

COMMONWEALTH OF PENNSYLVANIA



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December 12, 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 Reply Brief in the above-referenced proceeding.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Harrison W. Breitman".

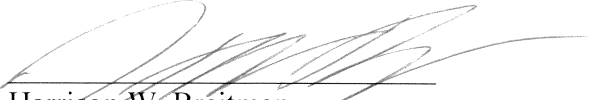
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cc: Honorable Mark A. Hoyer
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CERTIFICATE OF SERVICE

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 Reply 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:

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION :
 :
 v. : Docket No. R-2016-2554150
 :
 CITY OF DUBIOS – BUREAU OF WATER :

REPLY BRIEF
OF THE OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this Reply Brief in response to the Main Brief (M.B.) of the City of Dubois – Bureau of Water (City of Dubois or the City). The OCA’s Main Brief contained a comprehensive discussion of the evidence and its position on all issues, thus OCA will respond only to those matters raised by other parties that were not previously addressed or that require clarification. Nevertheless, the OCA does not waive its opposition on contested issues because it does not repeat arguments here. Accordingly, the OCA incorporates the arguments and analysis contained in its Main Brief herein by reference.

II. SUMMARY OF ARGUMENT

The City's arguments on contested issues in its Main Brief are not persuasive. As the party with the burden of proof, the City must conclusively demonstrate how its claims are justified under the facts and the law. Regarding the City's rate base claims, the City fails to show that certain projects will be used and useful by the end of the future test year, or that there is any credible evidence that the projects will even be underway during the future test year ending December 31, 2016. Regarding the City's expense claims, the City fails to show why its claims for contractual expenses, administrative and general expenses, and rate case normalization expense comport with basic ratemaking principles. The City's claims should not be adopted. Regarding rate of return, the City fails to show how its proposed capital structure is justified under the facts or the law or why its return on equity should not be adjusted by a tax factor.

The OCA's final recommendation is that the City be permitted to recover no more than \$50,418 in additional annual PUC-jurisdictional revenues. See Tables I and II.¹

¹ Appendix A, attached hereto for convenience, contains the OCA's Tables I and II which were attached to the OCA's Main Brief.

III. RATE BASE

A. Plant in Service

In its original filing, the City claimed a rate base of \$15,622,314. City Exh. CEH-1 at 13. Of this initial total rate base, \$4,493,848 was attributable to jurisdictional customers. City Exh. CEH-1 at 12. In rejoinder testimony, the City made an adjustment to rate base of \$642,060, which results in a revised rate base claim of \$14,980,254. City Exh. CEH-3RJ. The City's updated jurisdictional rate base claim is \$4,317,704. City Exh. CEH-3RJ; see also Table I, attached to OCA M.B. as Appendix A. As discussed in the OCA's Main Brief and below, the Company's rate base claim is overstated.

B. Additions To Rate Base That Are Not Made In The Future Test Year Should Not Be Included In Rate Base

The OCA's Main Brief, pages 8 to 15, contains a detailed discussion of the factual, legal, and policy reasons as to why the City cannot include, as additions to rate base, plant that is not used and useful in service to the public. See OCA M.B. at 8-15; see also 66 Pa. C. S. § 102; 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).

Furthermore, as discussed in the OCA's Main Brief, the Commission has determined 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. 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 City claims that, in regards to additions to rate base, “Ms. Everette’s proposals do not reflect the information provided on the record.” City M.B. at 7. Ms. Everette, however, only removed rate base claims for projects where the City has not begun work on the project and there was no evidence that the projects would be completed and used and useful during the future test year. The evidence in the record regarding those projects shows that there are no costs expended to date, there are no vendors selected and there is no evidence in the record (other than vague, unsupported statements by City witness Spanos) that those projects will be completed, and used and useful in the future test year or reasonably thereafter. It should be noted that Ms. Everette has not made adjustments to remove partially-completed projects from rate base. OCA St. 1 at 6-7.

The City claims in the Main Brief that it “provided an update confirming that most of the improvements were already in progress.” City M.B. at 7 (citing City St. 3R at 3, lines 4-5 and line 24; City St. 3R at 4 lines 1 and lines 14-15). While the City cites to City witness Spanos’ rebuttal testimony to support this proposition, nowhere in Mr. Spanos’ testimony does he state that the claimed plant additions that Ms. Everette disputes are in progress. Instead, the City’s cited references to City witness Spanos testimony states that providing the OCA with a start or completion date is an unreasonable expectation. See City St. 3R at lines 4-5. Furthermore, the remainder of the cited reference merely states the cost of a fire hydrant, a statement that the project will be completed in November, and an assertion that the project will not take three months to complete; all without any supporting documentation. See City St. 3R at 3, line 24; City St. 3R at 4 line 1, 14-15).

The OCA submits that the City has failed to provide any evidence that the disputed additions to rate base will be used or useful in the future test year. As such, the City has not met its burden of proof.

1. Establishing That Heating and Air Conditioning Additions To Plant Will Be Made In The Future Test Year Is A Reasonable Expectation.

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). As stated in the OCA's Main Brief, 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 answered only that it "expects to have this completed by the end of 2016." OCA M.B. at 9; OCA St. 1 at 4. While the City was asked to provide further 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." OCA M.B. at 9; City St. 3R at 3. The City did not even present evidence as to the current status of the project. Accordingly, 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. OCA M.B. at 10; Table II. The associated depreciation expense adjustment of \$309 with a \$93 jurisdictional component has also been reflected by Ms. Everette. OCA M.B. at 10; Table II. These costs were not incurred in the Future Test Year and should not be charged to the jurisdictional ratepayers.

2. The City Has Offered No Support That The High Street Mains Additions and The High Street Fire Hydrants Project Will Either Be Completed Or Started In The Future Test Year.

As stated in the OCA's Main Brief, the City's filing included a rate base addition of \$55,911 for the High Street mains project with a jurisdictional portion of \$14,531. OCA M.B. at 12; Table II; OCA St. 1S at 3; OCA Exh. AEE-1S at line 4. Additionally, the City's filing included a rate base addition of \$5,769 for fire hydrant additions related to the High Street mains project, with a jurisdictional portion of \$1,071. OCA M.B. at 13; Table II. The City argues that the High Street project, discussed in detail in OCA M.B. at 11-13, will be completed in November as was testified to by City witness Spanos despite the project not being commenced by the November 10, 2016 evidentiary hearing. City M.B. at 8. While testifying that the project will 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 M.B. at 11; OCA St. 1S at 2-3. Moreover, there have been no further updates to interrogatories or data requests that address the High Street project and its anticipated completion. OCA M.B. at 11; OCA St. 1S at 2. Despite City witness Spanos' assertions that the projects will take less than three months to complete, City Manager Suplizio provided no further updates or documentation when asked for "the estimated time from the start date until the in-service date." OCA M.B. at 9-10; OCA St. 1S at 4; OCA-V-1 (attached to OCA St. 1). The City has failed to show that the High Street project will be bid, started, completed or used and useful within the future test year. Accordingly, it is unreasonable to accept the City's claim for the High Street mains and fire hydrant additions to rate base when these additions are not used and

useful for the provision of service to the public during the future test year. The \$55,911 adjustment to rate base for mains and the \$5,769 adjustment to rate base for fire hydrants, as well as the associated \$475 and \$82 adjustments to depreciation expense should be adopted. Table II.

3. Billing, Payroll and Accounting Software Are Not Proper For Inclusion In Of Rate Base When The Software's Provider Has Not Been Chosen, When Nothing Has Been Spent On The Software, And When The Date The Software Is Implemented Is Unknown.

As stated in the OCA's Main Brief, 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 M.B. at 13; OCA St. 1S at 4; OCA. Exh. AEE-1S at line 7. The City has not yet confirmed a provider for this purchase. OCA M.B. at 13; OCA St. 1 at 9. Moreover, the City has spent nothing on the project and the project has not been started. OCA M.B. at 14; OCA St. 1 at 9. The City does not provide specific additional support as to why this project should be included in rate base for the Future Test Year (FTY) beyond its assertions regarding all of the disputed rate base additions discussed *supra*. For the reasons discussed *supra*, the OCA's adjustment regarding Billing, Payroll, and Accounting Software, which is a \$13,341 adjustment with an associated depreciation expense of \$890, should be adopted. Table II.

4. A Claim For A New Phone System, For Which There Is No Provider, Start Date, Or Known Cost, Should Not Be Included In Rate Base

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 M.B. at 14; 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 M.B. at 14; OCA St. 1S at 3. Moreover, the City has not confirmed a provider for this project. OCA M.B. at 14; OCA St. 1S at 3. The City does not provide specific additional

support as to why this project should be included in rate base for the FTY beyond its assertions regarding all disputed additions discussed *supra*. For the reasons discussed *supra*, the OCA recommends that an adjustment in the amount of \$5,833, with a \$1,663 jurisdictional component, should be adopted 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.

5. Cash Working Capital

As discussed at page 15 of the OCA's Main Brief, the City's cash working capital claim is based on one-eighth (12.5%) of its operating and maintenance expenses (O&M). The Commission should ultimately modify the adjustment to cash working capital in accordance with the total operations and maintenance adjustments adopted in this proceeding. See OCA Table II. The City did not address this issue in its Main Brief except to revise its own cash working capital adjustment based on its revised O&M expense claim. City M.B. at 7-8.

C. Deductions from Rate Base

The City's Main Brief is silent on the OCA's adjustment to remove a vacant home from rate base with a net book value of \$11,116. The expenses related to this vacant property are discussed *infra*.

In its expense section, the City states that, at the evidentiary hearing, City Manager Suplizio was consistent with City witness Heppenstall's testimony that the vacant property is being held for future use when he confirmed that the City Council has not voted on what action to take with the vacant property. City M.B. at 25 (citing Tr. at 45). The City's citation to

testimony, however, leaves out the section of City Manager Suplizio's testimony in which he testified that he recommended to City Council that the vacant property should be demolished. Tr. at 45. Indeed, the OCA and the City are in agreement that City Council has not yet voted on whether to demolish the vacant property.

The City argues in its expense section that the OCA's recommendations are premature since the City Council has not decided whether to demolish or repurpose this property. The City's argument misses the key point that at this time, the property is not used and useful. Moreover, there is no definite plan of use of this vacant property within a specific period of time and the property fails to meet the necessary legal requirements that plant held for future use must have a definite plan of use within a specific period of time. City M.B. at 25. In her surrebuttal testimony, 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. As discussed in detail on pages 15 to 17 of the OCA's Main Brief, plant held for future use must have a definite plan of use within a specific period of time. OCA M.B. at 15-17; Pa. PUC v. West Penn Power Co., 1979 Pa. PUC LEXIS 37. No such plan exists here. Accordingly, the jurisdictional net book value of the vacant home, or \$3,334 should be removed from rate base.

IV. REVENUES

As discussed in the OCA's Main Brief, the City's updated revenue adjustments are reflected in OCA's Table I. OCA M.B. at 18.

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.

The OCA's Main Brief contained a detailed discussion as to why the City cannot include an expense in rates that is not "known and measurable." See OCA M.B. at 9; PA PUC v. City of Lancaster – Sewer Fund, 2005 PA. PUC LEXIS 44, *102-103 (Lancaster Sewer). Indeed, when the City argues that revenue from the potential sale of water to Falls Creek should not be imputed, the City acknowledges that "[r]ecognizing revenue from sales to Falls Creek in this proceeding would contravene the bedrock ratemaking principle that only known and measurable revenues can be recognized for ratemaking purposes." City M.B. at 12 (citing Pa. PUC v. PPL Gas Utils. Corp., 102 Pa. PUC LEXIS 325, **28-30 *(2007)). The same bedrock principal must be applied to the City's expense claims.

B. Vacant Home Expenses Associated With Property That Is Neither Used Nor Useful Should Not Be Charged To Ratepayers

The City argues that expenses related to a vacant home, discussed *supra*, should be charged to the jurisdictional ratepayers. City M.B. at 24-25. Expenses related to the vacant home, however, will not be incurred because the home is not being used. Because this home is vacant and is not used or useful for the provision of water service, the expenses related to this

home should be removed from the City's claim. OCA St. 1 at 29. The OCA submits that a \$3,592 adjustment to expenses and \$572 adjustment to depreciation expense should be adopted.

Table II.

C. Transmission and Distribution Contractual Services Should Be Normalized To Reflect The Normal Level Of Expense

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 explained in detail in the OCA's Main Brief, Ms. Everette testified that since there has been a significant fluctuation in this expense from 2013 to 2015, the expense should be normalized for ratemaking purposes. See OCA M.B. at 20; OCA St. 1 at 29. 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 M.B. at 20; OCA St. 1 at 30.

Ms. Everette further testified as follows:

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.

In its Main Brief, the City does not discuss the proposed normalization of this expense. As the City provides no argument in their Main Brief as to why the expense should not be

normalized, and for the reasons stated in the OCA's Main Brief (see OCA M.B. at 20-21), the OCA submits that the expense should be normalized.

It should be noted that the City alleges that "However, as the City cannot rely upon shareholder equity where earned revenues are inadequate to meeting [sic] utility obligations, it is reasonable to recognize the City will incur significant T&D contractual services expenses in meeting its obligations under the Stipulation reached with OCA. *See* City/OCA Stipulation." City M.B. at 21. Additionally, the City states that I&E and the OCA's proposed reduction in this expense will remove revenues that the City may use to combat Unaccounted For Water concerns raised by both I&E and the OCA's expert witnesses. City M.B. at 20. The City provides no justification as to how the OCA's adjustments would remove revenues that the City would use to combat Unaccounted For Water levels.

The City/OCA stipulations cover the following: annual PUC report format, installation of water meters on all service lines connected to municipal buildings, submission of written monthly estimates of unmetered water use from fire companies, estimation of water loss at the time the repair is made, metered locations for street sweepers and fire companies, a script for and record of consumer complaints received, and the exercising of isolation valves. See City/OCA Stipulation. To meet the agreed upon City/OCA stipulations, however, the only additional costs that the City may incur would be associated with meter installation and the exercising of isolation valves.² Moreover, the City has not provided any support regarding a cost burden to meet the stipulations between the OCA and the City. Lastly, the purpose of the City/OCA stipulations is to more accurately measure and estimate the level of Unaccounted For Water. The

² The City had the opportunity to modify its test year claims if it believed that the City/OCA stipulations would create significant expense but the City did not modify its claim.

OCA submits that any expense that may be associated with the City's agreement to enter into stipulations with the OCA is speculative and unsupported.

D. Water Treatment Plant Contractual Services Expense Should Be Normalized To Acknowledge The Significant Level Of Fluctuation In This Account

The OCA's Main Brief contains a detailed discussion of the Water Treatment Plant Contractual Services expense (WTP Contractual Services expense). See OCA M.B. at 21-25. The only component of the City's claim which is at issue is the \$22,323 expense, which is the "normalization of other expenses" component. OCA M.B. at 22. The City argues that it has demonstrated that the City's filed and adjusted expense is justified and should be accepted without modification.³ City M.B. at 20. The City's sole argument against Ms. Everette's adjustment to the WTP Contractual Services expense was that the history of expense is not the best indicator of future expense and it is more appropriate to examine trends rather than use a three year average as was recommended by Ms. Everette. City M.B. at 20. The City provides no legal basis for this argument and no evidence in support of its position.

As discussed in detail in the OCA's Main Brief (See, OCA M.B. at 21-25), after the City made its adjustments, the expense in 2015 for this account was still significantly higher than in the previous years. The "other expenses" component for the three year period was as follows:

2013: \$1,825

2014: \$865

2015: \$22,323

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

³ The fact that the City adjusted its filed expense, however, demonstrates that its filed position was not justified; hence the City's adjustment.

As clearly illustrated above, the 2015 expense is significantly higher than prior levels and exceeds both the 2013 and 2014 expenses by a large margin. The City's Main Brief provides no explanation as to how this significantly larger expense level in 2015 is indicative of future expense and the City has not provided support evidencing that the 2015 expense is an ongoing level of expense. As such, and for the reasons stated in the OCA's Main Brief, a three year average of these expenses should be used in order to reflect a normalized level of expense for ratemaking purposes.

E. Administrative and General Expense Should Be Determined By A Reasoned Evaluation Of Each Individual Expense

The City argues that the Commission should consider the City's ratio of administrative expense to total Operations and Maintenance costs as a general indicator of reasonableness. City M.B. at 25. As discussed in the OCA's Main Brief, Ms. Everette testified as to the overall appropriateness of comparing the level of the City's Administrative and General (A&G) expense to total Operating and Maintenance (O&M) as follows:

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.

1. Introduction

For the reasons stated above and in the OCA's Main Brief, the OCA recommends that the Commission consider each A&G expense in determining which portion is appropriate to charge to the jurisdictional ratepayers. The OCA discussed the factual, legal, and policy reasons for its recommended adjustments to A&G expense in its Main Brief (See, OCA M.B. at 25-40) and responds to the City's Main Brief, *infra*.

2. The City's Claimed Allocation Of The City Manager's Salary To The Water Fund Is Unverifiable

The OCA recommends a 24% allocation of the City Manger's salary to the Water Fund, which is based on the verified allocation factor that the City utilizes to allocate Treasury and Finance Employees to the Water Fund. OCA M.B. at 33.

The City argues that "the OCA and I&E both make speculative and unwarranted assumptions regarding the City's allocation of the City Manager's salary." City M.B. at 27. In the following sentence of its Main Brief, the City states that "OCA claims that the City Manager's position requires him to conduct many other duties, such as 'supervision and management of administrators of various city departments, approval of all personnel decisions, the preparation and submission of all required reports, [and] financial planning for the City and, as a result, it cannot be possible for him to spend 60% of his time on water issues. OCA Statement No. 1, p. 34.'" City M.B. at 27. This is not a speculative claim by the OCA of the City Manager's job duties as the City suggests. Instead, the City Manager's job duties are based upon the City Manager's job description which was provided by the City and cited by Ms. Everette in her excerpted direct testimony. See, OCA St. 1 at 34; IE-RE-30 (attached to OCA St. 1). Indeed, the City's excerpt of Ms. Everette's direct testimony misconstrues the facts of Record

since the City did not include the beginning portion of the sentence of Ms. Everette's direct testimony from which the City quotes. This portion of Ms. Everette's testimony, in proper context, states as follows:

On the other hand, the City Manager's job description demonstrates that the City Manager is responsible for many different aspects of the City, including supervision and management of administrators of various City departments, approval of all personnel decisions, the preparation and submission of all required reports, financial planning for the City, and so on (I&E-RE-30, attached). The information available does not support a 60% allocation of the City Manager's salary to the Water Fund.

OCA St. 1 at 34 (emphasis added).

The job description was provided by the City in discovery and can be found in the record. OCA St. 1 at 34; IE-RE-30 (attached to OCA St. 1). The fact that City Manager Suplizio is responsible for many aspects of the City's management is not merely a speculative claim created by the OCA; it is in the City Manager's job description which was provided by the City. The City Manager's job description is three pages long and contains an exhaustive description of the City Manager's various job duties; none of which specifically reference his duties in regards to the water department beyond supervision. OCA M.B. at 30-31; I&E-RE-30D Part A (attached to OCA St. 1).

To establish support for its argument that time sheets are only one factor to consider in allocating employee time to the Water Fund, the City's Main Brief also incorrectly cites to I&E expert witness Patel's testimony at the evidentiary hearing. The City's Main Brief states "Moreover, I&E Witness D.C. Patel acknowledged that time sheets are just one factor to consider in allocating employee time to the water fund. Tr. at p. 117, lines 21-23." City M.B. at 28. The transcript citation to I&E expert witness Patel, however, states as follows:

I would say that the estimation of 60 percent of time for the water operation is not quantifiable. There is absence of time sheets and other proper records.

Tr. 117:21-23.

Thus, I&E expert witness Patel acknowledges that no proper records have been provided which would verify the City's allocation of the City Manager's salary. Tr. at 118. Moreover, I&E expert witness Patel listed five factors which was the basis for his allocation method: 1) lack of time sheets, 2) absence of proper record, 3) the fact that City Manager Suplizio is the chief administrative officer, 4) the inappropriateness of allocating the City Manager's salary based on the Public Works Director's time, and 5) that allowing only 35% of the City Manager's time allocation for other activities and responsibilities does not correlate with the City Manager's job. Tr. at 118-119.

The City also argues that it is reasonable to rely solely on City Manager Suplizio's own testimony regarding the allocation of his salary "as he is also the only City employee directly serving as a witness in the rate case." City M.B. at 28. The fact that the City chose to only have City Manager Suplizio serve as a witness in this case does not enhance the weight of his testimony. Sound business practice requires verification and it is those Records that are necessary to fully support the claim.

Speculation is defined as "The act or practice of theorizing about matters over which there is no certain knowledge." *Black's Law Dictionary*, (9th Ed. 2009). As illustrated by the City throughout its own citations in its Main Brief, City Manager Suplizio's salary allocation to the Water Fund is entirely based on City Manager Suplizio's unverifiable assertions as to how much of his salary should be allocated to the Water Fund; this is the only part of his salary which is paid exclusively by the ratepayers. This allocation has changed over time and directly

contradicts City witness Heppenstall's two-step allocation method.⁴ City witness Heppenstall's allocation factor, however, was based on interviews with the City Manager. OCA St. 1 at 34-35; City Exh. CEH-1 at 25. The lack of time sheets or any other verification besides City Manager Suplizio's testimony as to how much of his salary should be charged to ratepayers is theorizing about matters of which there is no certain knowledge.

Accordingly, Ms. Everette recommended a 24% allocation of the City Manger's salary to the Water Fund. OCA M.B. at 33. The 24% allocation factor is based on the verified allocation factor that the City utilizes to allocate Treasury and Finance Employee salary to the Water Fund. OCA M.B. at 33; OCA St. 1 at 20. It should be noted that during the evidentiary hearing, City witness Heppenstall agreed with Ms. 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.

Lastly, the City states that "for the balance of the City Manager's time not spent on finance-related tasks, it is logical to assume he would be working on the same projects reflected in the Public Works Director's timesheets. *See* Tr. at p. 33, line 2." City M.B. at 26-27.⁵ Despite a lack of support in the evidentiary hearing transcript regarding this contention, assuming that it is logical that the City Manager spends his time in the same manner as the Public Works Director is not supported by the record evidence. The City Manager's job description contains a wide scope of duties and does not require specialized knowledge regarding public works. OCA M.B. at 30-31; I&E-RE-30D Part A (attached to OCA St. 1). The OCA

⁴ At the evidentiary hearing, City Manager Suplizio stated "I think 60 percent is probably on the low end." Tr. at 26. It should be noted that City witness Heppenstall determined that the total City Manager salary allocated to the Water Fund is 55.7%, which is in contradiction to City Manager Suplizio's testimony at the evidentiary hearing. *See* City Exh. CEH-2R at lines 13-17.

⁵ The City's cite to the evidentiary hearing transcript reads as follows: "a hundred percent accurate." Tr. at 33:2.

submits that it is not logical to assume that the City Manager's time is allocated in the same way as the Public Work's Director.

As the jurisdictional customers do not receive any benefit from Mr. Suplizio's work in managing the City besides the time he spends on the water department, the OCA recommended an adjustment regarding the allocation of the City Manager's salary to the Water Fund, which results in a jurisdictional portion of \$11,209. OCA M.B. at 34; Table II.

3. Administrative Expense

The OCA's adjustment relating to Administrative Expense is addressed in detail on pages 34 to 35 of the OCA's Main Brief. As a result of clarifications in the City's testimony during discovery and rejoinder, the OCA accepts the dollar amount of the City's revised administrative expense claim despite the OCA's disagreement with the use of a 33% allocation factor. OCA M.B. at 34-35; Table II.

Despite the fact that the OCA is no longer disputing the amount of this claim, the City's Main Brief states that, "OCA disputes the relevance of expenses included under this account on purported grounds that such costs are 'wholly unrelated to water operations, such as removing a blighted property and purchases for the fire department.'" City M.B. at 26. The OCA submits that it is clear that expenses related to removing blighted property and purchases for the fire department, among other expenses claimed by the City, are not related to providing water service to the jurisdictional consumers, and should not be charged to jurisdictional water consumers. In fact, in her rebuttal, City witness Heppenstall is also in agreement with the OCA that these expenses related to the fire department and the removal of blighted property are not related to the provision of water service to jurisdictional customers and should be excluded since City witness

Heppenstall excluded these same expenses. See City St. 2R at 18-19. Nevertheless, the City argues in its Main Brief that the Commission should reject the OCA’s arguments on this issue because the OCA allegedly proposes to remove expense that relate to water operations. See City M.B. at 26. This argument is in contradiction of the City’s expert witness testimony and has no basis in fact. Accordingly, the OCA reiterates that the OCA accepts the dollar amount stated in the City’s revised administrative expense claim despite the OCA’s disagreement with the use of the 33% allocation method. OCA M.B. at 34-35; Table II.

4. City Buildings: Computer Parts/Supplies/Software

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. As discussed in detail in the OCA’s Main Brief, a breakdown of this expense showed that the primary increase in 2015 was to a computer parts account. OCA M.B. at 38; OCA St. 1 at 41. The expenses for this specific account are listed below:

2013: \$17,269

2014: \$19,562

2015: \$47,202

OCA M.B. at 38; OCA St. 1 at 41.

The City argues that in order to reflect an upward expense allocation over the past three years, the Commission should base its expense allowance for Computer Parts/Supplies/Software upon the increased expense level incurred in 2015. City M.B. at 30. The City provided general ledger entries, however, 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 M.B. at 38; 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 M.B. at 38; OCA St. 1 at 41 (emphasis added). Moreover, the overall amount of the City Buildings: Computer Parts/Supplies/Software expense increased significantly from 2014 to 2015. OCA St. 1S at 24. City witness Heppenstall does not provide any explanation as to why the expense more than doubled in one year. OCA M.B. at 38; OCA St. 1S at 24. There is no support to indicate that the increased expense in 2015 is an ongoing level of expense. OCA M.B. at 38; OCA St. 1S at 24. As such, OCA recommends that it is appropriate to normalize the expense as it is significantly higher than a normal year of expense. OCA M.B. at 38; OCA St. 1 at 41; OCA St. 1S at 24.

5. The City And OCA Are In Agreement In Regards To Pension Expense

As stated in detail in the OCA’s Main Brief, the OCA and the City are in agreement in regards to the City’s pension expense. See OCA M.B. at 39-40. In summation, subsequent information obtained in discovery and at the evidentiary hearing confirmed that there are 9 water department employees, which increased the percentage of Pension expense to be allocated to the Water Fund to 24% from the originally calculated 22%. See OCA M.B. at 39-40; Tr. at 76:18-20; OCA St. 1S at 25. The City’s revised pension expense claim is \$10,020, which the OCA accepts. OCA M.B. at 40; OCA St. 1S at 25.

F. Rate Case Expense Should Reflect The City’s Historical Average Interval Between Rate Filings

The City claims \$225,505 of rate case expense normalized over a 2.5 year period, for an annual expense of \$90,202. OCA M.B. at 40; 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. OCA M.B. at 40-43. The OCA submits that a 5 year normalization period is appropriate.

The City cites to Pa. PUC v. Lemont Water Co., 1994 Pa. PUC LEXIS 44, *18-19 (1994) (Lemont Water) to support its contention that the City's proposed 2.5 year normalization period is proper. See, City M.B at 22. The Commission's determination in the Lemont Water case, however, states as follows: "we would use a 1.6 year interval for the normalization of the \$120,000 of rate case expense incurred from the litigation of this proceeding. **This interval reflects the Company's historical average interval between rate filings.**" Lemont Water at *32 (emphasis added). Indeed, in Lemont Water, the OCA argued for a 2 year normalization period while the Commission determined that a 1.6 year normalization period accurately represented the Company's historical filing period, which was an adjustment to the OCA's recommendation of 0.4 years. Lemont Water does not support the City's contention that rate case expense should be based on the City's speculative intention to file a rate case rather than the historical average interval between rate filings. In fact, the City's citation to Lemont Water is to a section of the case that merely recites the parties arguments. See, Lemont Water at *18-19. The City does not cite to the Commission's determination. See, Lemont Water at *32.

The City's 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 Distribution 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 Lancaster – Bureau of Water, 2011 Pa. PUC LEXIS 1685, *56-57 (Lancaster 2011); Pa. PUC v. Emporium Water Co., Docket No. R-2014-2402324 Slip Op. (Jan. 15, 2015) (<http://www.puc.state.pa.us//pcdocs/1339803.docx>); Pa. PUC v. Metropolitan Edison Co., 2007 Pa. PUC LEXIS 5 (2007); Lancaster Sewer, 2005 Pa. PUC LEXIS *84.

In the present case, OCA witness Everette recommends that a 5 year normalization period be used for rate case expense as opposed to the City’s 2.5 year normalization period. OCA M.B. at 40; OCA St. 1 at 45. As explained in detail in the OCA’s Main Brief, the City’s last rate case was in 2013, three years prior to this case. OCA M.B. at 40. 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 three rate filings is more than six years.⁶ OCA M.B. at 40-41; OCA St. 1 at 45. In fact, the City’s average historical filing history in the last three cases is 6.61 years. OCA M.B. at 41; OCA St. 1 at 45. If the 1996 case is eliminated from the calculation, the average filing frequency is 5.33 years. OCA M.B. at 41; OCA St. 1 at 45. Therefore, Ms. Everette recommended a 5 year normalization period. OCA M.B. at 41; OCA St. 1 at 45.

Contrary to Commission precedent, City witness Heppenstall suggests that a 2.5 year normalization period is appropriate because it allegedly represents the time between when the last rate increase became effective and the filing of the current case. OCA M.B. at 41; OCA St.

⁶ 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.

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 M.B. at 41; OCA St. 1S at 26. Nevertheless, 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 M.B. at 41-42; OCA St. 1S at 27.

While the City argues that it is being forced to under-recover rate case expense under OCA's recommended normalization period, the current rate case has not come to a conclusion and it is unknown when the City will file its next rate case. It should be noted that the City alleges that "an unreasonably long normalization period, particularly for a smaller utility proposing *a relatively modest rate increase*, will jeopardize the utility's financial viability by effectively denying recovery of actually incurred rate case expense." City M.B. at 21 (emphasis added).

If the City's entire request is approved, the total bill for jurisdictional ratepayers will increase by approximately 33.6% per month; this is not a modest rate increase. Furthermore, it should be noted that in its 2013 Settlement, the City increased revenues from the jurisdictional ratepayers by 57.1%. City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 7.

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. OCA St. 1S at 27. 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. Moreover, the City's size does

not change the process by which the Commission determines the proper normalization period and the City provides no supporting justification to prove otherwise.

For these reasons, and consistent with Commission precedent, the OCA submits that the normalization period should be based off of the historical average interval between rate filings and that the OCA's 5 year normalization period is a reasonable and fair estimate of the City's historical average filing interval.

VI. TAXES

The City does not claim any taxes for ratemaking purposes.

VII. RATE OF RETURN

A. Introduction

As explained in the OCA's Main Brief at 45-65, the appropriate overall rate of return is 4.09%, which is calculated using the City's capital structure and a 8.25% equity cost rate that is adjusted to 6.6% to reflect the tax exempt status of the City. Contrary to the arguments made by the City, this is not an unreasonable rate of return for the City. Rather, it reflects the most accurate estimate of the cost of equity and properly adjusts that for the tax exempt status of the City. In addition it properly reflects the capital structure that exists and on which the financing for the Bureau of Water is based. The OCA submits that its rate of return recommendation is appropriate for ratemaking and will mean that customers do not pay more than is reasonable. The City's request for a higher than necessary return should be rejected. There is no evidence that it will not be able to continue to attract capital.

The discussion below will address the main areas of disagreement; however, the OCA's Main Brief contains a full discussion of the OCA's position.

B. Capital Structure

The OCA proposes using a capital structure of 70% debt/30% equity which is based on the City's financing of its rate base and is consistent with the ratios shown in the City's audited financial statements. OCA M.B. at 49-58; OCA St. 1 at 14-16. The City's actual capital structure is 99.5% debt/0.5% equity.⁷ OCA M.B. at 49; OCA St. 1S at 6. Given that the actual capital structure is almost entirely debt, an alternative capital structure must be carefully chosen because any capital structure will contain more equity than the actual capital structure and equity costs are higher than debt costs. OCA M.B. at 50; OCA St. 1 at 14.

⁷ In the OCA's Main Brief, the reference is to 99.6% debt/0.4% equity (OCA St. 1 at 14-15) which was revised in Ms. Everette's surrebuttal.

The City's arguments for a hypothetical capital structure of 50% debt/50% equity are flawed. The hypothetical capital structure proposed by the City, if adopted would unreasonably increase costs to ratepayers. OCA M.B. at 46-48.⁸ Generally, the use of a hypothetical capital structure should not increase costs to ratepayers. The City's proposed hypothetical capital structure improperly places too much additional cost on ratepayers and does not properly balance the interests of ratepayers and shareholders. See Emporium Water v. Pa. PUC, 955 A.2d 456 (Pa. Commw. 2008) appeal denied 599 Pa. 702, 961 A.2d 860 (2008).

The City argues that the OCA-recommended capital structure is not "typical" of the comparison group. City M.B. at 36, 38-41. That argument misses the point and should be rejected. The Bureau of Water is not traded as a separate entity, therefore it does not need to meet public market norms for capital structure ratios. See Lancaster 2011, 2011 Pa. PUC at 82-83; OCA M.B. at 56. Ms. Everette looked at the funding for the City's rate base as well as the debt and equity figures contained in the City's audited financial statements. OCA M.B. at 55; OCA St. 1 at 15; OCA St. 1S at 6. It is reasonable to use a capital structure that is closer to the actual capital structure for rate making purposes. None of the City-specific information would lead to the use of a 50% debt/50% equity capital structure as the City has proposed.

The Commission has specifically rejected that same argument in Lancaster 2011 and should do so again in this case. In its Main Brief, the City argues that the Commission's decision in Lancaster 2011 should not apply here because concerns about excessive costs in Lancaster 2011 are not present in this case. City M.B. at 40. The OCA submits that the Commission's concerns about ratepayers paying equity rates on low cost debt are also present in this case.

⁸ The City's weighted cost of debt is relatively low – 3.02%. The City would have the outside customers pay an equity return on that low cost debt. Under the City's proposal, that would mean outside customers would pay 10.5% on weighted debt that cost 3.02%. As Ms. Everette explained, using the City's claimed overall rate of return of 6.76% and the City's pro forma capital structure would result in an excessive 14.98% return on equity. OCA M.B. at 50; OCA St. 1 at 15-16.

Specifically, the City is asking the PUC-jurisdictional customers to pay an equity return of 10.5% on debt that has a weighted cost of 3.02%. Moreover, it would be “fair and reasonable to both the utility and the ratepayers” to adopt the OCA’s recommended capital structure rather than the City’s capital structure, thus complying with the principles most recently enunciated by the Commission in Lancaster 2011. In its Main Brief, the City relies on Pa. PUC v. Borough of Media, 77 Pa. PUC 446, 481 (1992) (Media). City M.B. at 39. In Media, the Commission adopted the hypothetical capital structure proposed by the Borough of Media. The City’s reliance on Media ignores the numerous subsequent cases that have used the actual capital structure as explained in the OCA’s Main Brief. OCA M.B. at 51-54.

The City also argues that the OCA’s debt ratio is too high because the debt ratio will change in the 2018-2021 time frame. City M.B. at 38. The City’s argument is not relevant to the capital structure that is appropriate for ratemaking purposes in the future test year chosen by the City. At December 31, 2016, the outstanding debt attributable to the Bureau of Water will be \$10,738,268. OCA M.B. at 49; OCA St. 1 at 14; City Exh. HW-1, Sch. 3. The fund equity shown on the most recent audited financial statement is \$46,488 which means that the actual capital structure is 99.5% debt/0.5% equity. Id.; OCA St. 1 at 14-15. Ms. Everette also looked at the rate base as of 12/31/16 and subtracted the total debt at 12/31/16, the result was a 71.7% debt/28.3 equity. OCA M.B. at 49-50; OCA St. 1S at 6. In reviewing the City data as of the end of the future test year, it is clear that the OCA’s recommended capital structure is reasonable and more closely tracks the actual capital structure of the test year. The OCA recognizes that debt ratios change over time, however, the relevant time period in this rate case is the future test year, ending 12/31/16. The debt ratio in 2018-2021, in addition to being speculative, is not relevant to

the test year in this proceeding. The City's argument also presumes that debt will be paid off and no new debt will be issued which is unlikely. See OCA St. 1S at 8.

The City also argues that the OCA recommended rate case normalization period of 5 years leads to even greater overstatement of the debt ratio. City M.B. at 38. This argument is without merit. As explained by Ms. Everette:

[T]he appropriate rate case expense normalization period is based on the City's actual historical filing frequency in order to properly reflect the normal amount of rate case expense in rates. The rate case expense normalization period is not prescriptive and does not ban the City from filing a rate case sooner if it determines it is necessary.

OCA St. 1S at 8.

In its Main Brief, the City also argues that the OCA's recommended capital structure overstates the debt ratio because it includes debt issuance discounts and expenses. City M.B. at 37. As explained by Ms. Everette, "These costs are part of the cost of constructing the asset and are therefore reasonable to include when determining the portion of rate base funded by debt." OCA St. 1S at 7. Moreover, even if these costs were excluded, City witness Walker's recalculation results in a capital structure of 67% debt/33% equity (City M.B. at 37) which is essentially identical to OCA's recommended capital structure of 70% debt/30% equity and far different than City witness Walker's recommendation.

The OCA's proposed capital structure is appropriate for ratemaking purposes. It reflects the basis upon which the financing has been done for the City's rate base. Thus, for the City, it is reasonable for ratemaking purposes and should be adopted.

C. Cost of Debt

The OCA has adopted the City's 3.02% weighted cost of debt. See OCA M.B. at 58; OCA St. 1 at 12.

D. Cost of Equity

1. Introduction

The OCA's recommended cost of equity is 8.25%, which is the midpoint of the range of 7.5-9% developed by Ms. Everette. OCA M.B. at 58-65. The OCA then adjusted the 8.25% cost of equity by a 22% tax factor to reflect the tax exempt status of the City which is consistent with PUC and Commonwealth Court holdings. OCA M.B. at 62-63. For the reasons discussed in OCA Statement 1 and 1S and in the OCA's Main Brief, the OCA's recommended cost of equity of 4.09%, including the tax factor adjustment, should be adopted for ratemaking purposes.

2. Cost of Equity

a. Introduction

The OCA's DCF derived cost of common equity is 8.25% for the comparable group. The OCA's recommended return on equity relies on the results of Ms. Everette's DCF analysis, because the Discounted Cash Flow (DCF) model provides the best measure of equity cost rates. OCA M.B. at 58-65. This approach is consistent with this Commission's long-standing reliance on the DCF. See OCA M.B. at 59-60. The City argues that its use of multiple valuation models is consistent with Commission precedent. City M.B. at 44. The Commission rejected the same argument in the Lancaster case in which Mr. Walker made the same arguments as he makes in this case. The use of additional models, which have flaws, does not lead to a better result, contrary to the City's position. The Lancaster 2011 case states as follows:

Although there are various models used to estimate the cost of equity, the Discounted Cash Flow (DCF) method applied to a barometer group of similar utilities, has historically been the primary determinant utilized by the Commission.

Lancaster 2011 at 83-84.

See Pa. PUC v. Emporium Water Co., Docket No. R-00061297, Order at 55-56, Pa. PUC v. Emporium Water Co., 95 Pa. PUC 191, 208 PUR4th 502 (2001); Pa. PUC v. Roaring Creek Water Co., 81 Pa. PUC 285, 150 PUR4th 449 (1994); Pa. PUC v. York Water Co., 75 Pa. PUC 134, 159-69 (1991); Pa. PUC v. Philadelphia Suburban Water Co., 71 Pa. PUC 593 (1989); 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). The City cites to Pa. PUC v. Emporium Water Co., Docket No. R-2014-2402324 (Jan. 28, 2015) (Emporium 2014) to support its position that three models must be used to set an appropriate return on equity in this proceeding. City M.B. at 45. The City claims that the Commission approved a cost of equity developed from the same three models as used by City witness Walker in this case. Id. A review of the Commission Order in Emporium 2014 shows that the Commission did not adopt the return on equity recommendation of any specific party in that proceeding. Order at 35. Thus, the City's argument is without merit. As discussed in the OCA's Main Brief, the Commission relies on the DCF and informed judgment. OCA M.B. at 60-61.

b. DCF

i. Dividend Yields

Ms. Everette used the average daily closing price over a 3-month period to determine P_0 . OCA M.B. at 60; OCA Exh. AEE-2, Sch. 4, p. 1. This data set smooths the day to day fluctuations that are found in the market. Id.

ii. Growth Rates

As explained in the OCA's Main Brief, Ms. Everette used a combination of historic and projected growth rates to develop her growth rate range of 5.2% to 6.7%. OCA M.B. at 60-61; OCA St. 1 at 19-20. Ms. Everette analyzed five indicators of growth including earnings per share (EPS), dividends per share (DPS) and she considered historic and projected estimates for each of these. OCA M.B. at 60-61; OCA St. 1 at 19. Ms. Everette noted that investors do not all use the same growth rate or apply the same weight to the various growth estimates. OCA M.B. at 60; OCA St. 1 at 18.

The City inaccurately criticizes the OCA's growth rate because it says Ms. Everette did not use the published earnings growth rates and calculated her own growth rates. City M.B. at 50-51. As explained in the OCA's Main Brief, Ms. Everette used a combination of historic and projected growth rates to arrive at her recommended growth rate of 5.2-6.7% for the comparable group. OCA M.B. at 60-61; OCA St. 1 at 18-20. Those growth rate indicators are from published sources, such as Yahoo Finance and Value Line Investment Survey. See OCA St. 1S at 10; OCA Exhibit AEE-2, Schedule 4.

As explained in the OCA's Main Brief and testimony, the City's use of projected growth rates, with no reliance on historic growth rates is in error. OCA M.B. at 64; OCA St. 1 at 24. City witness Walker admitted that investors have access to information on historic growth rates that would include periods when growth was negative (Tr. 99) yet he does not consider that data. OCA M.B. at 64. By excluding negative growth rates, City witness Walker's growth rates are skewed higher than is reasonable.⁹

⁹In addition to not fully considering the available data, City witness Walker misstates the average historical earnings growth rate for the proxy group, stating that it is 10.9% (City St. 4 at 43) and it is in fact 4.7%. OCA M.B. at 64; OCA St. 1 at 24. City witness Walker's growth rate should not be relied on for purposes of setting the DCF-derived cost of equity.

3. Leverage And Risk Adjustments

As explained in the OCA's Main Brief, the City's 70 basis point leverage adjustment and its 25 basis point adjustment for risk differential should be rejected. OCA M.B. at 64-65; OCA St. 1 at 24-25. City witness Walker states that when market value exceeds book value that indicates that a company is expected to earn more than investors require or higher than its cost of equity. City M.B. at 46. No adjustment to further increase the return on equity is needed in that situation. Thus, City witness Walker's leverage adjustment is illogical because it increases the return on equity for utilities that already have high returns and lowers the return on equity for utilities with low returns. Similarly, City witness Walker's risk adjustment is not necessary because it serves to inflate a return on equity that is determined by the model. The PUC has denied City witness Walker's leverage and risk adjustment in Lancaster 2011. 2011 Pa. PUC LEXIS *118.

There is no logical or empirical basis for the City's proposed 70 and 25 basis point adjustments as discussed above. The City's proposed adjustments should be denied.

4. Tax Factor Adjustment

The OCA applied a 20% tax factor adjustment to the 8.25% equity cost rate to arrive at a recommended equity cost rate of 6.6%. OCA M.B. at 62-63; OCA St. 1 at 21-23. The City does not acknowledge that a tax factor is appropriate despite the fact that the adjustment has been made in other municipal rate cases and was upheld by the courts. As discussed in the OCA's Main Brief, the PUC used a 20% tax factor in Lancaster 2011. There have not been material changes to the tax code since Lancaster 2011, thus the 20% tax factor adjustment used there is still appropriate in this case. OCA M.B. at 62; OCA St. 1 at 23.

The PUC' previously used a 28% tax factor in the City of Lancaster's 1998 water rate case and that was upheld by the Commonwealth Court. Lancaster's Petition for Allowance of Appeal was denied by the Pennsylvania Supreme Court. Lancaster Water v. Pa. PUC, 769 A.2d 567 (Pa. Commw. 2001) appeal denied, 568 Pa. 725, 797 A.2d 916 (2002).

The City argues that no tax factor adjustment should be made. City M. B. at 52. If an adjustment is to be made, however, the City argues that it should be no more than 9%. Id. The City criticizes the OCA because Ms. Everette did not conduct an analysis of the spread between bond yields. City M.B. at 54. As explained in Lancaster 2011, the Commission did not use the spread between bond yields as the basis for its 20% tax factor adjustment. Rather, the Commission used 20% because it found it to be representative of the marginal tax rate of the largest block of municipal investors. 2011 Pa. PUC LEXIS *121; OCA MB. at 62. As discussed above and in the OCA's Main Brief, Ms. Everette concluded that a 20% tax factor adjustment was still appropriate in this case because income tax rates have not changed materially since the Commission's Order in Lancaster 2011. See OCA M.B. at 62-63; OCA St. 1 at 23.

The OCA submits that a tax factor adjustment is appropriate for ratemaking purposes in this case just as it was in Lancaster 2011 and in cases before that (where a higher tax factor adjustment was used). In this case, a tax factor adjustment of 20% is appropriate, just as it was in Lancaster 2011. The City's arguments to the contrary should be rejected.

E. Conclusion

The OCA's recommendation of a tax adjusted 6.6% return on equity using a 70% debt/30% equity capital structure results in an overall return of 4.09% which is appropriate and reasonable for ratemaking purposes.

The City has not supported its overstated claim for a 10.5% return on equity and an overall return of 6.76%. The City's use of a 50% debt/50% equity hypothetical capital structure must be rejected because it increases costs for consumers by requiring higher equity returns for lower cost debt. The City has incorrectly proposed a too high equity cost rate by using methods which are not well founded. The OCA submits that its recommendations should be adopted.

VIII. MISCELLANEOUS ISSUES

A. The City Should Continue To Report Sales Of Water To Shale Gas Companies, As Was Agreed To During The Evidentiary Hearing

The City does not argue in its Main Brief against continuing to report sales of water to shale gas companies. 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

City Manager Suplizio testified as follows:

Q: Witnesses for I&E, Sandy Township and OCA stated that the City should be required to continue reporting sales of water to shale gas companies in its annual reports. Will the City continue this process?

A: Yes. The City will not oppose the parties. We will continue to report that annually.

Tr. at 22-23.

City Manager Suplizio further testified as follows:

Q: Just to make sure we're abundantly clear on the record, you have no objection to continuing to report driller revenues as you had in the past?

A: I have no objection to that.

Tr. at 32.

As discussed in detail in the OCA's Main Brief on pages 72 to 73, the sales information should be available and publicly recorded for review in future rate cases, as was previously agreed upon in the previous settlement and at the evidentiary hearing. OCA M.B. at 72-73. For these reasons, OCA submits that the City should continue to report sales to shale gas companies in its annual reports.

B. The City Should Report Sales of Water to the Borough of Falls Creek, As Agreed Upon During The Evidentiary Hearing

As discussed in the OCA's Main Brief, 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 M.B. at 74; OCA St. 1 at 47. The OCA recommended 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 M.B. at 74; OCA St. 1 at 47.

At the evidentiary hearing, City Manager Suplizio testified as follows:

Q: Do you have any objection to providing notice to the PUC if another development, for example, Falls Creek, were to come on line?

A: I have no objection to that.

Tr. at 32:13-16.

The City argues in its Main Brief that since City Manager Suplizio is not a lawyer, he cannot make such determinations for the City regarding reporting requirements. City M.B. at 10. The City Manager is tasked with the supervision of all departments (excluding the fire department). OCA M.B. at 30; I&E-RE-30D Part A (attached to OCA St. 1). No objections were made to this portion of City witness Suplizio's testimony and it became part of the record.¹⁰

¹⁰ The City Manager not being a lawyer has no effect on the City Manager's testimony at the evidentiary hearing in which he agreed to report future sales to Falls Creek. This suggestion, that only lawyers can make such determinations on behalf of the City, has no support in the law.

The reporting requirements listed above will not create an undue burden to the City. Accordingly, the OCA recommends that the City inform the Commission when it connects to Falls Creek and begins service in the manner listed above.

C. The City's Evidentiary Motion Should Be Overruled Because It Contradicts The Pennsylvania Rules of Evidence

The OCA provided a detailed legal discussion in its Main Brief regarding why Mr. Fought's testimony is not hearsay. See, OCA M.B. at 74-76. As discussed in the OCA's Main Brief, a statement is hearsay only if it is offered to prove the truth of the matter asserted in the statement. OCA M.B. at 74; Pa.R.E. 801(c). Furthermore, the OCA's Main Brief discussed Rule 703 of the Pennsylvania Rules of Evidence, which states that an expert may base an opinion on facts or data that the expert has been aware of or personally observed. See, OCA M.B. at 74-76; Pa.R.E. 703. The City takes issue with the fact that Mr. Fought was not contacted personally but was instead made aware of complaints regarding water quality made to the OCA. City M.B. at 55-56. The Pennsylvania Rules of Evidence do not require that a consumer make personal contact with an expert in order for an expert to be made aware of a statement.

The City takes issue with the fact that the customers were not presented at the evidentiary hearing to be cross-examined. City M.B. at 56. As stated in the OCA's Main Brief, however, the statements made by the jurisdictional customers are not being offered for the truth of the matter asserted. See OCA M.B. at 74-76. Indeed, the City agrees that:

[e]ven Mr. Fought conceded that he had not actually observed the water quality issues that were the subject of the alleged complaints, nor has he conclusively verified whether the alleged complainants are jurisdictional customers.

City M.B. at 56.

Mr. Fought's testimony was not that there were quality of service problems. Mr. Fought was testifying only to the point that complaints were made to the OCA. Thus, Mr. Fought's disputed statement in his surrebuttal is nonhearsay. The City makes an additional argument in passing that Mr. Fought's rebuttal testimony on this issue offers no probative value because the City entered into a stipulation with the OCA regarding complaint logs. City M.B. at 56. Mr. Fought is an expert in engineering and quality of service. See, OCA St. 2 at 1; see also OCA St. 2 at App. A. Consumer complaints are reasonably relied upon by an expert in the field of quality of service. The fact that the OCA and the City agreed upon stipulations does not, in any way, decrease the probative value of Mr. Fought's testimony. In fact, the testimony provides the evidentiary basis for the stipulation on this issue and the other issues contained in the stipulation.

Lastly, the City argues that the consumers were not identified at the evidentiary hearing. City M.B. at 56. The City, however, did not ask Mr. Fought, when he was on the stand, for the OCA to identify the consumers who made the complaints. See, Tr. at 131-142,

For the reasons stated above and in the OCA's Main Brief, the OCA submits that the City's motion to strike the disputed portion of Mr. Fought's testimony should be overruled.

IX. RATE STRUCTURE

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

X. CONCLUSION

For the reasons set forth in the Office of Consumer Advocate's Main Brief and above, the Office of Consumer Advocate respectfully requests that the Commission determine that the City of Dubois – Bureau of Water be allowed to increase rates by no more than \$50,418.

Respectfully submitted,



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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	<u>750,548</u>	<u>(74,878)</u>	<u>675,670</u>	<u>-</u>	<u>675,670</u>
Net Income Available for Return	<u>\$ 49,694</u>	<u>\$ 74,878</u>	<u>\$ 124,572</u>	<u>\$ 50,418</u>	<u>\$ 174,990</u>
Rate Base	<u>\$ 4,317,704</u>	<u>\$ (38,870)</u>	<u>\$ 4,278,834</u>		<u>\$ 4,278,834</u>
Rate of Return	1.15%		2.91%		4.09%

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

Table II

Summary of Adjustments

<u>Recommended Adjustment</u>	<u>Reference</u>	(A) Rate Base Effect	(B) Revenue Effect	(C) Expense Effect	(D) Effect Upon Other Taxes	(E) Depreciation Expense Effect	(F) <u>Income Tax</u>
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)	\$ -