 41; OCA St. 1S at 24.

162. For these reasons, OCA witness Everette recommends that a three-year normalization period be used, which results in an annual expense for the Computer Parts Supplies Software account of $28,011; a reduction of $19,191. OCA St. 1 at 41-42; OCA St. 1S at 24. Utilizing the City's 24% allocation factor results in an adjustment of $4,606 to this account with a jurisdictional component of $1,313. Table II; OCA St. 1 at 42; OCA Exh. AEE-1; OCA St. 1S at 24; OCA Exh. AEE-1S at line 36.

Pension Expense

163. The OCA and the City are in agreement in regard to the City's Pension expense.

164. The City initially claimed total pension expense of $225,233, with 15%, or $33,785 allocated to the Water Fund. OCA St. 1 at 42; City Exh. CEH-1 at 25.

165. The 15% allocation was based on the number of Water Fund employees compared to total City employees. OCA St. 1 at 42. This claimed level of pension expense included

both police and non-uniform pensions and reflects state and county aid received by the City. OCA St. 1 at 42.

166. The City's initial total pension expense accounts for the 53 City employees, of which 8 are Water Fund employees, 16 are full-time police officers, and the remaining 29 are other City employees. OCA St. 1 at 43.

167. Combining police pensions with non-uniformed employee pensions distorts the total pension expense for the non-uniformed City employees. OCA St. 1 at 43.

168. The appropriate amount of pension expense is calculated by allocating State and County Aid across the board. OCA St. 1 at 43.

169. 22% of the pension expense, after state and county aid, should be allocated to the Water Fund based on the ratio of 8 Water Fund employees to 37 total City employees provided by the City in a response to an OCA interrogatory. OCA St. 1S at 25.

170. Using the 22% allocation factor, Ms. Everette initially recommended an allocation of $9,207 to the Water Fund, with a jurisdictional portion of $7,078. OCA St. 1 at 44; OCA St. 1S at 25. This represented a $24,758 adjustment to the City's claim of $33,785. OCA St. 1 at 44.

171. In rebuttal, City witness Heppenstall accepted the premise of this adjustment. OCA St. 1 at 25; City St. 2R at 23-24.

172. City witness Heppenstall, however, stated that the number of water employees shown in the response to an I&E interrogatory should be used which shows 9 water employees rather than the 8 water employees shown in response to an OCA interrogatory. OCA St. 1S at 25; OCA St. 2R at 23.

173. At the evidentiary hearing, City witness Heppenstall confirmed that there are 9 water department employees. Tr at 76:18-20.

174. This increases the percentage of Pension expense to be allocated to the Water Fund to 24% from the originally calculated 22%. OCA St. 1S at 25. The City's revised expense claim is $10,020. OCA St. 1S at 25.

Rate Case Expense

175. The City claims $225,505 of rate case expense normalized over a 2.5 year period, for an annual expense of $90,202. OCA St. 1S at 27.

176. The OCA has not recommended any adjustment to the level of expense claimed, but does recommend an adjustment to the 2.5 year normalization period proposed by the City.

177. The OCA submits that a 5 year normalization period is appropriate based on the City's historical filing frequency.

178. City witness Heppenstall stated that the 2.5 year normalization period is based on "the recent history of City filings" and "expectations of the City regarding future filings." OCA St. 1 at 45.

179. In addition to the current case filed on June 30, 2016, the City has acknowledged that its three previous cases were filed in March 2013, October 2005, and August 1996. OCA St. 1 at 45.

180. These cases were filed 3, 9, and 7 years apart respectively, which is not indicative of a 2.5 year normalization period. OCA St. 1 at 45.

181. Even the most recent case does not support a 2.5 year normalization period as the most recent case and the present filing are separated by 3.25 years. OCA St. 1 at 45.

182. OCA witness Everette recommends that a 5 year normalization period be used for rate base expense. OCA St. 1 at 45.

183. The City's last rate case was in 2013, three years prior to this case. The case before that was in 2005, or seven years prior, and the case before that was filed nine years before, or in 1996. OCA St. 1 at 45.

184. The average time between City of DuBois's last three rate filings is more than six years. OCA St. 1 at 45. In fact, the City's average historical filing history in the last three cases is 6.61 years. OCA St. 1 at 45.

185. If the 1996 case is eliminated from the calculation, the average filing frequency is 5.33 years. OCA St. 1 at 45.

186. Using the estimated total rate case expense of $225,505, the annual normalization amount is $45,101. Table II.

187. This adjustment includes the full level of rate expense claimed by the City ($225,505), and as of the update provided on August 15, 2016, the City has spent $105,201 on rate case expense.

188. The previous 2013 rate case, however, was a black box settlement in which particular adjustments, including a rate case normalization period, were not agreed upon. 2013 Settlement, Docket No. R-2013-2350509 at Paragraph 7; OCA St. 1S at 26.

189. City witness Heppenstall does not explain why the 9 month suspension period, while rates are still in effect, is excluded from her calculation. OCA St. 1S at 26.

190. The rates established in the previous case will be effective for 3.25 years, which is longer than the normalization period proposed by the City in its previous case or in this case. OCA St. 1S at 27.

191. There are many reasons that the City may alter the timing of its filing of rate cases. Although Ms. Heppenstall's testimony focused on what percentage of rate case expense the City would recover if it chose to file earlier than the rate case normalization period, it is important to understand that the reverse is also true. If the City waits longer than the normalization period before filing its next rate case, it will continue to collect the annual rate case expense as part of annual revenues."

192. The City's rate case expense must accurately reflect the City's filing history.

193. Since the average historical period of time between the City's last three rate cases is more than five years, it is reasonable and appropriate to use a five year normalization period to ensure consistency with past Commission precedent.

**RATE OF RETURN**

194. Each of the capital structure components is identifiable and directly relates to the Company's facilities which are included in the rate base upon which the City seeks to earn a return. OCA St. 1 at 13-16; OCA St. 1S at 5-8.

195. The OCA used the 3.02% cost of debt claimed by the City. OCA St. 1 at 12.

196. The 8.25% cost of equity recommended by Ms. Everette is the result of the DCF analysis

197. The midpoint of a DCF range of 7.5% to 9.0% is 8.25%. OCA St. 1 at 12-13, 16-23; OCA St. 1S at 9-11.

198. Ms. Everette applied a tax factor adjustment of 20% based on prior Commission decision, to arrive at a tax factor adjusted cost of equity of 6.60%. OCA St. 1 at 12-13, 23.

199. The OCA's overall cost of capital is 4.09%. OCA St. 1 at 27; Exh. AEE-2.

200. The OCA recommends a capital structure of 70% debt/30% equity which reflects the financing used by the City for its future test year level of rate base. OCA St. 1 at 15.

201. Capital structure is the type and percentages of capital supplied by investors.

202. There are two basic types of capital used by utilities: debt and equity.

203. The City's per books capital structure of 0% debt/100% equity reflects the fact that the City is run on a cash basis.

204. Under cash accounting, the bonds and notes that are used for Bureau of Water do not exist as "cash" at the end of the future test year, because they would have been reported as "cash" only on the day they were issued. OCA St. 1 at 14.

205. The outstanding debt for the Bureau of Water at December 31, 2016 is $10,738,268 and the fund equity, according to the most recent audited financial statement is $46,488. OCA St. 1 at 14.

206. Using outstanding debt and the fund equity shown in the most recent audited financial statement results in a 99.6% debt/0.4% equity capital structure. OCA St. 1 at 14-15.

207. This is the best information that the City made available. OCA St. 1S at 5.

208. The City does not calculate equity on an accrual basis, so the equity amount shown in the audited financial statements is the only available amount. OCA St. 1S at 5.

209. The debt level on an accrual basis, is the best information to establish the actual debt level.

210. There is $8,458,809 of debt in 2014. OCA St. 1S at 6; City Exh. _HW-1.

211. The City's claimed total rate base as of rebuttal is $14,981,586 at December 31, 2016. OCA St. 1S at 6.

212. Subtracting total debt at December 31, 2016 of $10,738,268 results in $4,243,318 of what could be considered "equity", *i.e.*, the amount of rate base that was not funded by debt. OCA St. 1S at 6.

213. The resulting capital structure is 71.7% debt/28.3% equity. OCA St. 1S at 6.

214. A capital structure of 70% debt/30% equity is appropriate for ratemaking purposes. OCA St. 1 at 14-15.

215. Debt is generally considered to be a lower-cost source of capital than equity. OCA St. 1 at 14.

216. In a municipal situation, low-cost bonds are available for financing. OCA St. 1 at 14.

217. The Bureau of Water's debt has an average cost of 3.02%, while the claimed cost of equity is 10.5% (more than three times the cost of debt). OCA St. 1 at 14.

218. It is not appropriate to treat debt as if it were equity as this would force ratepayers to pay a higher cost than the Bureau of Water is actually incurring for its financing needs because the cost of equity claimed is approximately three times the cost of debt. OCA St. 1 at 14.

219. Using the overall rate of return of 6.76% claimed by the City and applied to its pro forma capital structure, with its cost rates, would result in an excessive 14.98% return on equity (ROE). OCA St. 1 at 15-16.

220. The City proposes a common equity cost rate of 10.50%, I&E 8.62% and the OCA 8.25%. City Exh. 4, Sch. 1; I&E St. 1 at 5; OCA St. 1 at 15.

221. OCA used the Discounted Cash Flow (DCF) method to estimate the cost of equity for the Bureau of Water. OCA St. 1 at 16.

222. Ms. Everette derived a DCF equity cost rate range of 7.50%-9.00% and recommended the midpoint of the range, 8.25% as appropriate for the Bureau of Water. OCA Exh. AEE-2, Sch. 1.

223. OCA's recommended 8.25% return on equity is in line with results of the DCF analysis and with current economic conditions.

224. The Bureau of Water, as a municipal utility, is not a publicly traded company, thus it is necessary to use a group of proxy companies as a substitute for the City to determine the City's cost of equity. OCA St. 1 at 16.

225. Ms. Everette noted that capital attraction needs for municipal utilities are not subject to the same market forces as investor owned utilities. OCA St. 1 at 17.

226. The income from municipal bonds is not taxable which affects the return that an investor requires, compared to the return required on an investor-owned utility's financing. OCA St. 1 at 17.

227. Unlike investor-owned utility bonds, general obligation bonds issued by a municipality are generally backed by the taxing power of the municipality, which decreases risk to the investor. OCA St 1 at 17.

228. Ms. Everette's proxy group consists of nine water companies from the group of water utility companies covered by Value Line. OCA Exh. AEE-2, Sch. 2.

229. OCA's proxy group is the same as the proxy group used by Company witness Walker with one difference-he did not include Artesian Water. See City St. 4 at 10.

230. Ms. Everette used the quarterly compounding version of the DCF model. OCA St. 1 at 17-18.

231. The $P_o$ is the average daily closing stock price for each company for the most recent three month period (June 2016-August 2016). OCA St. 1 at 17-18.

232. The $D_o$ is the current annualized dividend rate for each company. OCA St. 1 at 17-18.

233. Ms. Everette used the average daily closing price over a 3-month period to smooth the day to day fluctuations in the market to determine $P_o$. OCA Exh. AEE-2, Sch. 4, p. 1.

234. The average dividend yield is 2.3% for the proxy group, while the median adjusted yield is 2.2%. OCA St. 1 at 18.

235. The growth rate attempts to estimate the growth expected by investors. OCA St. 1 at 18.

236. Investors do not all use the same growth rate or apply the same weight to the various growth estimates. OCA St. 1 at 18.

237. Ms. Everette used five indicators of growth: historical (five-year average) earnings retention, or fundamental growth; five-year average historic growth in earnings per share ("EPS"), dividends per share ("DPS"), and book value per share ("BVPS"); projected earnings retention growth; projections of EPS, DPS, and BVPS; and, five-year projections of EPS growth as reported by Thomson First Call (formerly I/B/E/S). OCA St. 1 at 19.

238. Analyst projections of growth may be overstated, while historical growth may not equal future growth rates. OCA St. 1 at 19

239. Ms. Everette's analysis considered both historic and projected growth rates to develop her DCF based cost of equity range. OCA St. 1 at 19.

240. The five year average historical retention growth rate is 3.8%. OCA St. 1 at 19.

241. The five year average historical growth rate of earnings per share, dividends per share and book value per share is 6.2%. OCA St. 1 at 19.

242. The five year average projected retention growth rate is 4.8% and the average projected growth rate for the period 2013-2015 to 2019-2021 is 5.5%. OCA St. 1 at 20.

243. The average projected earnings per share growth rate for the proxy group is 6.5%. OCA St. 1 at 20; OCA Exh. AEE-2, Sch. 4, p. 4.

244. The average of each of the five growth analyses are in the range of 3.8% to 6.5%. Exhibit AEE-2, Sch. 4, page 4.

245. The median of each of the five growth analyses are in the range of 3.5% to 6.8%. Exhibit AEE-2, Sch. 4, page 4.

246. Ms. Everette determined an appropriate growth rate range of 5.2% to 6.7%. OCA St. 1 at 20.

247. Ms. Everette determined that a proper DCF cost of equity is in the range of 7.5% to 9.0%. OCA St. 1 at 20; Exh. AEE-2, Sch. 4, p. 4.

248. Investors in investor-owned utilities have income taxes associated with dividends and capital gains, and thus require a higher equity return than if the dividends and capital gains were tax exempt. OCA St. 1 at 21.

249. The equity returns required by investors in investor-owned utilities implicitly reflect a provision for the income taxes that the investor pays. OCA St. 1 at 21.

250. City witness Walker recommended a 9% tax factor adjustment if an adjustment is made by the Commission. OCA St. 1 at 22.

251. The 9% tax factor recommended by City witness Walker does not consider that there are multiple other reasons for differences in yields between general obligation bonds and similarly rated investor-owned public utility bonds. OCA St. 1 at 20.

252. It is not reasonable to calculate the income tax effect by comparing the yields of the two types of bonds. OCA St. 1 at 22.

253. The Commission has used a tax factor of 20% based on the marginal tax rate of the largest block of municipal investors. OCA St. 1 at 22.

254. The 20% tax factor adjustment is still appropriate because income tax rates have not changed materially since the Commission's Order in Lancaster 2011. OCA St. 1 at 23.

255. The OCA's cost of equity range for the City, adjusted by the 20% tax factor, is 4.8%-5.76%. OCA St. 1 at 23.

**MISCELLANEOUS ISSUES**

Stipulations

256. City/OCA Stipulation 1 provides: In future rate cases, the City will provide UFW Calculations in the format shown on Exhibit TLF-1 that is used by water utilities in submission of their Annual PUC Reports.

257. OCA witness Fought recommended that the City provide UFW calculations in the format shown in Exhibit TLF-1 which is used by water utilities in submission of their Annual PUC Reports. OCA St. 2 at 7; OCA St. 2S at 5.

258. The City was not using the PUC procedure in section 500 of the PUC Annual Report forms for public water utilities for calculating UFW. OCA St. 2 at 3.

259. The OCA and the City are in agreement that in future rate cases, the City will provide UFW Calculations in the format shown in Exh. TLF-1 which is used by water utilities in the submission of their Annual PUC Reports. City OCA Stipulation at ¶ 1.

260. The City/OCA stipulation 1 addresses this concern.

261. City/OCA Stipulation 2 provides: "Within six months of a final order in this case, the City will install water meters on all water service lines connected to the Public Works Garage, City Municipal Building, Waste Water Treatment Plant, Public Library, City Pool, and the five Fire Halls. The Water Treatment Plant may not need metering if the water is withdrawn prior to the metering of the flow into the distribution system."

262. Mr. Fought recommended that the City install water meters in the city facilities. OCA St. 2 at 8; OCA St. 2S at 5.

263. In response to an OCA interrogatory, the City stated that the volume of water used for the category "other" was estimated by assuming that each of the eleven municipal buildings used 500 gallons per day. OCA St. 2 at 7; Exh. TLF-9; OCA-IV-7.

264. OCA expert witness Fought raised concerns regarding the estimations. OCA St. 2 at 3-5. During Mr. Fought's site visit on October 3, 2016, the City Manager and the City Engineer explained that, to the best of their knowledge, there is not any unusual construction problem that would prevent the metering of all of the City buildings. OCA St. 2 at 7.

265. The City/OCA stipulation 2 addresses this concern.

266. City/OCA Stipulation 3 provides: "Within two months of the final order in this case, the City should require each of the Fire Companies to submit a monthly written estimate of the unmetered water used and what it was used for."

267. OCA witness Fought recommended that the Fire companies should submit monthly written estimates to the City in order to properly measure UFW. OCA St. 2 at 8; OCA St. 2S at 5.

268. Mr. Fought raised concerns regarding how the City estimated and accounted for unmetered water use to the nearest 1 million gallons. OCA St. 2 at 3-5.

269. Mr. Fought noted as follows regarding the use of estimations: "[O]n Exhibit TLF-4, the City has estimated the Accounted For Water (Unmetered) Use to the nearest 1 million gallons per year for 'Fire Department Use', 'Water Line Construction' and 'Other'. In some cases, the estimated volumes are the same for more than one year…In my experience such rounding and consistency of using the same numbers for more than one year is unusual in UFW calculations. This indicates that some of the City's volumes of unmetered uses may be educated guesses instead of reasonably accurate estimates taken at the time the use occurred."

270. The City Manager explained that in addition to cleaning their own parking lots, the Fire Department sometimes cleans private parking lots as part of fireman training exercises. OCA St. 2 at 4.

271. OCA witness Fought was concerned that "[i]t appears that the City does not have information from the fire companies that would provide a reasonable estimate of the unmetered water used by each company." OCA St. 2 at 5.

272. The City/OCA stipulation 3 addresses this concern.

273. City/OCA Stipulation 4 provides: "Upon entry of a final order in this case, the City will estimate (at the time the repair is made) the water loss of each waterline/service line leak or break that was repaired."

274. OCA witness Fought recommended that the City estimate water loss for line breaks and repairs. OCA St. 2 at 8; OCA St. 1S at 5.

275. This recommendation was based on OCA witness Fought's concerns regarding the City's estimation of UFW discussed above and is intended to lead to greater accuracy in measuring the level of UFW. See generally, OCA St. 2 at 2-7.

276. The City/OCA stipulation 4 addresses OCA's concerns regarding the calculation of UFW.

277. City/OCA Stipulation 5 provides: “Upon entry of a final order in this case, the City will provide metered location(s) for use by the street sweeper and fire companies for their non-firefighting uses.”

278. As mentioned above, OCA witness Fought expressed concerns regarding UFW in relation to the City’s Fire Companies. See, OCA St. 2 at 4 (“the Fire Department sometimes cleans private parking lots as part of fireman training exercises”).

279. OCA witness Fought also expressed concern that the City claimed its one street sweeper used 250,000 gallons per year for street cleaning and 200,000 gallons per year for parking lot cleaning. OCA St. 2 at 5.

280. OCA witness Fought stated that “using almost as much water for parking lot cleaning as street cleaning seems unusual because the area covered by the streets is much larger than the area of the parking lots. OCA St. 2 at 5.

281. Parking lot cleaning was also included in the Fire Department usage. OCA St. 2 at 5.

282. The City/OCA stipulation 5 addresses OCA’s concerns regarding the calculation of UFW.

283. City/OCA Stipulation 6 provides: “The City will prepare a script for customer service complaints made via telephone, requiring the responding City representative to obtain the customer name, customer address, and a description of the service issue.” City/OCA Stipulation at ¶ 6.

284. City/OCA Stipulation 7 provides: “The City will preserve a record of customer service complaints received via telephone. The Complaint logs should include the names and addresses of the complainants, the date and character of the complaint, and the final disposition of the complaint.” City/OCA Stipulation at ¶ 7.

285. In his direct testimony, OCA witness Fought expressed concerns regarding the City’s lack of a complaint log. OCA St. 2 at 8.

286. At the time of Mr. Fought's direct testimony, the City did not keep a record of complaints from jurisdictional customers. OCA St. 2 at 8.

287. The number of water quality and service complaints received by the City from jurisdictional customers by phone calls or other non-written methods during the years 2013, 2014, 2015 and 2016 to date is unknown. OCA St. 2 at 8; OCA Exh. TLF-10.

288. Ongoing records are important information since they show whether customers have quality of service issues and because they would show what steps the City took to remedy customer complaints and whether the City responded in a timely manner. OCA St. 2 at 8.

289. Mr. Fought had the following recommendations in his direct testimony: "First, the City should keep records of complaints as required by the Commission in accordance with 52 Pa. Code § 65.3. The City should maintain a written log of all complaints received from jurisdictional customers. The complaint logs should include the names and address of the complainants, the date and character of the complaint and the final disposition of the complaint. Second, the phone number listed on the City's bills should be used to log complaints by the jurisdictional customers."

290. Subsequent to the filing of OCA witness Fought's direct testimony, Mr. Fought was made aware of complaints made to OCA by jurisdictional customers via telephone. OCA St. 2S at 3-4.

291. The reported existence of complaints being made to the City was in contradiction to what OCA witness Fought was told by City witness Suplizio during OCA witness Fought's site visit. OCA St. 2 at 3-4.

292. In his rebuttal, City witness Suplizio stated that: "[o]f course, some residents at times approach known City employees informally to address minor service inquiries. Such is the nature of life in a small city like DuBois. However, if a resident sent a written Complaint to the City, the City would certainly keep original correspondence with a record of the ensuing investigation. But the City should not be expected to track every phone call or record every instance of a customer flagging down a City employee in public spaces. To the contrary, the City's customer service record should be referenced

as a justification for providing the City with sufficient revenue to continue providing customers with exemplary service and high quality water." City St. 1R at 11.

293. In surrebuttal, OCA witness Fought re-iterated the importance of keeping complaint logs. OCA St. 2 at 4. "The City should not disregard a consumer complaint regarding water quality because the complaint was made in-person or over the telephone as opposed to in a formal writing." OCA St. 2 at 4.

294. The stipulations require the City to keep complaint logs for all forms of contact with the City.

295. The OCA accepts the City's stipulations relating to consumer compliant logs being kept for all consumer contact with the City regarding water service.

296. City/OCA Stipulation 8 provides: "The City will exercise all isolation valves in the jurisdictional area prior to October 2017 and subsequently submit a schedule to the OCA and other parties for repairing or replacing all isolation valves that could not be exercised."

297. In response to OCA interrogatories, the City indicated that there are 105 isolation valves installed in the jurisdictional areas but that none of the isolation valves have been exercised in the past 5 years. OCA St. 2 at 9.

298. The City does not know if any of these isolation valves need to be repaired or replaced. Id.; OCA Exh. TLF-11.

299. In his direct testimony, OCA witness Fought testified as to the importance of exercising isolation valves to prevent the valves from seizing-up and getting stuck from corrosion or other deposits adjacent to the valves. OCA St. 2 at 9-10.

300. Mr. Fought testified: "An isolation valve that cannot be fully closed will increase the water loss during a water main break and increase the number of customers affected." OCA St. 2 at 10.

301. Mr. Fought recommended that isolation valves be exercised in a routine manner as part of a maintenance program. OCA St. 2 at 10; OCA St. 2S at 6.

Sales to Shale Gas Companies

302. In 2013, a settlement was entered into between the City and the OCA regarding rate base.

303. In this 2013 Settlement, which was previously the City's most recent base rate case before the immediate case, the City agreed to "include any and all revenues from water service contracts received from shale gas exploration or drilling companies (and volumes delivered thereto), during a given year, in future annual reports filed with the Commission." 2013 Settlement, Docket No. R-2013-2350509 at 6.

304. Reporting gas driller sales separately does not impose an additional burden on the City because the City will already be filing its Annual Report with the Commission, and volumes and sales revenues for any such sales in the prior year are available to the City at the time the annual report is filed. OCA St. 1S at 28.

305. The volumes and sales revenues for the driller sales is relevant because the City charges above-tariff rates for these sales. OCA St. 1S at 28.

306. At the evidentiary hearing Mr. Suplizio stated that the City will continue to report sales of water to shale gas companies in its annual reports. Tr. at 22-23, 32.

307. The sales information should be available and publicly recorded for review in future rate cases, as was previously agreed upon in the previous settlement.

308. The City should continue to report sales to shale gas companies in its annual reports.

Sales of Water to the Borough of Falls Creek

309. The City initially included a rate base claim for the addition of a waterline intended to be used to serve Falls Creek. OCA St. 1 at 46; I&E-RB-8 (attached to OCA St. 1).

310. In response to a Sandy Township interrogatory, the City stated that it "planned a line extension to serve the Borough of Fall [sic] Creek…However, this extension will not be

completed as originally anticipated and the expense will be removed from rate base." OCA St. 1 at 46.

311. Although the City initially included the cost of this main extension in its filing, the City did not include any revenues from sales to Falls Creek. OCA St. 1 at 46.

312. If the extension of sales for resale service to Falls Creek occurs after the end of the FTY, neither costs nor revenue would be included for ratemaking purposes in this case. OCA St. 1S at 47.

313. As service to Falls Creek would potentially create additional revenue, the OCA recommends that the City be required to inform the Commission when it connects Falls Creek and begins service. OCA St. 1S at 47.

314. The OCA recommends that the City be required to provide the following: 1) The date service began, 2) The annual number of gallons to be sold to Falls Creek, 3) The rate to be charged per thousand gallons, 4) The expected annual customer charge revenue and, 5) A copy of the contract with Falls Creek. OCA St. 1 at 47.

<u>Evidentiary Motion</u>

315. At the evidentiary hearing, the City made an oral Motion to Strike testimony in OCA Statement Number 2S from page 3, line 19 to page 4, line 17.

316. In the disputed testimony, OCA expert Fought is asked "[c]an you provide an example of why it is important to have the information you described above [referencing a complete log of complaint which includes telephonic complaints]?" OCA St. 2S at 3: 19-21. In response, Mr. Fought states that he was made aware of complaints regarding water quality.

317. Mr. Fought includes the disputed answer in his testimony as a part of his basis as to why a complaint log which accounts for telephonic complaints to the City is necessary for the City to maintain high water quality standards.

318. All of Mr. Fought's statements in this section of his surrebuttal testimony regarding customer contact specifically state that he received reports or was informed by customers of water quality issues.

319. At no point in this section does Mr. Fought state that the City of DuBois in fact has water quality issues.

320. When Mr. Fought spoke to Mr. Suplizio during his site visit on October 3, 2016, he was assured that no water quality issues exist. OCA St. 2S at 3.

321. However, Mr. Fought was made aware of jurisdictional customers who claim that they have contacted the City with water quality issues. OCA St. 2S at 3-4.

## PROPOSED CONCLUSIONS OF LAW

1. The Pennsylvania Public Utility Commission ("Commission") has jurisdiction over the Parties and subject matter of this proceedings. 66 Pa.C.S. § 101, *et seq.*

2. A public utility seeking a rate increase has the burden of proof to establish the justness and reasonableness of each element of its request. 66 Pa.C.S. § 315(a).

3. City of DuBois-Bureau of Water, for the service to customers outside of its municipal boundary, is a public utility as defined in Section 102 of the Public Utility Code. 66 Pa. C.S. § 102.

4. The Commission has jurisdiction over the parties and subject matter in this proceeding.

5. The utility requesting the rate increase has the burden of proving that the rate involved is just and reasonable. 66 Pa. C.S. §§ 315 (a), 1301, and 1308(e).

6. Regardless of the method used, the rates must be just and reasonable. 66 Pa. C.S. § 1301.

7. The Commission must consider managerial efficiency and effectiveness and the adequacy of service in setting just and reasonable rates. 66 Pa. C.S. §§ 523, 526, and 1501.

8. The City has not sustained its burden of proving that additional annual revenue of $229,551 is just and reasonable.

## PROPOSED ORDERING PARAGRAPHS

It is hereby ORDERED THAT:

1. City of DuBois-Bureau of Water, shall not place into effect the rates contained in Supplement No. 22 to Tariff Water-Pa. P.U.C. No. 4, which have been found to be unjust, unreasonable and, therefore, unlawful.

2. City of DuBois-Bureau of Water, is hereby authorized to file tariffs, tariff supplements, or tariff revisions containing rates, provisions, rules and regulations, consistent with the findings herein, to produce revenues not in excess of $50,418.

3. The tariffs, tariff supplements, or tariff revisions may be filed upon less than statutory notice, and pursuant to the provisions of 52 Pa. Code §§53.31 and 53.101, may be filed to be effective for service rendered on and after the date of entry of this Commission's Opinion and Order.

4. City of DuBois-Bureau of Water, shall file detailed calculations with its tariff filing, which shall demonstrate to this Commission's satisfaction that the filed rates comply with the proof of revenue, in the form and manner customarily filed in support of compliance tariffs.

5. City of DuBois-Bureau of Water, shall comply with all directives, conclusions and recommendations contained in this Commission's Opinion and Order that are not the subject of individual ordering paragraphs as fully as if there were the subject of specific ordering paragraphs.

6. City of DuBois-Bureau of Water, shall cause all future rate filings to comply with 52 Pa. Code § 53.53(c).

7. City of DuBois-Bureau of Water, shall allocate the authorized increase in operating revenues to each customer class and rate schedule within each class in the manner set forth in this Order.

8. The Complaints filed by the various parties to this proceeding at Docket Number R-2016-2554150 are granted in part and denied in part, to the extent consistent with this Commission's Opinion and Order.

DATE:________________________ ________________________________

Mark A. Hoyer

Administrative Law Judge

227496

Appendix D
Unpublished Cases

**PENNSYLVANIA**
**PUBLIC UTILITY COMMISSION**
**Harrisburg, PA 17105-3265**

Public Meeting held December 21, 2006

Commissioners Present:

Wendell F. Holland, Chairman
James H. Cawley, Vice Chairman
Kim Pizzingrilli
Terrance J. Fitzpatrick

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|---|---|---|
| Pennsylvania Public Utility Commission | : | R-00061297 |
| | : | R-00061297C0001-C0003 |
| v. | | |
| Emporium Water Company | | |

## OPINION AND ORDER

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**BY THE COMMISSION:**

Before the Commission for consideration and disposition is the Recommended Decision of Administrative Law Judge (ALJ) Cynthia Williams Fordham, issued on October 26, 2006, relative to the above-captioned general rate increase proceedings, and the Exceptions and Replies filed with respect thereto.

On November 15, 2006, Exceptions to the Recommended Decision were filed by the following Parties: (1) Emporium Water Company (Emporium or Company); (2) The Office of Small Business Advocate (OSBA); and (3) the Office of Consumer Advocate (OCA). On the same date, the Office of Trial Staff (OTS) filed a Letter indicating that it would not be filing Exceptions.

Emporium, the OTS and the OCA each filed Reply Exceptions on November 27, 2006. On the same date, the OSBA informed the Commission that it would not be filing Reply Exceptions.

(*Western Utilities*) and *Pennsylvania Public Utility Commission v. Emporium Water Company,* 2001 Pa. PUC LEXIS 7, 208 P.U.R.4th 502 (Order entered March 8, 2001) (*Emporium*).

Unlike the earlier cases of *Carnegie*, *Riverton* and *Lower Paxton*, the Commission rejected the use of the hypothetical capital structure in both *Emporium* and *Western Utilities.* In both cases, the Commission distinguished the *Emporium* and *Western Utilities* fact situations from *Carnegie*, *Riverton* and *Lower Paxton* on the basis that a very high percentage of the rate base of both Emporium and Western Utilities had been financed by a very low interest loan that would not have been available on the open market. Because a PennVest loan carries a very low interest rate, a utility carrying a great deal of PennVest debt would have a lesser burden than a utility carrying the same amount of commercial debt.

In the settlement resolving its 1996 rate case, the Company requested, and was granted, rate base/rate of return treatment of its PennVest loan obligations, as opposed to establishing a surcharge. *Pennsylvania Public Utility Commission v. Emporium Water Company*, Docket No. R-00953500 (Order entered June 20, 1996); s*ee* OCA M.B., Appendix C. Under the rate base/rate of return option, a utility forgoes collection of the actual low interest debt through a surcharge in favor of longer-term recovery that exceeds the actual debt.

In considering the use of actual capital structure or hypothetical capital structure in this case, there are several factors that support the use of the Company's actual capital structure. First, it would be consistent with the Commission's precedent in *Western Utilities, Emporium,* and the distinguishing factors of C*ity of Lancaster*. Second, use of the actual capital structure would recognize the ratepayers' interest in not paying a high return on publicly-funded PennVest plant. Third, a cost of equity adjustment could be used to make up for the difference between the principal due on the loan and the depreciation expense related to the PennVest-funded plant, adjusting the unbalanced capital structure, thereby recognizing the Company's needs and securing timely repayment of the PennVest loan. Fourth, this result would be consistent with an interpretation of *Lower Paxton, Carnegie* and *Riverton* that emphasizes the Commission's use of discretion, the necessity of balancing both the utility's and the ratepayers' interests and recognition of the special public nature of PennVest financing.

The record in this proceeding demonstrates that the use of a hypothetical capital structure would be improper because it would require the Company's customers to pay a return of approximately 10% on 10.09% of the Company's rate base, when, in fact, that rate base is financed by PennVest debt that costs only 1%.

In the Company's case, the actual capital structure is correcting itself as the large PennVest loan is being paid off. On September 30, 2005, the Company had an actual capital structure consisting of 81.79% long-term debt and 18.21% common equity, and on September 30, 2006, it had 69.24% long-term debt and 30.76% common equity. (R.D. at 44). Given that the debt is low-interest PennVest loans, 69.24% long-term debt is not overly onerous.

This case illustrates one of the problems that can occur when a relatively small utility company includes a proportionately large amount of PennVest-financed plant in rate base. Debt amortization rates are more accelerated than depreciation rates. According to the Company, use of the actual capital structure will cause the Company to experience inadequate debt service coverage, thereby placing repayment of the PennVest loan at risk. However, as the OTS points out, because the Company recovers revenues to repay its PennVest loan under rate base/rate of return, the difference in rates results in continuing rate base recovery after the PennVest debt is extinguished. Consequently, although the Company will recover a lower amount of revenue on a monthly or yearly basis under the actual capital structure, it will collect depreciation on the PennVest funded plant long after the related PennVest debt has been retired. (OTS M.B. at 29-30) (Co. M.B. at 2, footnote 5).

In our view, use of the Company's actual capital structure, as recommended by the ALJ, properly accounts for the portion of the capital structure financed by 1% debt. Accordingly, we determine that the record before us establishes that the use of the Company's actual capital structure of 69.24% long-term debt and 30.76% common equity, as recommended by the ALJ, is appropriate under the circumstances in this proceeding. Therefore, we will deny the Company's Exceptions regarding this issue.

2. Cost of Debt

a. Positions of the Parties

The Company's claimed cost of debt for this proceeding is 3.18%, using the estimated actual capital structure at the end of the future test year. The OCA accepted this cost of debt as appropriate. The OTS made several adjustments to reduce the long term debt rate. The OTS included the new PennVest loan even though it did not recommend including the new PennVest-financed assets in rate base. The other adjustment related to reducing the cost rate for shareholder and affiliate related loans. (R.D. at 52-53).

b. ALJ's Recommendation

The ALJ recommended the use of the cost of debt proposed by the Company. (R.D. at 54).

c. Disposition