**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17105-3265**

Public Meeting held March 16, 2017

Commissioners Present:

 Gladys M. Brown, Chairman

 Andrew G. Place, Vice Chairman, dissenting in part

 John F. Coleman, Jr.

 Robert F. Powelson

 David W. Sweet

Pennsylvania Public Utility Commission R‑2016-2554150

Pennsylvania Office of Small Business AdvocateC-2016-2556342

Pennsylvania Office of Consumer Advocate C-2016-2556376

Sandy Township, C-2016-2557459

 v.

City of DuBois - Bureau of Water

**OPINION AND ORDER**

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**BY THE COMMISSION:**

**I. Matter Before the Commission**

Before the Pennsylvania Public Utility Commission (PUC or Commission) for consideration and disposition are the Exceptions of the City of DuBois – Bureau of Water (DuBois or the City), the Commission’s Bureau of Investigation and Enforcement (I&E), the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA) and Sandy Township, all filed on February 2, 2017, to the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Mark A. Hoyer issued on January 13, 2017, relative to the above-captioned proceeding. On February 13, 2017, Replies to Exceptions were submitted by DuBois, I&E and the OCA. On February 15, 2017, the OCA and I&E filed Motions to Strike a Portion of Exceptions (Motions to Strike) concerning “new evidence” contained in the City’s Exceptions requesting that the new evidence be stricken from the City’s Exceptions. On February 27, 2017, the City filed Answers to Motions to Strike (City Answer). For the reasons stated below, we shall grant the Motions to Strike, deny the Exceptions filed by the OSBA and Sandy Township, and grant, in part, the Exceptions of the City, I&E and the OCA.

**II. History of the Proceeding**

 On June 30, 2016, DuBois filed Supplement No. 22 to Tariff Water - Pa. P.U.C. No. 4, with the Commission to become effective August 29, 2016, at Docket No. R‑2016-2554150. In its original filing, DuBois proposed an annual increase in base rate revenues of $257,604 or an approximately 33.7% increase for customers located outside of the City limits. City Exh. CEH-1 at 6. However, in rejoinder, the City reduced the annual revenue requirement increase to $229,551. City Exh. CEH-3RJ. The rates and service of these customers are subject to the jurisdiction of the Commission, pursuant to 66 Pa. C.S. §§ 1301 and 1501. Pursuant to 66 Pa. C.S. § 1308(d), the filing was suspended by operation of law until March 29, 2017.

On July 13, 2016, the OSBA filed a Formal Complaint at Docket No. C‑2016-2556342. On July 14, 2016, the OCA filed a Formal Complaint at Docket No. C‑2016-2556376 and a Notice of Appearance. On July 20, 2016, Sandy Township filed a Formal Complaint at Docket No. C-2016-2557459. On July 25, 2016, I&E filed a Notice of Appearance.

 By Order entered August 11, 2016, the Commission suspended Supplement No. 22 to Tariff Water – Pa. P.U.C. No. 4 by operation of law until March 29, 2017, unless permitted by Commission Order to become effective at an earlier date. The Order also instituted an investigation into the lawfulness, justness, and reasonableness of the proposed Supplement No. 22, and existing rates, rules, and regulations. The Order directed that the case be assigned to the Office of Administrative Law Judge (OALJ) for the scheduling of such hearings as may be necessary. This matter was then assigned to ALJ Hoyer for the conduct of hearings, culminating in a Recommended Decision for the consideration of the Commission.

On November 10, 2016, in accordance with the litigation schedule established at the Prehearing Conference, the ALJ convened an evidentiary hearing in Harrisburg, Pennsylvania.

On November 16, 2016, a First Interim Order Setting Requirements for Briefs was issued. On November 28, 2016, Sandy Township filed a Motion to Accept Newspaper Article into the Record (Sandy Township’s Motion). Pursuant to 52 Pa. Code § 5.103(b), responses to Sandy Township’s Motion were due December 19, 2016.

On November 29, 2016, Main Briefs (M.B.) were filed by the City, I&E, the OCA, the OSBA, and Sandy Township. Sandy Township improperly attached the Newspaper Article that was the basis for its Motion on November 28, 2016, to its Main Brief as Attachment 1 and made references to it within its Main Brief at pages 5 and 6.

On December 12, 2016, Reply Briefs (R.B.) were filed by DuBois, I&E, the OCA, the OSBA, and Sandy Township.

On December 19, 2016, DuBois filed a Motion addressing Sandy Township’s Motion in its Reply Brief and filed an Answer and Motion to Strike Attachment 1 and all references thereto from Sandy Township’s Main Brief. No other Party filed responses to Sandy Township’s Motion.

 On December 21, 2016, a Second Interim Order was issued addressing outstanding oral Motions to Strike made at the evidentiary hearing, denying Sandy Township’s Motion, striking Attachment 1 from Sandy Township’s Main Brief and all references thereto.[[1]](#footnote-1) The record was closed on the same day. The record includes a 150‑page transcript and the Parties’ testimonies and exhibits.

 ALJ Hoyer’s Recommended Decision was issued on January 13, 2017. In his Recommended Decision, the ALJ recommended a maximum revenue increase of $97,354 out of the $229,551 increase requested by the City. This represents an increase of, approximately, 12% over existing rates instead of the approximately 28% requested by the City.[[2]](#footnote-2) ALJ Hoyer also recommended approval of the City’s proposed increase to the customer charges and recommended that the reduction in the requested revenues be achieved by cutting the volumetric rates for the first 100,000 gallons and over 100,000 gallons. R.D. at 1 (citing Appendix A). The ALJ stated that the revised rates are $5.68 or 10.29% over present rates (for the first 100,000 gallons) and $4.30 or 14.06% (for usage over 100,000 gallons), resulting in a revenue increase of approximately $97,341 and total annual revenue of about $897,583. *Id.* According to the ALJ, because the increases in customer charges are maintained, a reduction in the volumetric rates which is proportional to the reduction in the requested revenue increase, results in greater than allowable annual revenue. The ALJ therefore, adjusted the volumetric rates to maintain the percentage of revenues from jurisdictional residential, commercial, industrial and “Other Water Utilities” customers as close to the cost of service, as reasonably possible. R.D. at 1.

 Exceptions and Reply Exceptions to the Recommended Decision were filed as noted above.

**III. Discussion**

**A. Description of the Company**

DuBois operates a small, community-based water system serving customers within its municipal boundaries and in the surrounding Sandy Township. In total, DuBois provides water distribution service to 4,501 customers, including 3,338 customers inside of its municipal boundaries and 528 in Sandy Township. Furthermore, DuBois sells water to Sandy Township for resale to additional customers served directly through the Sandy Township’s distribution system. DuBois also provides bulk water service to Union Township and the Borough of Sykesville (Sykesville), both through contract sales. *See* R.D. at 4; City St. 1 at 3; City St. 4 at 6-7. The City’s main source of supply is the Anderson Creek Reservoir, which is fed by Anderson Creek, Dressler Run and Montgomery Run. City St. 4 at 7.

**B. Legal Standard**

 The most fundamental principle in Commission rate proceedings is that resultant rates must be just and reasonable and in conformity with the Regulations and Orders of the Commission. 66 Pa. C.S. §1301. The City, as a municipal corporation, is regulated by the Commission for service outside of its corporate boundaries pursuant to Section 1301 of the Public Utility Code (Code). *See* 66 Pa. C.S. § 1301. The Code provides that public utility service being provided by municipal corporations, beyond their corporate limits, shall be subject to rate regulation by the Commission, with the same force, and in like manner, as if such service were provided by a public utility. *Id*. In addition, a public utility is entitled to such rates as will provide it the opportunity to earn a fair rate of return on the value of its property dedicated to public service. *Pennsylvania Gas and Water Co. v. Pa. PUC*, 341 A.2d 239 (Pa. Cmwlth1975); *Bluefield Water Works and Improvement Co. v. Public Service Comm’n of West Virginia* (*Bluefield)*, 262 U.S. 679, 692-3 (1923).

 The Code also provides that the burden of establishing the justness and reasonableness of its rates is clearly on the City as to rates charged to customers outside its municipal boundaries. *See* 66 Pa. C.S. §§ 315(a) and 1301. The Pennsylvania Commonwealth Court has interpreted Section 315(a) of the Code as follows:

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 public 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*, 409 A.2d 505, 507 (Pa. Cmwlth. 1980) (Emphasis added). *See also, Brockway Glass v. Pa. PUC,* 437 A.2d 1067 (Pa. Cmwlth. 1981).

 Substantial evidence is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. *Dutchland Tours, Inc. v. Pa. PUC,* 337 A.2d 922 (Pa. Cmwlth. 1975).

 The Commission has affirmed the utility’s burden of proof in base rate proceedings in numerous cases including, *Pa. PUC v. Aqua Pennsylvania, Inc.,* R‑00038805, (Order entered August 5, 2004 at 7; *Pa. PUC v. National Fuel Gas Distribution Corp,* 1994 Pa. PUC LEXIS 134 \*5 (1994); *Pa. PUC v. Breezewood Telephone Company* (*Breezewood)*, 74 PA PUC 431 (1991); and, *Pa. PUC v. Equitable Gas Co.,* 57 PA PUC 423, 471 (1983). In *Breezewood*, the Commission made the following ruling with respect to Breezewood Telephone Company’s (BTC) burden of proof:

Thus, where a party has raised a question concerning an element at issue, the affirmative burden of proving justness and reasonableness of its claim is upon BTC.

74 PA P.U.C. at 442.

 It is also well-established that the burden of proof does not shift to parties challenging a requested rate increase. Instead, the utility’s burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one and that burden remains with the public utility throughout the course of the rate proceeding. There is no similar burden placed on parties which are challenging a proposed rate. As stated by the Pennsylvania Supreme Court in *Berner v. Pa. P.U.C.,* 382 Pa. 622, 631, 116 A.2d 738, 744 (1955):

[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 . . . .

This does not mean, however, that in proving its case, a public utility must affirmatively defend claims that no Party has questioned. As held by the Pennsylvania Commonwealth Court:

While it is axiomatic that a utility has the burden of proving the justness and reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged.

*Allegheny Center Assocs. v. Pa. PUC,* 570 A.2d 149, 153 (Pa. Cmwlth. 1990); *see also*, *Pa. PUC v. Equitable Gas Co.,* 73 PA PUC 310, 359-60 (1990).

 Additionally, the General Assembly has given the Commission discretionary authority to consider the efficiency, effectiveness and adequacy of service as a performance factor consideration in determining just and reasonable rates, 66 Pa. C.S. § 523, and also provided this Commission with the authority to deny, in whole or in part, a proposed rate increase, if we find “that the service rendered by the public utility is inadequate.” 66 Pa. C.S. § 526(a).

When, as in the instant case, a rate filing involves a municipality serving both nonjurisdictional (inside) and jurisdictional (outside) customers, the costs of service must be allocated between the two customer groups. In this rate case, the City developed a revenue requirement on a total water system basis, and then prepared a cost of service allocation study (City Exh. CEH-2) which allocated operation and maintenance expenses, depreciation expense and rate base to jurisdictional customers based upon certain allocation factors. These allocation percentages are to be based upon some reasonable relationship to the jurisdictional customers’ relative cost, as compared to the total system cost of service.

 The opposing Parties have challenged various elements of the City’s rate filing, and those issues being litigated will be addressed in accordance with the previously mentioned standard rate case principles. As we proceed in our review of the various positions espoused in this proceeding, we are reminded that we are not required to consider expressly or at great length each and every contention raised by a party to our proceedings. *University of Pennsylvania, et al. v. Pa. P.U.C*., 485 A.2d 1217, 1222 (Pa. Cmwlth. Ct. 1084). Moreover, any Exception or argument that is not specifically addressed herein shall be deemed to have been duly considered and denied without further discussion.

 We note that the standard formula for determining a utility’s base rate revenue requirement is:

 RR = E + D + T + (RB x ROR)

RR: Revenue Requirement

E: Operating Expense

D: Depreciation Expense

T: Taxes

RB: Rate Base

ROR: Overall Rate of Return

I&E St. 1 at 2-3; I&E M.B. at 26, fn. 102.

 The focus of a base rate case is to determine the correct values to insert into the formula above. After determining the correct revenue requirement, the appropriate allocation of that revenue among the rate classes will then be determined. R.D. at 6.

**C. Motions to Strike Portions of Exceptions and Answers to Motion**

 **1. Motions to Strike**

 Before addressing the litigated issues in this proceeding, we will address the Motions to Strike filed by the OCA and I&E regarding the City’s Exceptions to the ALJ’s adjustments pertaining to the five additions to rate base claimed by the City, as well as the City Answer filed in response.

The presiding ALJ adopted the recommendations of the OCA and recommended the following adjustments to rate base:

1. Heating and air conditioning-rate base adjustment $17,352 (jurisdictional component $5,204). Depreciation Expense Adjustment $309 with a jurisdictional component of $93.

2. Main Additions (originally requested $807,500. City updated to remove $518,870). Agree with the OCA removal of High Street mains addition project. Remove $55,911 of mains and accessories with a jurisdictional component of $14,531. Depreciation Expense Adjustment $475 with a jurisdictional component of $124.

3. Fire Hydrants (originally City wanted $120,000 for additions and replacements but no longer planning $63,579. The current addition the City requests is $56,421). Remove $5,769 of High Street hydrants *see above* (jurisdictional component $1071). Depreciation Expense Adjustment $82 with a jurisdictional component of $15.

4. Billing, Payroll and accounting software. Remove $13,341 from rate base for Office Furniture and equipment with a jurisdictional component of $1,426). Depreciation Expense Adjustment $890 with a jurisdictional component of $254.

5. Phone System. Remove $5,833 from Office Furniture and Equipment with a jurisdictional component of $1663. Depreciation Expense Adjustment of $389 with a jurisdictional component of $111.

R.D. at 17.

In its Exceptions, the City asserts that in light of “new evidence” showing that the City spent approximately $113,200 on improvements to its heating and air conditioning, phone system, and High Street mains during the time period between the evidentiary hearing and the end of the test year in this proceeding, the ALJ’s recommendation approving the OCA’s adjustments should be rejected. The City states that consistent with the invoices in Appendix A attached to its Exceptions, it spent $113,200 in investment cost in only three of the five identified rate base additions which exceeds the $98,206 the City originally budgeted for the five items in its rate base additions. The City requests that the Commission take judicial notice of the additional invoices pursuant to Section 5.408 of the Commission Regulations, 52 Pa. Code § 5.408. City Exc. at 3-5 (citing R.D. at 8-17).

In their Motions to Strike, the OCA and I&E assert that the City’s request should be denied and the new evidence presented by the City as Appendix A to its Exceptions should be stricken from the record. The OCA and I&E point out that the proposed evidence is proffered more than one month beyond the formal close of the record. The OCA and I&E aver that not only did the City fail to follow proper procedure, but DuBois also failed to show good cause that would allow admission of the new evidence into the record. The OCA and I&E allege that this attempt to introduce new evidence violates their due process by depriving them of the right to conduct discovery, as well as to cross-examine, rebut or meaningfully reply. OCA Motion to Strike at 2-7; I&E Motion to Strike at 2-5.

 **2. City Answer**

In the City Answer, the City contends that the Commission should deny the Motions to Strike because the OCA and I&E fail to acknowledge that the invoices in Appendix A pertain to limited portions of the City’s claim for rate base additions to be completed before December 31, 2016, the future test year (FTY). The City further argues that its claimed rate base additions should be approved regardless of the new evidence due to its assertion of, and explanation of, reasons it presented in its Main and Reply Briefs. The City, however, states that the Commission should consider the new invoices which represent expenses incurred prior to the conclusion of the FTY. City Answer at 1‑5.

**3. Disposition**

On consideration of the positions of the Parties, we shall grant the OCA’s and I&E’s Motions to Strike. We acknowledge the vigorousness with which the adjustments to rate base were litigated. On balance, however, we shall not consider the documents and invoices presented by the City in its Exceptions. We find that the rights of the OCA and I&E to engage in meaningful cross-examination have been impaired as a result of this procedure. *See* 52 Pa. Code § 5.243. Presentation by parties: (a) A party, has the right of presentation of evidence, *cross-examination*, objection, motion and argument . . . (Emphasis added).

The City and the ALJ correctly cite and reference cases standing for the proposition that in the area of adjustments to rate base, this Commission has wide discretion. *See* R.D. at 16, citing *Pa. Power & Light Company v. Pa. PUC,* 516 A.2d 426 (Pa. Cmwlth. Ct. 1985); *UGI Corp. v. Pa. PUC,* 410 A.2d 923, 929 (Pa. Cmwlth. Ct. 1980)(*UGI case*); *Duquesne Light Co. v. Pa. PUC,* 174 Pa. Superior Ct. 62, 69-70, 99 A.2d 61, 69 (1953).

Also, this Commission has previously found that expenditures for projects to be completed shortly after the end of the test year may be allowed if such projects do not affect the level of operations at the end of the test year *i.e.*, they are nonrevenue producing and nonexpense reducing. R.D. at 15, citing *Pa. PUC v. The Bell Telephone Co. of Pa.*, 51 Pa. P.U.C. 570 (Dec. 15, 1997), at 576; *see also Pa. PUC v. Phila. Suburban Water Co.*, 50 Pa. P.U.C. 407 (Dec. 9, 1976).

Notwithstanding the foregoing, we are mindful of our Rules of Practice and Procedure which are designed to obtain an orderly and just determination of matters coming before us. According to 52 Pa. Code § 5.431(a), “(a) Once the record is closed no additional evidence may be introduced or relied upon by a participant unless allowed for good cause shown by the Commission or presiding officer upon motion of a participant . . .” *See Application of* *Apollo Gas Company . . .*, Docket No. A-120450, F003 (Order entered February 10, 1994). We cannot conclude, on the basis of the record, and at the Exceptions stage of these proceedings, that the City has shown good cause.[[3]](#footnote-3) Further, the City’s reliance on our authority to take official [judicial] notice according to 52 Pa. Code §5.408, does not recognize that the rule, itself, permits a party the opportunity to receive notice and to respond. *See Application of Pennsylvania Ambulance, LLC* . . . Docket No. A-2014-2420246 (Order entered July 30, 2015), “[f]urthermore, we recognize that by taking official notice of this evidence the Protestant would not have an opportunity to offer evidence in explanation or rebuttal which could present due process concerns. *See,* [*Hess v. Pa. PUC*, 107 A.3d 246, 266 (Pa. Cmwlth. 2014).](http://www.lexis.com/research/buttonTFLink?_m=d1c4f196fe4f136f7f0597d7fae80a0a&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b2015%20Pa.%20PUC%20LEXIS%20395%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=35&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b107%20A.3d%20246%2cat%20266%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=2&_startdoc=1&wchp=dGLbVzk-zSkAz&_md5=2436311a9f3d2d9540f0bb772bee03cb)”

In granting the Motions to Strike, we do not base our determination as grounded in an unduly restrictive interpretation of the obligation of the utility to prove every element of its claim. *See* *Pa PUC v. City of Lancaster – Sewer Fund*, 2005 Pa. PUC LEXIS 44 (Jan. 1, 2005) (*Lancaster Sewer 2005*), citing [*Berner v. Pa. PUC*, 382 Pa. 622, 631, 116 A.2d 738 (1955)](http://www.lexis.com/research/buttonTFLink?_m=a7b095c345cc35b0d21ea14b35505cdc&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b2005%20Pa.%20PUC%20LEXIS%2044%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=18&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b382%20Pa.%20622%2cat%20631%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzk-zSkAz&_md5=4c28df3e8eec2731344ee15b8fdaa656) – the utility’s burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one and that burden remains with the public utility throughout the course of the rate proceeding.

Also, we do not address the merits of the opposing contentions that the City failed to prove that the projects which are the subject of the Motions to Strike would be started, completed or used and useful within the future test year based on their, alleged, short-term nature. *See* [*Pa. PUC v. Pennsylvania American Water Company*, 68 Pa. P.U.C. 343, 352, 97 P.U.R. 4](http://www.lexis.com/research/buttonTFLink?_m=a7b095c345cc35b0d21ea14b35505cdc&_xfercite=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b2005%20Pa.%20PUC%20LEXIS%2044%5d%5d%3e%3c%2fcite%3e&_butType=3&_butStat=2&_butNum=29&_butInline=1&_butinfo=%3ccite%20cc%3d%22USA%22%3e%3c%21%5bCDATA%5b68%20Pa.%20PUC%20343%2cat%20352%5d%5d%3e%3c%2fcite%3e&_fmtstr=FULL&docnum=1&_startdoc=1&wchp=dGLbVzk-zSkAz&_md5=641d7c2bf73ff840e1c3838302143532)th 469 (1988).

Our decision is primarily based on the failure of the City to follow those procedures that would afford the OCA and I&E a meaningful opportunity to respond.[[4]](#footnote-4) This is especially of importance given the jurisdictional allocation and depreciation adjustment components involved in this proceeding.

Based on the foregoing, we shall grant the Motions to Strike.

**D. Rate Base**

 **1. Plant in Service**

  **a. Position of the Parties**

DuBois originally claimed a rate base of $15,622,314, with a jurisdictional portion of $4,493,848. City CEH-1 at 12-13; OCA St. 1 at 3. However, in rejoinder, DuBois made a downward adjustment of $642,060, for 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.[[5]](#footnote-5) City Exh. CEH-3RJ; Table 1.

 None of the other Parties opposed the City’s rate base calculation. Although the OCA’s initial total rate base was slightly higher than that claimed by the City, the OCA agreed with DuBois’ and I&E’s updated jurisdictional rate base of $4,317,704. OCA M.B. at 8-9 (citing City Exh. CEH-1 at 10; City Exh. CEH-3RJ; Table I; OCA R.B at 3); City R.B. at 3.

 **b. ALJ’s Recommendation**

The ALJ stated that the OCA’s initial calculation of the City’s total rate base in the amount of $14,980,254 was slightly higher than that calculated by both DuBois and I&E, which is $14,727,868. The ALJ explained that the reason the OCA’s rate base claim was slightly higher was because the OCA included cash working capital (CWC) in its calculation, while I&E and the City’s restated rate base did not include CWC. The ALJ, however, noted that the OCA, I&E, and DuBois all agreed on the rate base amount of $14,727,868. None of the Parties disputed the City’s calculation of Plant in Service and the City’s updated rate base claim of $4,317,704. R.D. at 7-8 (citing City Exh. CEH‑1 at 12-13; City Exh. CEH-3RJ; Table I, attached to OCA M.B. as Appendix A; City R.B. at 3).

**c. Disposition**

No Party filed Exceptions regarding the ALJs’ recommendation on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment.

**2. Additions to Rate Base**

1. **Position of the Parties**

No other Party except the OCA made adjustments to the City’s additions to rate base. The OCA made five specific adjustments stating that none of the additions would be in service or would be used and useful by December 31, 2016. The City’s rate base additions and the OCA’s five adjustments are highlighted below:

(1) **Heating and Air Conditioning** – DuBois claimed $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). OCA reduced that amount to $17,352 with a jurisdictional portion of $5,204. Table II; OCA Exh. AEE-1S at line 2.

(2) **High Street Mains Project** – The City’s initial filing also included a rate base addition of $807,500 for Main additions and replacements in 2016. OCA St. 1 at 5. DuBois later reduced this amount to $288,630. However, because no work has commenced regarding the High Street Mains project, the OCA further proposed the removal of $55,911 for Mains and Accessories with a jurisdictional portion of $14,531. OCA St. 1 at 5; Table II; OCA St. 1S at 3; OCA Exh. AEE-1S at line 19; OCA M.B. at 12.

(3) **Fire Hydrants (High Street Fire Hydrants Project)** – The City’s initial filing included a rate base addition of $120,000 for Fire Hydrant additions and replacements in 2016, but DuBois later changed this amount to $56,421. City Exh. JJS-1R at 2. The OCA, therefore, proposed the removal of $63,579 for this item with a jurisdictional portion of $11,800. OCA St. 1 at 7. Subsequently, the OCA proposed the removal of $5,769 for fire hydrants additions related to the High Street mains project with a jurisdictional component of $1,071, because the City was unable to demonstrate that the project would be completed in November as earlier claimed by the City. Table II; OCA St. 1 at 8; OCA Exh. AEE-1S at line 6.

(4) **Billing, Payroll and Accounting Software** – The City claimed a rate base addition of $13,341 for Office Furniture and Equipment for new billing, payroll, and accounting software. However, because DuBois failed to demonstrate that this project would be completed within the FTY, the OCA recommended the removal of this plant item from rate base with a jurisdictional portion of $1,426. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 7.

(5) **Phone System Expenses** – The City’s filing included a rate base addition of $5,833 for Office Furniture and Equipment regarding a new phone system. OCA St. 1S at 4; OCA Exh. AEE-1S at line 8. The OCA proposed the removal of this item from rate base because no money has been spent and the City has not demonstrated that any money would be spent on this item within the FTY. The OCA, therefore, recommended the removal of $5,833 from rate base with a jurisdictional portion of $1,663. Table II; OCA St. 1S at 4; OCA Exh. AEE-1S at line 8.

The City, on the other hand, averred that the Commission should disregard the OCA’s overly severe adjustments regarding its rate base additions. According to the City, each of the plant additions would be placed in service prior to the completion of the FTY. City R.B. at 3-6. Therefore, DuBois requested that the Commission accept its revised rate base and deny the OCA’s unnecessary adjustments. Alternatively, the City averred that to the extent that the Commission denies its claimed rate base additions, DuBois “reserves its right to motion to reopen the record to supply additional documentation available following the conclusion of the FTY of December 31, 2016.” *Id.* at 6.

 **b. ALJ’s Recommendation**

ALJ Hoyer adopted the five adjustments proposed by the OCA. The ALJ emphasized 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. R.D. at 16 (citing *Lancaster Sewer 2005* \*102-103). The ALJ posited that despite having the burden of proof in this proceeding, DuBois failed to provide additional evidence regarding the OCA’s five proposed adjustments. Furthermore, the ALJ noted that although the City claimed all of the identified projects are short-term projects that would be completed and would be used and useful by December 31, 2016, the City failed to provide any documentation to prove that these projects belong in rate base. R.D. at 17. Therefore, ALJ Hoyer recommended the following five adjustments to rate base:

1. Heating and air conditioning-rate base adjustment $17,352 (jurisdictional component $5,204). Depreciation Expense Adjustment $309 with a jurisdictional component of $93.

2. Main Additions (originally requested $807,500. City updated to remove $518,870). Agree with the OCA removal of High Street mains addition project. Remove $55,911 of mains and accessories with a jurisdictional component of $14,531. Depreciation Expense Adjustment $475 with a jurisdictional component of $124.

3. Fire Hydrants (originally City wanted $120,000 for additions and replacements but no longer planning $63,579. The current addition the City requests is $56,421). Remove $5,769 of High Street hydrants *see above* (jurisdictional component $1071). Depreciation Expense Adjustment $82 with a jurisdictional component of $15.

4. Billing, Payroll and accounting software. Remove $13,341 from rate base for Office Furniture and Equipment with a jurisdictional component of $1,426). Depreciation Expense Adjustment $890 with a jurisdictional component of $254.

5. Phone System. Remove $5,833 from Office Furniture and Equipment with a jurisdictional component of $1,663. Depreciation Expense Adjustment of $389 with a jurisdictional component of $111.

R.D. at 16-17. Consequently, ALJ Hoyer made a total jurisdiction adjustment of $9,364 (*sic*) to rate base.[[6]](#footnote-6)

 **c. Exceptions and Replies**

In its Exceptions, the City avers that in light of “new evidence” showing that it spent approximately $113,200 on improvements to its heating and air conditioning, phone system, and High Street mains during the time period between the evidentiary hearing and the end of the test year in this proceeding, the ALJ’s recommendation adopting the OCA’s adjustments should be rejected. As previously discussed, we have determined to grant the Motions to Strike filed by the OCA and I&E, thus this portion of the City’s Exceptions will not be considered.

However, the City asserts that alternatively, if the Commission declines to consider the new evidence, the Commission should reverse the ALJ’s recommendation on this issue on the “grounds that reasonably anticipated capital expenditures should be included in rate base where evidentiary hearings are held prior to conclusion of the test year.” City Exc. at 4.

In Reply, the OCA argues that ALJ Hoyer correctly adopted its proposed adjustments to the City’s five rate base additions. The OCA asserts that DuBois failed to demonstrate that the projects had started or would be completed within the test year. OCA Exc. at 2 (citing R.D. at 8-17). The OCA reiterates that the ALJ properly adopted its recommendation because DuBois was unable to demonstrate that the projects would be used and useful within the test year. OCA Exc. at 2-5 (citing 52 Pa. C.S. § 5.431(b); 52 Pa. C.S. § 5.571).

**d. Disposition**

Consistent with our decision to grant the Motions to Strike, we shall deny the City’s Exceptions regarding the new evidence. Furthermore, we concur with the ALJ 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. R.D. at 16 (citing *Lancaster Sewer 2005* \*102-103).

We are not in agreement with the City’s alternate request that the Commission reverse the ALJ’s recommendation on the “grounds that reasonably anticipated capital expenditures should be included in rate base where evidentiary hearings are held prior to conclusion of the test year.” City Exc. at 4. As we indicated earlier, the City had ample procedural opportunity to provide additional evidence to support its proposed rate base additions prior to the close of record but failed to do so. Therefore, we concur with the ALJ that despite having the burden of proof in this case, the City failed to demonstrate that its proposed rate base additions would be completed or used and useful within the test year at the close of the record in this proceeding. As such, the City’s Exceptions regarding the ALJ’s adjustments to its rate base additions are hereby denied. And we shall adopt the recommendation of the ALJ on this issue.

 **3. Cash Working Capital**

  **a. Position of the Parties**

 The City included a CWC amount of $252,385 in its rate base claim. City Exh. CEH-3RJ. The City’s CWC was calculated using the formula method, or 1/8 of the FTY expenses. City St. 2R at 5; OCA St. 1 at 11.

Both I&E and the OCA agreed with the City’s CWC calculation but made jurisdictional adjustments in order to reflect an adjustment equal to 1/8, or 12.5%, of the adjustments each Party made to the City’s claimed expenses. OCA M.B. at 15; OCA R.B. at 8 (citing City M.B. at 7-8); OCA Table II; I&E M.B. at 5, 10; I&E R.B. at 2.

 **b. ALJ’s Recommendation**

ALJ Hoyer concluded that all the Parties agreed with the City’s rate base claim for CWC of $252,385. According to the ALJ, the City’s CWC was calculated using the formula method, or 1/8 of adjusted FTY expenses. R.D. at 16 (citing City Exh. CEH-3RJ). The ALJ noted that both I&E and the OCA made jurisdictional adjustments to CWC to reflect an adjustment equal to 1/8, or 12.5%, of the adjustments each Party made to the City’s claimed expenses. Using the above formula, ALJ Hoyer multiplied the adjusted total Expenses from Table II in the amount of $63,960 by 1/8 (0.125) to produce a CWC jurisdictional adjustment of $7,995. R.D. at 16-17 (citing Appendix A at  4).

**c. Disposition**

No Party filed Exceptions regarding the ALJs’ recommendation on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment.

**4. Deductions from Rate Base**

 **a. Position of the Parties**

No other Party except the OCA proposed a deduction from the City’s rate base claim. The OCA recommended that a home owned by the City which was previously occupied by the Water Treatment Plant Supervisor (WTPS) but is now vacant, should be removed from rate base. OCA St. 1 at 28. DuBois claimed a net book value of $11,116 for the vacant property. OCA St. 1S at 13. According to the OCA, because the home “is vacant and is not used or useful for the provision of water service,” it should be removed from rate base. *Id.* at 29; OCA M.B. at 15-16.

 DuBois, on the other hand, argued that the OCA’s proposed adjustment should be rejected because the property had recently become vacant due to the death of the City’s WTPS. According to DuBois, although the City Manager had recommended a demolition of the property to the City Council, the property is being held for future use and the City is considering how best to use the property going forward. City St. 2R at 14; Tr. at 43-45; OCA M.B. at 15-16.

 **b. ALJ’s Recommendation**

The ALJ adopted the OCA’s proposed deduction of the vacant home from rate base. The ALJ reasoned that because the home in question is vacant, has no specific time frame in which it would be put into use, and is currently not used and useful for the provision of water service, it should be removed from rate base. R.D. at 20 (citing OCA St. 1 at 29; OCA St. 1S at 13). The ALJ noted the City Manager testified that his recommendation to the City Council was to “go ahead to begin planning for demolition of the caretaker’s house at the City reservoir.” R.D. at 20 (citing Tr. at 43:23-45:20; OCA M.B. at 15-16. Therefore, ALJ Hoyer recommended that the $11,116 net book value of the vacant property should be deducted from rate base. R.D. at 20 (citing Table II; OCA Exh. AEE-1S at line 9).

 **c. Exceptions and Replies**

In its Exceptions, the City asserts that the ALJ erred in adopting the OCA’s recommendation that the vacant property be removed from rate base. DuBois believes the basis of the OCA’s recommendation is speculative and premature, at best, because the City has testified that the property may or may not become used and useful in the future. DuBois contends that the ALJ failed to properly consider its testimony that although there is discussion on possible demolition of the vacant property, no decision has been made in that regard. According to DuBois, until and unless the City Council votes on what to do with the property, any determination regarding the property is premature and should be rejected.[[7]](#footnote-7) City Exc. at 6-7 (citing R.D. at 18-20).

In Reply, the OCA asserts that the ALJ properly recommended the removal of the value of the vacant home from rate base. According to the OCA, the City Manager has already recommended a demolition of the property to City Council. The OCA argues that the vacant property does not qualify as plant held for future use as purported by DuBois, because the City currently does not have a definite plan for a specific timeframe with which it would put the property into use. The OCA concludes that because the vacant building is currently not used and useful for the provision of water service, it should be removed from rate base. OCA R. Exc. at 5-7 (citing Tr. at 43-45; OCA M.B. at 15-17; OCA St. 1S at 13, 29; *West Penn*[[8]](#footnote-8) \*37-39).

 **d. Disposition**

After consideration of the record evidence and the positions of the Parties regarding this issue, we concur with the ALJ that the value of the vacant property should be deducted from rate base. The record evidence in this proceeding shows that the vacant property is currently not used and useful and should therefore not be included in rate base. Although the City argued that no decision has been made whether or not to demolish the property, and that the vacant building is being considered as plant held for future use, we agree with the OCA that the vacant property does not meet the requirements for a plant held for future use. The record evidence, which includes a recommendation by the City Manager for demolition, indicates that the City currently does not have a definite plan for when the property will become used and useful. OCA R. Exc. at 5-7 (citing *West Penn* at 37-39). Consistent with the above discussion, we will deduct the jurisdictional net book value of $3,334 from the City’s rate base for the vacant home. Accordingly, we will deny the City’s Exceptions regarding this issue and adopt the ALJ’s recommendation.

**5. Recommendation of Jurisdictional Rate Base**

 **a. Position of the Parties**

As earlier indicated, DuBois originally claimed a rate base of $15,622,314. City CEH-1 at 12-13; OCA St. 1 at 3. However, in rejoinder, DuBois made a downward adjustment of $642,060, for a revised rate base claim of $14,980,254. City Exh. CEH-3RJ. The City’s updated rate base is therefore $14,727,865 with a jurisdictional portion of $4,317,704, excluding CWC. City Exh. CEH-3RJ; Table 1.

The OCA made a jurisdictional adjustment of $38,870[[9]](#footnote-9) to the City’s revised rate base of $4,317,704. The OCA, therefore, proposed a jurisdictional rate base of $4,278,834. OCA M.B. at 8-17; OCA Table II; OCA R.B. at 3-9.

I&E did not contest the City’s revised rate base. I&E also did not propose any additions or deductions from the City’s rate base. However, I&E made to rate base, a jurisdictional adjustment of $10,406 for CWC, using the agreed-upon 1/8th method to calculate CWC, incorporating all of its proposed adjustments. I&E therefore, proposed a jurisdictional rate base of $4,307,298. I&E M.B. at 5; I&E Table I; I&E R.B. at 2.

Sandy Township did not propose any adjustments to the City’s additions or deductions to rate base but supported the adjustments proposed by the Statutory Advocates reducing the City’s rate base claim. Sandy Township M.B. at 4; Sandy Township R.B. at 2.

 **b. ALJ’s Recommendation**

Based on the foregoing adjustments to rate base and cash working capital, along with the proposed deduction from rate base of the vacant caretaker’s home, the ALJ recommended a jurisdictional rate base of $4,942,159. R.D. at 20 (citing Appendix A attached).

 **c. Disposition**

No Party filed Exceptions to the ALJs’ recommended rate base. However, upon our review of the record and the Recommended Decision including Table 1 of Appendix A attached to the R.D., we found that the ALJ inadvertently omitted a jurisdictional adjustment of $14,531 for Mains and Accessories made to the City’s additions to rate base. Furthermore, a recognition and consideration of this adjustment increases the total jurisdictional rate base adjustments from $20,693 to $35,224. Also, we note that the ALJ’s addition of $646,380 to rate base and his recommended total jurisdictional rate base of $4,942,159, shown in Table 1 of Appendix A was made in error. R.D. at 20 (citing Appendix A). To this end, we have updated the adjustments and recalculated the total jurisdictional rate base. Accordingly, we recommend a total rate base adjustment of $35,224 and a total jurisdictional rate base of $4,282,480. *See* attached Table 1 in Appendix A attached to this Opinion and Order.

**E. Revenues**

None of the Parties except Sandy Township is seeking adjustments to the City’s proposed revenues. Sandy Township proposed to impute revenues from potential bulk water sales to Falls Creek Borough (Falls Creek), and two contract customers including Union Township and the Sykesville, as discussed below.

 **1. Falls Creek Borough**

 **a. Position of the Parties**

Sandy Township averred that Falls Creek is a neighboring municipality to the City and is currently under a Consent Order and Agreement (COA) with the Pennsylvania Department of Environmental Protection (DEP) regarding its water supply. Falls Creek is scheduled to purchase water from the City. Sandy Township M.B. at 5 (citing Sandy Township St. 1 at 4). Citing to several newspaper articles, Sandy Township stated that Falls Creek Borough Council has unanimously voted to enter into an “Intergovernmental Cooperation Agreement” for the purchase of water from DuBois at a cost of $4.05 per 1,000 gallons. *Id.* (citing City St. 2-R at 24). Although Sandy Township referenced a newspaper article stating that there is currently no executed agreement between Falls Creek and the City, Sandy Township questioned why the potential revenue from this transaction was not considered in the City’s revenue. *Id.* at 5‑6. According to Sandy Township, the City is expected to sell approximately 80,000 gallons of water per day for approximately $110,000 in additional revenues at existing rates or approximately $150,000 in additional revenue at the City’s proposed rates. Therefore, Sandy Township proposed that the additional $110,000 be considered as part of the City’s revenue in the instant proceeding. *Id.* at 6-7. Further, Sandy Township believes the City can decide at any time to enter into an executed agreement with Falls Creek but is deliberately delaying execution of the agreement in order not to include revenue from the Falls Creek transaction in the instant proceeding. Sandy Township R.B. at 2-5.

DuBois, on the other hand, indicated that while it does not dispute having discussions with Falls Creek regarding a potential interconnection, there is currently no executed agreement regarding this transaction. Tr. at 27-28, 50-56. Hence, according to DuBois, the Falls Creek project remains unknown, unmeasurable and inapplicable in the instant proceeding. DuBois, however, agreed with the OCA’s recommendation that if and when the Falls Creek transaction is finalized, DuBois should be required to notify the Commission. The Parties agreed that the notification should include: (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.[[10]](#footnote-10) Tr. at 32, 59; City M.B. at 9-13; OCA St. 1 at 47: OCA M.B. at 74).

 **b. ALJ’s Recommendation**

In his Recommended Decision, ALJ Hoyer rejected Sandy Township’s proposed revenue adjustment of $110,000 and recommended that no revenue from potential water sales to Falls Creek need to be imputed in this proceeding. The ALJ, however, adopted the OCA’s recommendation and ordered that upon final connection and commencement of service to Falls Creek, DuBois should be required to file with the Commission, the notification information identified by the OCA, for reporting purposes. R.D. at 22.

 **c. Exceptions and Replies**

In its Exceptions, Sandy Township reiterates that several newspapers have reported on the City’s potential bulk water sale to Falls Creek and contends that the ALJ erred in failing to consider the additional revenue stream from the sale in the instant proceeding.[[11]](#footnote-11) Sandy Township Exc. at 2-3 (citing R.D. at 20-22). Sandy Township argues that failure to consider its proposed $110,000 revenue adjustment would result in a potential windfall for the City, which will be detrimental to Sandy Township and its customers. Sandy Township disputes the ALJ’s determination that the proposed revenue adjustment would contravene “Commission precedent limiting revenue recognized for ratemaking purposes to those *reasonably known and measurable*.” Sandy Township Exc. at 3-5 (citing R.D. at 21; *Pa. PUC v. PPL Gas Utilities Corporation,* 102 Pa. P.U.C. 325 (2007)) (Emphasis added). According to Sandy Township, based on the newspaper reports admitted into the record and from the testimony of its witness, the bulk water sale to Falls Creek is “reasonably known.” Thus, Sandy Township requests that the Commission include the additional $110,000 to the City’s revenue requirement in this proceeding. Sandy Township Exc. at 5 (citing Sandy Township St. 1 at 3-6; Sandy Township St. 1-SR at 2-4).

In Reply, the City describes Sandy Township’s arguments as baseless and woefully flawed. The City also discredits the testimony of Sandy Township’s Manager and avers that the newspaper reports referenced by Sandy Township involves contractual terms between the City and Falls Creek that are still under negotiation and are yet to be finalized. City R. Exc. at 3 (citing City R.B. at 9-10). Specifically, DuBois notes that there is no guarantee at this point that Falls Creek will connect to the City’s system. The City further argues that the potential connection could be delayed well beyond any completion date being considered in current negotiations. DuBois asserts that it is too early to make a determination on whether a connection to Falls Creek would result in jurisdictional service to Falls Creek or non-jurisdictional service originating from a point within the City. City R. Exc. at 3-4 (citing City R.B. at 9, 12-13). DuBois, however, affirms its commitment to comply with the notification requirement, as directed by the Recommended Decision. City R. Exc. at 4.

 **d. Disposition**

After consideration of the record evidence and the arguments of the Parties, we agree with the ALJ’s recommendation denying Sandy Township’s proposed revenue adjustment. It is clear from the record evidence that there is currently no executed agreement between the City and Falls Creek regarding bulk water sales. We further note that the City removed from rate base its claim for a waterline extension to serve Falls Creek because the extension would not be completed prior to the end of the FTY. OCA St. 1 at 46; I&E-RB-8 (attached to OCA St. 1); OCA St. 1 at 46; OCA M.B. at 73. For the reasons set forth, we do not see a need to include potential revenues from the sale of water from the City to Falls Creek in the instant proceeding. Moreover, the City has agreed to submit a report to the Commission upon completion of a connection to Falls Creek including: (1) the date service began; (2) projected annual sales to Falls Creek; (3) applicable rates and customer charges; and (4) a copy of any contract with Falls Creek. City Exc. at 4 (citing R.D. at 22). Therefore, the Exceptions of Sandy Township regarding this issue are hereby denied and we shall adopt the recommendation of the ALJ.

 **2. Union Township Contract Sales**

 **a. Position of the Parties**

 Sandy Township observed that the contract rate of $2.00 per 1,000 gallons that Union Township pays the City for bulk water sale is significantly less than the City’s standard tariff rates. According to Sandy Township, pursuant to Section 507 of the Code, 66 Pa. C.S. § 507, the contract rates are not legal because there is no evidence that the contract was filed with or approved by the Commission. Sandy Township M.B. at 7-8 (citing Sandy Township St. 1SR at 5; N.T/Tr. at 28-29; 66 Pa. C.S. § 507). Sandy Township averred that the difference between the standard tariff rates and the contract rates would provide an additional $21,241. The City projected 2016 sales of 11,065,000 gallons to Union Township with total annual revenue of $22,130, assuming a rate of $2.00 per thousand gallons. Sandy Township St. No. 1, Attachment 7. The charge to Union Township at existing rates would be $43,371 (i.e., (100,000 gallons per month multiplied by $5.15 per thousand gallons multiplied by 12 months) plus (9,865,000 gallons multiplied by $3.77 per thousand gallons)). The difference between the below tariff charge of $22,130 and full tariff charge of $43,371 is $21,241. Therefore, Sandy Township proposed that a proportional adjustment of $21,241 be made to the City’s revenue in this proceeding. Sandy Township M.B. at 8; R.B. at 5.

 The City, on the other hand, averred that it provides bulk water service to Union Township. The City stated that “it is very reasonable for Union Township to pay a rate less than the sale for resale rate charged for service to Sandy Township because Union Township and Sandy Township are not similarly situated customers.” City M.B. at 13-14 (citing City Statement 1-R at 7). The City further stated that Sandy Township “benefits from the City’s treatment and distribution facilities, while Union Township primarily benefits from the City’s treatment facilities.” *Id.* Most importantly, DuBois averred that “Union Township constructed and paid for a water main extending from its system to a meter pit at the City’s water treatment plant.” *Id.* According to the City “the water flowing to Union Township never flows through the City’s distribution lines . . . [while] Sandy Township takes bulk water service at twelve separate meter pits located at different points on the City’s distribution system.” *Id.* DuBois averred that based on the above reasons, it entered into a contract with Union Township that allows Union Township to take bulk water service under an annual pricing formula that excludes the cost for infrastructure and services for which it does not benefit. *Id.* In addition, to the extent that the Commission requires a filed copy of the contract, DuBois admitted the contract between the City and Union Township into the record in this proceeding as Attachment 6 to Sandy Township St. No. 1 and is not opposed to filing a separate copy of the contract with the Commission, if necessary. City M.B. at 14 (citing Tr. at 28-29).

 **b. ALJ’s Recommendation**

In his Recommended Decision, the ALJ denied Sandy Township’s proposed revenue adjustment regarding the City’s bulk water sales to Union Township stating that the revenue has already been included in prior base rate proceedings. The ALJ also rejected Sandy Township’s suggestion that revenue from bulk water sales be imputed at the standard tariff rates rather than the contract rate. Lastly, although approved in prior rate cases and admitted into evidence in the instant proceeding, the ALJ recommended that the City file the contract in question separately with the Commission. R.D. at 26.

 **c. Exceptions and Replies**

In its Exceptions, Sandy Township argues that the ALJ erred in denying its proposed revenue adjustment and reiterates its argument that because Union Township pays a contract rate for bulk water sales that is significantly less than the City’s standard water rates, a revenue adjustment of $21,241 should be made to the City’s revenue requirement “for the purpose of this rate proceeding.” Sandy Township Exc. at 6 (citing R.D. at 26; Sandy Township M.B. at 7-8; Attachment 6 and 7 to Sandy Township St. 1; Sandy Township St. 1 at 9). Sandy Township further contends that pursuant to Section 507 of the Code, 66 Pa. C.S. § 507, the contract rate between the City and Union Township has never been vetted and validated by the Commission through a Section 507 filing, and should therefore, not be charged by the City. Sandy Township Exc. at 6‑7.

In Reply, the City asserts that the ALJ appropriately denied Sandy Township’s proposal to impute additional revenue of $21,241 from bulk water sales to Union Township. The City avers that Sandy Township’s arguments in support of its revenue adjustment proposal overlooks the fact that the contract rate and its associated revenues were previously approved by the Commission in each of the City’s prior three base rate cases. City R. Exc. at 5 (citing Sandy Township Exc. at 6-7). Further, the City contends that Section 507 is not applicable to two municipal corporations and the ALJ affirmed this fact when he stated that “the Commission’s authority over the City does not extend to inter-municipal contracts, therefore, the Union Township contract falls under the “tariff rate” exemption of Section 507.” City R. Exc. at 5-6 (citing R.D. at 24-25; City R.B. at 12).

Additionally, DuBois points out that Sandy Township and Union Township are not similarly situated customers because unlike Sandy Township, Union Township constructed and paid for its own water main which extends from its system to a meter pit at the City’s water treatment plant. On the other hand, Sandy Township takes bulk water service at twelve separate meter pits at different points of the City’s distribution system. Consequently, the City’s contract with Union Township for bulk water service was negotiated under a pricing formula that excluded costs for infrastructure and services that are not applicable to Union Township. City R. Exc. at 6. The City agrees with the ALJ’s recommendation that requires it to separately file the contract with the Commission. *Id.* at 6-7.

 **d. Disposition**

After consideration of the record evidence and the arguments put forth by the Parties, we concur with the ALJ’s recommendation. We shall, therefore, reject the proposed revenue adjustment of $21,241, for bulk water sales to Union Township proposed by Sandy Township. It is clear from the record evidence that the contract rates in question were considered and approved by the Commission in the City’s prior three base rate cases. We are not convinced by Sandy Township’s arguments invoking the application of Section 507 of the Code to the contract between the City and Union Township. We concur with the ALJ that “the Commission’s authority over the City does not extend to inter-municipal contracts, therefore, the Union Township contract falls under the “tariff rate” exemption of Section 507.” *See* R.D. at 24-25. We believe Sandy Township has failed to make a legitimate case for us to consider its proposed revenue adjustments to the City’s revenue requirement in the instant proceeding. As such, the Exceptions filed by Sandy Township requesting that the Commission impute additional revenues of $21,241 for sales to Union Township are hereby denied and we shall adopt the recommendation of the ALJ on this issue.

 **3. Borough of Sykesville**

 **a. Position of the Parties**

Sandy Township disagreed with the City’s qualification of the City’s service to Sykesville as jurisdictional because its interconnection with Sykesville is inside the City’s municipal boundaries. Tr. at 77-78. According to Sandy Township, “the residence of the consumer . . . determines Commission jurisdiction under the Code, not the location of the interconnection.” Sandy Township M.B. at 13-14; R.B. at 5-6.

 The City rejected Sandy Township’s argument stating that Sykesville takes service within the boundaries of the City and is therefore a non-jurisdictional customer of the City. City M.B. at 15 (citing City Statement 1-R at 8; 66 Pa. C.S. § 1102(a)(5)).

 **b. ALJ’s Recommendation**

In his Recommended Decision, the ALJ rejected Sandy Township’s argument that bulk water sales to Sykesville is within the Commission’s jurisdiction. R.D. at 28.

 **c. Exceptions and Replies**

Sandy Township disputes the City’s failure to recognize Sykesville as a jurisdictional customer in the City’s revenue/cost allocation. Sandy Township argues that the City’s bulk water sale to Sykesville is in no way different from its bulk water sale to Sandy Township or Union Township, which, according to Sandy Township, are all under the Commission’s jurisdiction. Sandy Township Exc. at 7. Sandy Township avers that Sykesville should be recognized as a jurisdictional customer, if not in this rate case, at least in the City’s next base rate case for cost or revenue allocation purposes, in order to ensure just and reasonable rates for the City’s customers. *Id*. at 7-8 (citing Sandy Township R.B. at 6).

Sandy Township avers that the City’s argument that its bulk water service to Sykesville is non-jurisdictional because Sykesville takes service within the boundaries of the City is contrary to established precedent. Sandy Township Exc. at 8 (citing City M.B. at 5; City M.B. at Section III.B.3). In particular, Sandy Township avers that the basis of its argument stems from the fact that Sykesville is not a resident of the City and going by the Code, it is the residence of the consumer that determines Commission jurisdiction and not the location. Sandy Township Exc. at 8 (citing *County of Dauphin v. Pa. P.U.C.,* 159 Pa. Cmwlth. 649, 634 A.2d. 281 (1983); citing *State College Borough Authority v. Pa. P.U.C.* 152 Pa Superior Ct. 363, 31 A.2d. 557 (1943)).

In Reply, the City asserts that the ALJ properly rejected Sandy Township’s proposal that Sykesville be considered a jurisdictional customer in the determination of the City’s rates. The City argues that contrary to Sandy Township’s position, the Commission “has traditionally regarded the provision of utility service by one municipality to another whereby the line of one customer connects to the line of the provider municipality within the latter’s corporate limits as non-jurisdictional. City R. Exc. at 7-8 (citing *Lehigh Valley Coop. Farmers v. City of Allentown*, 54 Pa. PUC 495, 499 (Sept. 18, 1980) *(Lehigh)* citing *Borough of Brookhaven v. City of Chester,* 39 Pa P.U.C. 472, 479 (1962)); R.D. at 27; City M.B. at 15)).

The City argues that in addition to determining whether the utility in question serves the indefinite public, the Commission also considers other factors in deciding if the service is outside corporate limits and therefore non-jurisdictional. According to the City, these additional factors include: “(1) the source of consumer billing; (2) the authority to set consumer rates; (3) the authority to accept or reject new customer service; (4) the nature of the service rendered by the provider municipality, *i.e.* bulk/wholesale as opposed to individual/retail service; and (5) ownership of and control over extraterritorial facilities . . .” City R. Exc. at 8 (citing *Petition of the Borough of Springdale for a Declaratory Order,* 63 Pa. PUC 3, \*6 (Oct. 21, 1986) *(Springdale)* citing *Re Chestnut Knoll Assocs.*, 1984 Pa. P.U.C. LEXIS 55 (Apr. 6, 1984); *Lehigh,* 54 Pa. P.U.C. 495 (1980); and Petition of Borough of Middletown, P-830466 (1984)).

The City explains that in *Lehigh,* the City of Allentown (Allentown) provided bulk/wholesale sewage service to adjacent municipalities and their authorities by way of agreements. *Id.* According to DuBois, the Commission determined that Allentown was not rendering service beyond its corporate boundaries to the public for compensation because “the adjacent municipalities and their authorities are the direct customers of Allentown, and . . . the individual customers are ultimately served by these adjacent municipalities and their authorities [therefore] there is no basis to support a finding that Allentown is providing extraterritorial sewage service; accordingly, no basis for establishing [C]omission jurisdiction” *Id.* at 500; City R.B. at 15-16. The City, concludes that based on the above, Sandy Township’s claim that jurisdiction is determined by residence of the customer has no basis and should be dismissed. City R. Exc. at 8-9.

 **d. Disposition**

Pursuant to Section 1301 of the Code, 66 Pa. C.S. § 1301, utility service provided by a municipal corporation or its operating agencies beyond its corporate limits is subject to regulation by this Commission:

**§ 1301. Rates to be just and reasonable.**

Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission. Only public utility service being furnished or rendered by a municipal corporation, or by the operating agencies of any municipal corporation, beyond its corporate limits, shall be subject to regulation and control by the commission as to rates, with the same force, and in like manner, as if such service were rendered by a public utility.

(Emphasis added).

After a careful consideration of the record evidence and the positions and Exceptions of the Parties, we agree with the ALJ’s recommendation and shall adopt it. The determination of whether a municipality renders service outside of its corporate boundaries so as to subject those activities to Commission jurisdiction is, necessarily, a fact-driven inquiry subject to administrative and legal precedent. *See County of Dauphin v. Pa. PUC*, 634 A.2d 281 (Pa. Cmwlth. 1993), citing *Borough of Ridgway v. Pa. PUC*, 480 A.2d 1253 (Pa. Cmwlth. 1984) - The primary consideration in making such a determination is whether the municipality holds itself out, by express or implied terms, as a supplier of the utility service to the public beyond its boundaries, as a class or a limited portion thereof, to the extent that the capacity of the municipality’s utility permits.

We find that the presiding ALJ correctly rejected Sandy Township’s position to qualify the bulk water sales to Sykesville as a jurisdictional service, based on the facts of this proceeding. The position of Sandy Township presumes a “bright-line” consideration or factor for making this determination that does significantly address the totality of considerations that must be examined. We conclude that the ALJ’s reasoning and analysis, which, in turn, adopted the position of the City to be sound. In pertinent part, the ALJ concluded:

The City submits that even where a municipal corporation furnishes service beyond its corporate limits, the Commission must also determine whether the service provider held itself out as “in the business of supplying his product or service to the [indefinite] public.” *Borough of Ambridge v. Pa. Pub. Serv. Comm’n*, 108 Pa.Super. Ct. 298, 304 (1933); *see also Lehigh Valley Coop. Farmers v. City of Allentown*, 54 Pa. PUC 495, 497-98 (Sept. 18, 1980) (“*Lehigh”*) (“The test is, therefore, whether or not such person holds himself out, expressly or impliedly, as engaged in the business of supplying his product or service to the public, as a class, or to any limited portion of it, as contradistinguished from holding himself out as serving or ready to serve only particular individuals”). City R.B., pp. 14-15.

In addition to determining whether the utility in question serves the indefinite public, the PUC also considers other factors when deciding whether service is outside corporate limits and therefore non-jurisdictional, such as “(1) the source of consumer billing, (2) the authority to set consumer rates, (3) the authority to accept or reject new customer service, (4) the nature of the service rendered by the provider municipality, i.e. bulk/wholesale as opposed to individual/retail service, [and] (5) ownership of and control over extraterritorial facilities. . . .” *Petition of the Borough of Springdale for a Declaratory Order*, 63 Pa. PUC 3, at 6 (Oct. 21, 1986) (“*Springdale”*) (citing *Re Chestnut Knoll Assocs.*, 1984 Pa. PUC LEXIS 55 (Apr. 6, 1984); *Lehigh*, 54 Pa. PUC 495 (1980); and Petition of Borough of Middletown, P-830466 (1984)); City R.B., p. 15.

The PUC “has traditionally regarded the provision of utility service by one municipality to another, whereby the line of the customer municipality connects to the line of the provider municipality within the latter’s corporate limits, as nonjurisdictional.” *See Lehigh*, 54 Pa. PUC at 499 (citing *Borough of Brookhaven v. City of Chester*, 39 Pa. PUC 472, 479 (1962)); *see also Springdale,* 63 Pa. PUC at 6; City R.B., p. 15.

 \* \* \*

The City provides bulk water service to the Borough of Sykesville via an interconnection located inside City limits. Sandy Township M.B., p. 13. . . .

 \* \* \*

. . . Sandy Township contends it is the residence of the consumer that determines Commission jurisdiction under the Public Utility Code, not the location of the interconnection. *County of Dauphin v. Pa. Pub. Util. Comm’n*, 159 Pa.Cmwlth. 649, 634 A.2d. 281 (1993), citing [*State College Borough Authority v. Pa. Pub. Util. Comm’n,* 152 Pa. Superior Ct. 363, 31 A.2d 557 (1943)](http://www.westlaw.com/Link/Document/FullText?findType=Y&serNum=1943111241&pubNum=162&originatingDoc=I5625b5e3352e11d9abe5ec754599669c&refType=RP&originationContext=document&vr=3.0&rs=cblt1.0&transitionType=DocumentItem&contextData=(sc.Search)); Sandy Township R.B., pp. 5-6.

I agree with the City. I recommend that Sandy Township’s argument that bulk water sales to the Borough of Sykesville are within the Commission’s jurisdiction be rejected.

R.D. at 26-28.

Based on the foregoing, we shall adopt the ALJ’s recommendation and the Exceptions of Sandy Township are, hereby, denied.

**F. Expenses**

 Both the OCA and I&E proposed adjustments to expenses claimed by the City. Each proposed adjustment will be addressed below.

 **1. Vacant Home Expenses**

 **a. Position of the Parties**

In addition to claiming the vacant building in rate base, the City also claimed $3,592 for expenses associated with the vacant home ($828 for electricity, $1,668 for heat, $240 for building repairs and maintenance, $856 for telephone services) with a jurisdictional portion of $1,077. City M.B. at 24-25.

 The OCA, however, proposed a deduction of the $3,592 in expense and $572 for depreciation claimed by the City for the vacant property because it is not used and useful for the provision of water service. OCA St.1 at 28-29; OCA M.B. at 19; OCA R.B. at 11-12.

 **b. ALJ’s Recommendation**

In his Recommended Decision, the ALJ adopted the OCA’s proposed adjustment regarding the expenses associated with the vacant home because the property is not used and useful. According to the ALJ, because the vacant home is currently not used and useful for the provision of water service, ratepayers should not be charged this expense. R.D. at 29.

 **c. Exceptions and Replies**

In its Exceptions, the City contends that, similar to its argument regarding the vacant property in rate base, it is premature to exclude this expense from the City’s expense claim prior to the City Council’s vote to demolish the property or put it to other uses. City Exc. at 7.

In Reply, the OCA argues that similar to its proposal to exclude the vacant building from the City’s rate base claim, expenses related to the vacant property, including telephone service, will not be incurred because the home is not being used. According to the OCA, telephone service for the property has been disconnected and should not be allowed in the City’s expense claim. Thus, the OCA submits that ALJ Hoyer’s recommended jurisdictional adjustment of $1,077 for this expense item should be adopted because the vacant home is not used and useful for the provision of water service. OCA R. Exc. at 7-8 (citing OCA M.B. at 19; OCA R.B. at 11-12; City M.B. at 24-25; R.D. at 29; OCA St. 1 at 29).

 **d. Disposition**

After consideration of the record evidence, and the arguments put forth by the Parties, we concur with the ALJ’s recommendation adopting the OCA’s proposed adjustment. We agree that the vacant property is currently not used and useful for the provision of water service; therefore, the expenses related to the property should be removed from the City’s expense claims. Accordingly, we concur with the ALJ’s jurisdictional adjustment of $1,077 to the City’s expense claim regarding the vacant property and we shall deny the Exceptions of the City on this issue.

 **2. Transmission and Distribution (T&D) Contractual Services**

 **a. Position of the Parties**

DuBois claimed a *pro forma* expense of $132,771 for Transmission and Distribution (T&D) contractual services, with a jurisdictional portion of $36,671, which is equal to the historical test year (HTY) expense. City Exh. CEH-1 at 16. DuBois contended that this expense is reasonable and accurately reflects the City’s anticipated expenses because the City would incur significant T&D contractual services expenses in meeting its obligation under the Stipulation it reached with the OCA.[[12]](#footnote-12) Tr. at 138-139; City M.B. at 20-21 (citing City/OCA Stipulation); City R.B. at 20-21.

 The OCA argued that based on the significant fluctuations in this expense in the last three years,[[13]](#footnote-13) the expense should be normalized for ratemaking purposes. The OCA, therefore, recommended a total claim of $92,148 for this expense. This results in a reduction of the City’s claim by $40,623 with a jurisdictional portion of $11,216. OCA M.B. at 20-21 (citing Table II; OCA St. 1S at 15; OCA St. 1 at 30; OCA Exh. AEE-1S at line 26); OCA R.B. at 12-14.

 I&E also recommended that this expense item be normalized and therefore, also proposed a total claim of $92,148, with a jurisdictional portion of $11,220. I&E Statement 2-SR at 19; I&E R.B. at 20-21.

 **b. ALJ’s Recommendation**

In his Recommended Decision, ALJ Hoyer agreed with the City that normalization of this expense would not appropriately capture the City’s projected T&D contractual expenses which includes contractual costs related to water leak detection, water line break repairs, GIS mapping, road work, patching and paving concrete, etc. The ALJ posited that the City would continue to accrue higher T&D contractual services expenses in the future. Therefore, the ALJ accepted the City’s claim for this expense item and rejected the adjustments proposed by I&E and the OCA. R.D. at 32.

 **c. Exceptions and Replies**

In its Exceptions, the OCA disagrees with the ALJ’s recommendation denying its proposal to normalize this expense item. OCA Exc. at 3 (citing R.D. at 29‑32; OCA M.B. at 20-21; OCA R.B. at 12-14). The OCA reiterates that just like it indicated in its Briefs, the large annual fluctuation in the T&D contractual services expense from 2013 to 2015 requires normalization over the three year period for ratemaking purposes. Exc. at 3 (citing OCA St. 1 at 29). The OCA argues that the ALJ’s decision, which was based on his consideration of the City/OCA Stipulation, failed to provide any evidence to demonstrate that it is reasonable to use the 2015 expense level as the pro forma expense. OCA Exc. at 3-6 (citing R.D. at 31, 51; OCA St. 1S at 14-15; City/ OCA Stipulation ¶¶ 1-8; City R.B. at 17-18). The OCA asserts that while the City has yet to provide any evidence regarding a cost burden associated with the City/OCA Stipulation, the only additional costs the City may incur involves meter installation and exercising of valves.[[14]](#footnote-14) The OCA further contends that because the 2015 level of expense for this item is more than nine times that of the prior year and there is no evidence that this expense will be as high in the upcoming year, normalization of this expense is appropriate. Thus, the OCA proposes a jurisdictional adjustment of $11,216 for this expense item. OCA Exc. at 6-7 (citing Table II; R.D. at 31, 51; OCA St. 1S at 15-16; OCA St. 1 at 30; OCA Exh. AEE-1S at line 26).

I&E also disagrees with the ALJ’s recommendation regarding this expense item. Echoing the OCA’s argument, I&E contends that the ALJ’s recommendation approving the City’s $132,771 claim for this expense item should be denied. Alternatively, I&E advocates a normalization of this expense and proposes a downward adjustment of this expense to $92,148, which would allow the City to cover its future expenses but still protect ratepayers. I&E Exc. at 8-10 (citing R.D. at 31; I&E M.B. at 24).

In its Replies, DuBois agrees with the ALJ’s recommendation that approves the City’s $132,771 claim for T&D contractual services expense. The City avers that the OCA’s and I&E’s proposed adjustments should be rejected because they would deprive DuBois from recovering known and measurable costs. DuBois further argues that normalizing this expense using the prior three years would unreasonably incorporate data from 2014, which was an extraordinary outlier year, and fails to reflect the actual costs to be incurred by the City, especially since the City is required to continue working to improve its UFW levels. City R. Exc. at 10-11.

In addition, the City disputes the OCA’s argument which downplays the potential costs associated with the City/OCA Stipulation. The City argues that irrespective of the OCA’s baseless assertions, its agreement to undertake the additional measures in the Stipulation supports a recovery of the full cost of this expense item. *Id.* at 11-12. Finally, regarding I&E’s reliance on the City’s T&D contractual expense as of June 2016 to make a case for the variance in the expense levels from 2013 and 2015, the City contends that I&E’s argument should be rejected because it fails to recognize the fact that similar to its T&D contractual expenses in 2013 and 2015, the City typically incurs most of its T&D contractual expenses in the second half of the year.[[15]](#footnote-15) The City, therefore, concludes that as determined by the ALJ in his Recommended Decision, the City’s 2015 T&D contractual expenses represents a normal expense level based both on historical and record evidence and should be approved as recommended by the ALJ. *Id.* at 12.

**d. Disposition**

After considering the evidence and arguments on this issue, we concur with the ALJ’s adoption of the City’s 2015 claim of $132,771 for T&D contractual services expense in his recommendation. We agree that normalization of this expense will not appropriately capture the City’s projected T&D contractual expenses including contractual costs related to water leak detection, water line break repairs, GIS mapping, road work, patching and paving concrete, etc. We believe the record evidence supports approval of the City’s claim for this expense item because it reflects the actual cost that will be incurred by the City considering the City/OCA Stipulation and the potential financial impact of the Stipulation. City R. Exc. at 10-11. As such, the OCA and I&E’s Exceptions regarding the ALJ’s recommendation on this issue are, hereby, denied and we shall adopt the recommendation of the ALJ on this issue.

 **3. Water Treatment Plant (WTP) Contractual Services**

**a. Position of the Parties**

The City averred that it incurred $101,288 for Water Treatment Plant (WTP) 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 expenses as recurring over a 2 to 5 year period and made the appropriate normalization adjustment. OCA St. 1S at 15. The City also identified an additional $8,665 as recurring annually. OCA St. 1S at 15; OCA-I-16; OCA M.B. at 21. The City’s $51,138 claim in 2016 is 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 M.B. at 21.

The OCA disagreed with the City’s 2015 “other expenses” claim of $22,323. In opposing this claim, the OCA averred that the two prior years of this expense item indicated that the 2015 expense level was an anomaly. The OCA proposed a three-year normalization period from 2013 to 2015 and recommended $8,338 for this expense item instead of the $22,323 claimed by the City.[[16]](#footnote-16) OCA M.B. at 22-23: OCA St. 1 at 32-33. This results in a jurisdictional portion of $4,194 for this expense item. Table II; OCA St. 1 at 32; OCA St. 1S at 18; OCA Exh. AEE-1S at line 28.

 In rebuttal, the City disagreed with the OCA’s proposed normalization of this expense item stating that the FTY 2016 expense for this item should be annualized because it demonstrates an ongoing level of expense. City St. 2R at 11.

 I&E also proposed a three-year normalization of this expense which resulted in an expense reduction of $5,497 to the City’s claim. I&E M.B. at 23; I&E St. 2-SR at 17.

 **b. ALJ’s Recommendation**

In his Recommended Decision, ALJ Hoyer adopted the normalization adjustment proposed by the OCA, including the OCA’s position regarding “normalization of other expense.” R.D. at 37. Therefore, the ALJ recommended a jurisdictional adjustment of $4,194 for this expense, stating that annualization is not proper in this case. *Id.*

 **c. Exceptions and Replies**

In its Exceptions, DuBois agrees with most of the ALJ’s recommendations regarding its WTP contractual expenses, but disagrees with the ALJ’s normalization of the City’s “other expense” claim in the amount of $22,323.[[17]](#footnote-17) DuBois asserts that it has already made sufficient concessions in agreeing to normalize $40,300 of its total originally claimed WTP contractual expense and the removal of $30,000 it inadvertently included in non-recurring expenses. City Exc. at 13 (citing R.D. at 32). The City argues that it addressed the expense fluctuation concerns of the ALJ by electing to annualize its 2015 costs rather than the 2016 other expenses, which the City believes would have increased its claim from $22,322 to $26,090. City Exc. at 13-14 (citing R.D. at 35; M.B. at 20; City Statement 2-R at 11). DuBois avers that because the normalization adjustment proposed by the OCA and adopted by the ALJ ignores clear trends of the City’s ongoing cost increases, the Commission should deny the ALJ’s recommendation and adopt the City’s proposed annualization of its HTY cost of $22,323 for “other expense.” City Exc. at 13-14.

In Reply, the OCA avers that it agrees with ALJ Hoyer’s normalization of the City’s “other expense” claim because the City’s 2015 claim of $22,323 for “other expense” significantly exceeds those of the prior years.[[18]](#footnote-18) The OCA argues that the City failed to provide any evidence to support its assertion that the 2015 expense is an ongoing level of expense. Therefore, the OCA concludes that the ALJ’s recommendation normalizing this expense item is appropriate and should be adopted. OCA R. Exc. at 14‑15 (citing R.D. at 32-37; OCA M.B. at 21-25; OCA R.B. at 14-15; OCA St. 1 at 31; OCA St. 1S at 16).

I&E also supports the ALJ’s recommendation for the normalization of the City’s “other expense” claim stating that normalization is a fair and equitable resolution to the issue due to the annual fluctuations in the expense item. I&E R. Exc. at 8-10 (citing R.D. at 32-37; I&E M.B. at 23-24; I&E R.B. at 18-19).

**d. Disposition**

After consideration of the record evidence and the arguments of the Parties, we concur with the ALJ’s recommendation regarding this issue. The record evidence indicates significant fluctuation of this expense item in the prior years including the years 2013, 2014 and 2015. We note that despite proposing that the 2015 expense amount for “other expense” be annualized, the City has failed to present any credible evidence to ascertain that the 2015 amount will be an ongoing expense level. Therefore, we are therefore not convinced that the City met its burden of proof to demonstrate an annualization of its 2015 expense claim for “other expenses.” As such, the City’s Exceptions regarding this matter are hereby denied and we shall adopt the ALJ’s recommendation on this issue.

**4. Administrative and General Expenses**

 Both the OCA and I&E proposed adjustments to the City’s claim for administrative and general expenses. Each proposed adjustment will be addressed below.

 **a. City Manager’s Salary**

 **1. Position of the Parties**

According to DuBois, the City Manager earns $124,076 per year. The City averred that $14,868 of the City Manager’s salary is included in treasury and finance salaries and 24% of the $14,868 is allocated to the Water Fund. City M.B. at 26 (citing City St. 2-R at 16); Tr. at 72-73. The City further stated that 60% of the remaining $109,208 of the City Manager’s salary is allocated to the Water Fund. The City claimed $69,093 for the City Manager’s salary. City M.B. at 26 (citing City St. 2-R at 16). The City indicated that the 60% allocation is appropriate because the City Manager accurately estimated that he spends approximately 60% of his time on water-related issues. City M.B. at 26-29. The City Manager testified that water operations consume more of his time in comparison to other City operations. Tr. at 23-27, 32-33. DuBois also compared the responsibilities of the City Manager to those of the Public Works Director (PWD) as it relates to water operations stating that the City Manager is “on-call 24/7” in the event of a water emergency such as a leak or main break. City M.B. at 26-29.

The OCA disagreed with the City’s 60% allocation for the City Manager’s salary stating that in its last rate case settlement, DuBois agreed that in its next base rate filing, “Administrative and General Expenses shall be allocated to the Water Fund on the basis of actual and measurable costs attributable to the Water Fund.” OCA M.B. at 26 (citing City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 5). Citing to several prior Commission rulings on similar cases, the OCA contended that other than the City Manager’s testimony, the City failed to provide any credible evidence to support its proposed 60% allocation factor. OCA M.B. at 26-29. The OCA, therefore, proposed that instead of the two-part allocation by the City (24% and 60% allocation of the City’s Manager’s salary), the City Manager’s salary should be allocated to the Water Fund based on the 24% allocation factor for treasury and finance employees. According to the OCA, a 24% allocation would result in an adjustment with a jurisdictional portion of $11,209. *Id.* at 29-34 (citing Table II; Tr. at 73; OCA St. 1S at 20-21; OCA St. 1 at 34‑35).

Similar to the OCA, I&E took issue with the City’s failure to provide timesheets for the City Manager. In the absence of timesheets or any records, I&E proposed a 25% allocation factor for the City Manager’s salary. Tr.at 117-119; I&E M.B. at 13-16. Consistent with this allocation, I&E proposed that $28,684 of the City Manager’s salary should be allocated to the City’s Water Fund with a jurisdictional portion of $8,178. I&E M.B. at 16. I&E also stated that to prevent a reoccurrence of this issue in the future, the Commission should order the City to maintain timesheets or develop a cost-effective means to track and allocate the time between the several responsibilities of the City Manager, just as it did in *Quakertown*[[19]](#footnote-19) and *Media Borough*.[[20]](#footnote-20) I&E further proposed a 25% allocation factor for the City’s Health Insurance and Other Benefits Expenses claim. *Id.* at 16-17.

 **2. ALJ’s Recommendation**

In his Recommended Decision, ALJ Hoyer adopted the OCA’s and I&E’s 24% allocation for the City Manager’s salary to the Water Fund. The ALJ did not find the City Manager’s testimony regarding the time he spends in addressing water-related issues to be credible because the City failed to keep or provide accurate records or timesheets to substantiate the City Manger’s testimony and the City’s proposed 60% allocation factor. Therefore, ALJ Hoyer adopted the OCA’s proposed 24% allocation factor because it reflects a verified allocation for treasury and finance employees. R.D. at 42 (citing OCA St. 1 at 35; OCA M.B. at 26).

**3. Exceptions and Replies**

In its Exceptions, the City notes its objections to the ALJ’s recommendation. DuBois avers that it disagrees with the ALJ’s understated 24% allocation for the City Manager’s salary and requests that the Commission impose a more reasonable allocation factor that considers the City Manager’s testimony regarding the time he spends on water-related issues. The City contends that the ALJ’s reliance on prior similar cases in reaching a decision in this proceeding is flawed and should be rejected. The City argues that, unlike those cases in which there was no cross-examination of the associated employees, in order to support its proposed 60% allocation, it presented the testimony of the City Manager to explain the scope of duties set forth in his job description. Exc. at 10-11 (citing R.D. at 38-39; Tr. at 38-39). The City avers that in light of the time-consuming and comprehensive water-related responsibilities of the City Manager, including compliance and operational issues relating to the reservoir and watershed, managing connections for new construction, and approval and oversight of water shut-offs and water-related emergency calls, the 60% allocation factor is appropriate and should be allowed. City Exc. at 11-12.

In Reply, the OCA argues that the City’s 60% allocation factor for the City Manager’s salary is based on unverifiable assertions by the City Manager and should be rejected. The OCA contends that the City’s allocation factor is unreliable as it has changed over time and contradicts the City’s two-step allocation method which was based solely on interviews with the City Manager.[[21]](#footnote-21) OCA R. Exc. at 11-12 (citing OCA M.B. at 25-35; OCA St. 1 at 34-35; City Exh. CEH-1 at 25). Responding to the City’s request that the Commission should, in the alternative, impose its own allocation factor, the OCA retorts that the City’s request is purely speculative and inappropriate. The OCA asserts that its proposed 24% allocation, which is developed for the treasury and finance employees, should be adopted because finance personnel is relevant to the City as a whole including the City Manager. OCA R. Exc. at 12-13 (citing OCA M.B. at 33-34; OCA St. 1 at 35). Finally, the OCA reiterates its argument that the City agreed in the settlement of its last base rate case that Administrative and General expenses, which includes the City Manager’s salary, would be allocated to the Water Fund on the basis of actual and measurable costs attributable to the Water Fund. OCA R. Exc. at 13-14 (citing City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 5). Thus, the OCA asserts that the ALJ’s recommended 24% allocation factor for the City Manager’s annual salary of $109,208, which results in a jurisdictional portion of $11,209, is appropriate and should be adopted. OCA R. Exc. at 13-14 (citing OCA M.B. at 34; Table II).

I&E also opposes the City’s 60% allocation factor. I&E avers that the City Manager has several responsibilities of which water operations are a part. According to I&E, in spite of all the various functions and responsibilities of the City Manager and the fact that the City failed to provide any recorded timesheets to support its claim, the Commission should deny the City’s claim just like it did in prior similar cases. I&E R. Exc. at 5-7 (citing I&E Exh. 2, Schedule 8 at 5-6; City St. 1-R at 9; *Media Borough*). I&E also disputes the City’s comparison of the City Manager’s salary allocation to that of the PWD stating that the City did not explain why two people with different job descriptions would be doing the same work. Therefore, I&E requests that the Commission adopt the ALJ’s recommended 24% allocation factor and reject the City’s 60% allocation factor. I&E R. Exc. at 7-8 (citing City Exc. at 10; R.D. at 34-35, 38-42).

**4. Disposition**

After consideration of the record evidence and the Parties’ arguments, we concur with the ALJ that the OCA’s proposed 24% allocation factor for the City Manager’s salary is appropriate. We note that the City has failed to support its 60% allocation with substantial evidence. As indicated by the OCA and I&E, the City failed to provide timesheets or any other verifiable record to support its claim. Rather, the City’s 60% allocation is based entirely on the City Manager’s testimony. We note that in *Quakertown,* the Commission rejected the Borough’s 25% allocation for administrative and finance expenses. Similar to this case, in *Quakertown*, the Borough relied on the judgment and knowledge of its Director of Finance who testified that she had daily interaction with all phases of the Borough’s daily operations, including the water department. *Quakertown* at 22 (citing R.D at 16; Tr. at 131-132). In its rejection of the Borough’s claim, the Commission stated:

We concur, however, with the ALJ that Quakertown has failed to adequately support its claim that the water department was or should be responsible for twenty-five percent of the Borough’s administrative and finance expenses. Consequently, we cannot adopt Quakertown’s proposed $57,350 transfer from jurisdictional water customers to the Borough’s General Fund.[[22]](#footnote-22)

*Quakertown* at 24-25.

In the same vein, in the instant proceeding, the City’s 60% allocation factor for the City Manager’s salary is based solely on the unsupported testimony of the City Manager. In addition, we agree with the OCA that in the Settlement adopted by the Commission in the City’s last rate case, DuBois agreed that in its next base rate filing, “Administrative and General Expenses shall be allocated to the Water Fund on the basis of actual and measurable costs attributable to the Water Fund.” OCA M.B. at 26 (citing City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 5). Yet, the City’s 60% allocation for the City Manager’s salary in the instant proceeding is not based on actual or measurable costs. Thus, we concur with the ALJ’s adoption of the OCA’s allocation of 24% of the City Manager’s salary to the Water Fund because it reflects a verified allocation for treasury and finance employees. R.D. at 42. As such, the City’s Exceptions regarding the ALJ’s recommendation on this issue are hereby denied and we shall adopt the recommendation of the ALJ on this issue.

**b. Administrative Expenses**

**1. Position of the Parties**

The City, in its revised City St. No. 2-R and Rejoinder Exhibit (CEH-3RJ), claimed a total of $41,170 in administrative expenses using a composite allocation of 42.5%. This represents a $17,493 claim for Health Insurance and Other Benefits for Administrative Employees. The jurisdictional portion of the City’s claim for this expense is $4,987. City St. 2-R at 20; CEH-3-R; City M.B. at 29; City R.B. at 31.

 I&E, on the other hand, proposed a composite allocation factor of 33.37% for this expense item which resulted in downward adjustment of $1,071 to the City’s jurisdictional claim of $4,987, or a jurisdictional portion of $3,916. I&E St. 2-SR at 29, 36; I&E R.B. at 7-9.

The OCA opposed both the City’s 42.5 allocation factor and the 33.37% allocation factor proposed by I&E for administrative expenses. OCA M.B. at 34-35. However, in its Reply Briefs, the OCA averred that “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 R.B. at 20-21 (citing OCA M.B. at 34-35; OCA Table II).

 **2. ALJ’s Recommendation**

In his Recommended Decision, the ALJ agreed with the OCA and I&E that the City’s 42.5% allocation for the other administrative expenses was too high. Consistent with his adoption of the 24% allocation factor for the City Manager’s salary, the ALJ recommended a revised allocation factor of 33.11%, which is slightly lower than the 33.37% proposed by I&E. This revised allocation factor resulted in a downward adjustment of $3,885 for jurisdictional ratepayers. R.D. at 44.

 **3. Exceptions and Replies**

In its Exceptions, the City disagrees with the ALJ’s adoption and recommendation of an allocation factor of 33.11% as opposed to the City’s proposed composite allocation factor of 42.5%. The City requests that the Commission adopt its proposed 42.5% allocation for Health Insurance and Other Benefits for Administrative Employees. City Exc. at 12-13.

In Reply, the OCA agrees with the ALJ’s recommendation because it addresses both the OCA’s and I&E’s concerns regarding the allocation factor claimed by the City. OCA R. Exc. at 14.

**4. Disposition**

After consideration of the record evidence and the arguments put forth by the Parties, we concur with the ALJ’s recommended allocation factor of 33.11%. We agree with the ALJ that, consistent with his recommended allocation factor of 24% for the City’s Manager’s salary, the composite allocation factor of 33.11% for administrative expenses is appropriate and adequately addresses both the OCA’s and I&E’s concerns regarding the City’s allocation factor for this expense item. As such, the City’s Exceptions to the ALJ’s recommendation on this issue are hereby denied and we shall adopt the recommendation of the ALJ on this issue.

 **5. City Buildings: Computer Parts/Supplies/Software**

 **a. Positions of the Parties**

The City included a total City Buildings expense claim of $213,227 based upon the 2015 historical expenses for this account and allocated 24%, or $51,174 to the Water Fund. City St. No. 1, Exh. CEH-1 at 25.

 The OCA recommended that a three-year normalization period be used to value this expense claim as the 2015 expense amount was significantly higher than a normal year of expense. The OCA provided that normalization of this expense results in a reduction of $19,191 to this account. According to the OCA, utilizing the City’s 24% allocation factor results in an adjustment of $4,606 to this account with a jurisdictional component of $1,313. OCA M.B. at 38-39.

 **b. ALJ’s Recommendation**

 In his Recommended Decision, the ALJ stated his agreement with the position of the OCA and recommended a jurisdictional adjustment to this expense category in the amount of $1,313. The ALJ determined that it was appropriate to normalize this expense as the amount from 2015 was significantly higher than a normal year of this expense. R.D. at 46.

 **c. Exceptions and Replies**

 In its Exceptions, the City states that it proposed to allocate expenses for the City Building/Computer Parts/Supplies/Software Expenses based upon the actual expense incurred in the HTY. The City claims that despite the fact that it confirmed the increased expense in this account in 2015 was due to payments made to a vendor named RAK Computer Associates, and despite the fact that the City provided evidence these expenses would be ongoing as part of the City’s information technology needs, the OCA perceived that this expense was an anomaly and that normalization of this expense was more appropriate. DuBois further claimed that many of the expenses in this account will continue to be incurred in the future and that this expense has increased every year since 2013. According to the City, to accurately reflect the City’s increasing expenses over the past three years, the Commission should base its allowance for this account upon the increased expense level incurred in 2015. The City asserts that the ALJ’s recommendation to adopt the OCA’s normalization of this expense should be rejected. City Exc. at 14-15.

 In reply, the OCA states that the expense amounts for this account were $186,119 in 2013, $175,306 in 2014 and $213,227 in 2015. As such, the OCA points out that the 2015 expense for this account was 22% higher than the 2014 amount and was 15% higher than the 2013 amount. The OCA explains that a breakdown of this expense shows that the primary increase in 2015 was due to a computer parts account that increased from $19,562 in 2014 to $47,202 in 2015. The OCA states that the reason for this increase in 2015 was due to the fact that payments to a vendor, RAK Computer Associates, increased from $45 in 2013, to $1,127 in 2014, to $23,116 in 2015. The OCA claims that the City did not provide any explanation for this significant increase and did not provide support that the increased expense is an ongoing level of expense. As such, the OCA maintains that it is appropriate to normalize this expense as it is significantly higher than a normal year of expense. OCA R. Exc. at 16-17.

 **d. Disposition**

 Based upon our review of the evidence of record, we agree with the recommendation of the ALJ that it is reasonable and appropriate to normalize the City Building/Computer Parts/Supplies/Software Expenses as the City failed to provide support that the increased level of expense identified by the OCA is an ongoing level of expense. As such, we shall deny the Exceptions of the City on this issue and adopt the ALJ’s recommendation to adopt the OCA jurisdictional expense adjustment of $1,313.

 **6. Rate Case Expense**

 **a. Positions of the Parties**

The City claimed $225,505 of rate case expense normalized over a 2.5 year period, for an annual expense of $90,202. The City stated that the 2.5 year normalization period is based on the recent history of City rate filings and expectations of the City regarding future filings. City M.B. at 21-22.

The OCA and I&E did not recommend any adjustment to the level of the rate case expense claimed, but each recommended an adjustment to the 2.5 year normalization period proposed by the City based upon historical rate case filing frequency. The OCA recommended that a five-year normalization period is appropriate. The OCA stated that in addition to the current case filed on June 30, 2016, the City’s three previous cases were filed in March of 2013, October of 2005 and August of 1996. As such, the OCA claimed that these filing intervals are not indicative of a 2.5 year normalization period. Based upon its recommended five-year normalization period, the OCA recommended that the annual normalization amount should be $45,101. OCA M.B. at 40‑41.

I&E proposed that a 64-month normalization period be adopted to determine an allowable rate case expense claim. I&E essentially agreed with the OCA’s rate case normalization but did not round down the time period over which recovery will occur. I&E determined that if the 1996 case is eliminated from the calculation, the average filing frequency is 5.33 years or 64 months. I&E M.B. at 18.

**b. ALJ’s Recommendation**

 In his Recommended Decision, the ALJ concluded that the I&E’s rate case expense adjustment, which is based upon a 64 month rate case normalization period, should be adopted. The ALJ explained that I&E’s proposal is more accurate than the OCA’s proposal of five years and is also consistent with Commission precedent. According to the ALJ, I&E’s recommended normalization period accurately takes into account the City’s historical filing frequency. R.D. at 48-49.

**c. Exceptions and Replies**

In its Exceptions, the City states that the ALJ’s recommendation adopts an overly rigid and unreasonable interpretation of Commission precedent that would promote under-recovery of rate case expense for the City. Dubois claims that normalization of rate case expense over a reasonable period is appropriate because the expense is only incurred during the period of the actual rate case, but the benefits of the increased rates last for more than one year. However, the City avers that an unreasonably long normalization period, particularly for a smaller utility proposing a relatively modest rate increase, will jeopardize the utility’s financial health by denying recovery of actually incurred rate case expense. The City avers that a 2.5-year normalization period would balance these concerns by acknowledging that rate case expense recovery can be spread over a period of years while allowing the City to recover rate case expense in a reasonable amount of time. City Exc. at 7-8.

 Next, the City claims that the Commission has previously held that a two-year normalization period is acceptable when the interval periods between a utility’s rate case filings showed a decreasing trend, even though the average interval supported a three-year normalization.[[23]](#footnote-23) According to DuBois, a similar result should follow in this case where undisputed factual evidence shows the past filing patterns will not be repeated. The City states that its past rate filings, including this case, occurred in 2005, 2013 and 2016. DuBois explains that by simply averaging the interval periods between those filings would produce a normalization period of five years. However, the City asserts that a significant factor contributing to the City’s avoidance of rate increases between 2005 and 2013 was the availability of unanticipated revenues from sales of water to shale gas companies occurring during that period. The City asserts that the Commission should consider the extended stay-out from 2005 to 2013 as an anomaly and adjust the normalization period to 2.5 years. City Exc. at 8-9.

 DuBois next states that the actual history from its 2013 rate case further confirms why a 2.5-year normalization period is appropriate. DuBois explains that as of October 2016, it had only recovered 40% of its prior rate case expense stemming from the 2013 rate case. The City opines that it should not be forced to, once again, under-recover its rate case expense due to an unreasonably protracted rate case normalization period. The City avers that the Commission should reject the overly formulaic normalization period proposed by the ALJ and approve either the 2.5-year normalization period proposed by the City or an alternative, but significant, reduction to the 5.33 year period, as may be deemed appropriate. City Exc. at 9.

 In reply, I&E states that throughout this proceeding, DuBois relies exclusively upon *Lemont Water* in support of its overly aggressive and unfounded rate case normalization request. I&E asserts that this case is a lone and outdated one that is not only distinguishable from the case at hand but has been clearly superseded by volumes of case law. Furthermore, I&E claims that *Lemont Water* is not applicable in this matter noting that the Final Order in *Lemont Water* was issued in 1994, two years before the Commonwealth Court acknowledged the historical filing frequency standard[[24]](#footnote-24) and several years before other Commission decisions, like *Pennsylvania P.U.C. v. Emporium Water Company*, Docket No. R-2014-2402324 (Order entered January 28, 2015)(*Emporium Water)* at 48, adhered to the historical filing frequency standard. As such, I&E argues that *Lemont Water* has been superseded for years. I&E R. Exc. at 2-3.

 Next, I&E states that the facts in *Lemont Water* are very different from the case at hand as in that case its predecessor, the Office of Trial Staff (OTS) advocated for the use of an approximate three-year historical filing frequency but ended up supporting Lemont’s two-year filing frequency in surrebuttal. According to I&E, this was done in conjunction with a recommendation to disallow $56,682 of Lemont’s rate case expense claim. I&E explains that in this proceeding, the timing difference between the City’s 30‑month normalization period and I&E’s 64-month recommendation is much longer than the 12‑month difference in *Lemont Water* and I&E has not sought disallowance of any component of the City’s rate case expense claim. I&E R. Exc. at 3.

 Next, I&E cites to the City’s attempt to obfuscate this issue by insisting a shortened normalization period is merited because rate case filings may become more frequent in the future. I&E asserts that the City has repeatedly and glaringly failed to address the fact that this reasoning has been explicitly rejected by the Commission in the past in such cases such as: *Pennsylvania P.U.C. v. City of Lancaster – Bureau of Water*, Docket No. R-2010-2179103 (Order entered July 14, 2011) (*Lancaster Water)* at 38 and *Emporium Water.* I&E R. Exc. at 3-4.

 Next, I&E states that the City’s claim of failing to recover rate case expense is speculative and unfounded and that the City has mistakenly claimed injustice has been perpetrated because it has not been given the rate case normalization period it has sought. I&E maintains that the City is never guaranteed to fully recover any normalized expense and has confused normalization with amortization of expenses. I&E notes that as stated by the ALJ, there was no demarcation of rate case expense or a normalization period for this expense in the City’s prior rate case since it was the subject of a black box settlement. I&E opines that given that the precedent in this case is overwhelmingly in support of the ALJ’s recommendation, the normalization period for rate case expense of 64-months is fair, reasonable and supported by record evidence. I&E R. Exc. at 4.

 In its Replies to Exceptions, the OCA notes that the City’s last four rate cases were filed in 2016, 2013, 2005 and 1996. As such, the OCA states that the average time between the City’s last three rate filings is more than six years.[[25]](#footnote-25) The OCA explains that if the 1996 case is eliminated from the calculation, the average filing frequency is 5.33 years. While the OCA notes that it rounded down to five years for its recommended normalization period, the ALJ determined that the 5.33 actual average filing frequency recommended by I&E was more appropriate. The OCA notes that it supports the ALJ’s recommendation. OCA R. Exc. at 8-9.

 Next, the OCA cites to the City’s dependence on *Lemont Water* noting that the Commission’s determination in that 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. The OCA explains that in *Lemont Water*, it argued for a two-year normalization period while the Commission determined that a 1.6 year normalization period accurately represented the Company’s historical filing period. As such, the OCA asserts that *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. OCA R. Exc. at 9.

 The OCA avers that the Commission has consistently held that rate case expenses are normal operating expenses, and normalization should be based on the historical frequency of the utility’s rate filings.[[26]](#footnote-26) The OCA points out that 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.” citing *Lancaster Water* and *Emporium Water*. The OCA mentions that the City argued that it was able to reduce its filing frequency in the past because it received additional revenues from the sale of water to shale gas companies. The OCA notes that the City stated in its Main Brief at 25 that “[i]mportantly, all parties have conceded that such sales [of water to shale gas companies] are not expected to recur.” However, the OCA claims that it made no such concession as it has no knowledge of sales of water to shale gas companies the City may or not make in the future. Therefore, the OCA submits that the normalization period should be based off of the historical average interval between rate filings and that the ALJ’s recommended 5.33 year period is a reasonable and fair estimate of the City’s historical average filing interval. OCA R. Exc. at 9-11.

 **d. Disposition**

 Upon our review of the evidence of record, we are in agreement with the ALJ’s recommendation that the City’s rate case expense should be normalized based upon the 64 month period as recommended by I&E. We note that both I&E and the OCA made similar recommendations which differed slightly due to the OCA rounding the 64-month period to five years. We are not convinced by the position of the City that its 2.5 year normalization period is reasonable considering the filing frequency of its most recent base rate filings. We further conclude that the City’s position is not in accord with Commission precedent on this issue and that the *Lemont Water* decision upon which the City relied upon is not applicable to the facts of the instant proceeding.

 Accordingly, we shall deny the Exceptions filed by the City on this issue and adopt the ALJ’s recommendation that the City’s rate case expense claim be normalized over a 64-month period. This results in a jurisdictional expense adjustment of $47,920.

 **7. Unaccounted for Water (UFW)**

 **a. Positions of the Parties**

I&E stated that UFW is the difference between total system output and the metered quantity of water billed plus an estimate for the amount used for fire service, testing, main-flushing, and unmetered Company use. I&E noted that in this case, UFW is calculated by taking the total amount of water produced and purchased and subtracting accounted-for water. According to I&E, accounted-for water is water sold, billed, metered for use, fire department use, hydrant flushing, backwashing/blow-offs, pool filling, tank cleaning/filling, street cleaning, bulk sales, water bill adjustments, waterline construction, and other usage by City buildings, wastewater treatment plants, garages and fire halls. I&E averred that typically, UFW can be traced to under registration of meters, leaks in mains, hydrants, theft of service, and natural losses. I&E asserted that the Commission has stated that it considers any UFW above 20% to be excessive citing 52 Pa. Code § 65.20(4). I&E M.B. at 20.

 I&E asserted that pursuant to Commission policy, it calculated that the “acceptable” level of UFW for DuBois would be 146,278,067 gallons of water and by subtracting that amount from the City’s three-year average of 195,562,237 gallons of UFW in total results in an excessive amount of UFW of 49,284,171 gallons. I&E then multiplied this amount of excessive UFW by the cost incurred by the City to produce 1,000 gallons of water at $0.238 resulting in an adjustment of $11,754 on a total City basis or $3,615 on a jurisdictional basis. I&E stated that this adjustment will ensure that customers are not made to reimburse the City for this excessive UFW, which is on a distinct upward trend. I&E M.B. at 20-21.

The City countered the I&E recommendation. The City argued that by emphasizing the year-to-year fluctuations rather than the broader trend, I&E misrepresented the City’s progress towards lower UFW rates. According to the City, the trend indicates substantial progress in reducing UFW since its 2013 rate proceeding concluded, and asserted that it has regularly performed leak testing to further reduce its UFW amount. Additionally, the City claimed that through a Stipulation with the OCA, it adopted numerous operational recommendations made by the OCA to further improve its UFW. citingCity/OCA Stipulation. Consistent with the City/OCA Stipulation, the City committed to perform the following tasks related to UFW:[[27]](#footnote-27)

1. In future rate cases, the City will provide Unaccounted-For-Water (“UFW”) calculations in the format shown on Exhibit TLF-1 that is used by water utilities in submission of their Annual PUC Reports.

2. 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.

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

4. 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.

5. 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, ¶¶ 1-8; City R.B. at 17-18.

The City asserted that it has made progress toward reducing its UFW and has further adopted additional measures to reduce its UFW, which the Commission has previously held to mitigate against downward adjustments to UFW expense claims. *Citing Pa. PUC, et al. v. City of Bethlehem,* 1995 Pa. PUC LEXIS 38,58 (March 16, 1995). As such, the City opined that I&E’s proposed adjustment should be denied.

City R.B. at 18.

**b. ALJ’s Recommendation**

The ALJ referenced the Stipulation entered into between the City and the OCA, wherein the City committed to further reduce UFW and noted that, based upon this Stipulation, he agreed with the City that I&E’s proposed expense adjustment should be denied. According to the ALJ, the City’s expense is justified to insure the provision of water service to jurisdictional customers in accordance with the Code. R.D. at 52.

**c. Exceptions and Replies**

In its Exceptions filed on this issue, I&E first notes that the Commission has stated that it considers any UFW above twenty percent to be excessive.[[28]](#footnote-28) I&E asserts that since its prior rate case, DuBois has allowed its UFW to consistently grow worse with yearly UFW averages of 25.78% in 2013, 26.22% in 2014 and 28.07% in 2015. I&E explains that the real impact of this excessive waste is the unwarranted pumping, treatment and transportation expenses incurred. Also, I&E provides that UFW reduces the amount of water available to customers. I&E proposes an expense adjustment on this issue to ensure that customers are not compelled to pay for the City’s worsening UFW and also to incentivize the City to address this issue. I&E Exc. at 3-4.

 I&E explains that the cost of power purchased, along with supplies and expenses for treatment and maintenance incurred by the City, to produce 1,000 gallons of water was calculated at $0.238. I&E asserts that by multiplying this per thousand gallon rate by the total excessive UFW amount of 49,284,171 gallons of water, it was able to calculate that the amount of expense the City incurs producing the excessive portion of its UFW is $11,754 or $3,615 on a jurisdictional basis. I&E opines that there is no dispute that the City’s UFW levels have increased steadily since its last rate case. According to I&E, this worsening trend is troubling and its concern is not alleviated by the City’s contention that current UFW percentages are not as high as they once were many years ago. I&E Exc. at 4.

Next, I&E cites to the joint stipulation entered into between DuBois and the OCA which sets out certain operational measures that will hopefully help the City reduce UFW. According to I&E, this stipulation merely codifies measures that should have been undertaken already. I&E points out that DuBois is just now agreeing to enter into an established plan to reduce its UFW and has presented no evidence or justification in this proceeding regarding its UFW. I&E notes that the *City of Bethlehem* case cited by DuBois is distinguishable from this situation as in the former case the utility had already been executing a significant and detailed plan to reduce its UFW. Also, I&E claims that shielding the City from responsibility for their excessive UFW unfairly and prematurely rewards the City simply for agreeing to address an issue in the future that it should have been addressing over the past three years. I&E asserts that the ALJ’s recommendation directly harms customers by forcing them to foot the bill for the City’s increasingly excessive UFW level. Additionally, I&E opines that this adjustment can be mitigated by the City simply be reducing its UFW to non-excessive levels. I&E requests that the Commission implement the UFW adjustment of $3,615. I&E Exc. at 4-6.

In reply, the City states that I&E’s proposed adjustment is fundamentally flawed and premised on a misreading of a Commission policy. DuBois asserts that I&E has mischaracterized the City’s record of UFW noting that its average UFW for the period 2010-2012 was 30.2% and the average UFW for the period 2013-2015 was 26.69%. The City maintains that by all reasonable measures, this data shows improved UFW levels for the period since the City’s last base rate case. The City states that despite this fact, I&E wrongfully attempts to skew the data and characterize the City’s UFW as a “worsening trend” because the UFW levels increased by minor increments between 2013 and 2015. DuBois asserts that I&E’s proposed adjustment should be denied as unfounded and contrary to record evidence. City R. Exc. at 13.

Next, the City states that I&E fails to account for the City’s history of reducing UFW and its further commitments to adopt measures intended to achieve further reductions to UFW. DuBois claims that it has provided evidence confirming its average UFW has decreased since the last base rate filing and that it has performed leak testing to reduce its UFW. I&E further claims that during the course of this proceeding it subsequently agreed to meter all City buildings instead of using estimates, which will result in more accurate UFW data. Finally, the City notes that it developed a comprehensive plan to achieve additional improvements to its UFW, which was admitted to the record as a Stipulation with the OCA. Contrary to I&E’s allegations, the City avers that it has demonstrated a history and now-established practice of improving UFW and a commitment to future reduce its UFW. City R. Exc. at 13-14.

DuBois next asserts that I&E mischaracterizes the Commission’s policy statement regarding water conservation in claiming “[t]he PUC has stated it considers any unaccounted for water above 20% to be excessive.” The City claims that actually, the policy statement observes that “levels above 20% have been considered by the Commission to be excessive.” See52 Pa. Code § 65.20(4). According to the City, this distinction reflects the discretion applied by the Commission in assessing whether an adjustment to UFW is appropriate in individual base rate proceedings. The City points out that in the only case cited to by I&E in support of its downward adjustment to UFW, the Commission stated that “the Company’s unaccounted-for water history is consistently in the range of 30%, with no sign of decreasing.” *See, Pa. PUC v. Total Environmental Solutions, Inc.*, 103 Pa. P.U.C. (July 30, 2008). To the contrary, the City opines that as determined by the ALJ, the City’s circumstances are more analogous to those in the *City of Bethlehem* case, where the Commission denied to adjust the UFW claim where the utility established a plan to combat otherwise excessive UFW. City R. Exc. at 14‑15.

**d. Disposition**

Based upon our review of the record evidence, we shall adopt the recommendation of the ALJ that I&E’s proposed expense adjustment is not justified under the facts of this proceeding. We are in agreement with the argument advanced by the City that while there may exist an upward trend in the City’s UFW, its average UFW for the period 2010-2012 was 30.2% and the average UFW for the period 2013-2015 was 26.69%. As such, we agree with the City that this data shows improved UFW levels since the City’s last base rate case. It is also significant to consider the potential ramifications of the Stipulation the City entered into with the OCA, which illustrates the commitment of the City to reverse the recent upward trend of UFW. We conclude that the City deserves the opportunity to implement the measures it has agreed to within the Stipulation and to present the results of these measures in its next base rate proceeding.

Accordingly, we shall deny the Exceptions filed by I&E on this issue and adopt the ALJ’s recommendation to deny I&E’s proposed UFW adjustment.

 **8. Overtime Expenses**

 **a. Positions of the Parties**

 The City claimed overtime expenses in two separate categories, including an amount of $43,534 for Water Treatment Plant (WTP) overtime and an amount of $34,397 for T&D overtime, based solely on expenses from the HTY. City M.B. at 18.

 I&E noted that the HTY happens to have the largest expenses in these categories since the previous rate case. As such, I&E recommends that this expense be modified based upon a three-year historical average, which is a generally accepted practice used to even out fluctuations in historical data and to produce a more accurate estimation of future expenses. I&E provided that this averaging results in a recommended downward adjustment to the City’s claim in the amounts of $3,741 for WTP overtime and $9,748 for T&D overtime. I&E M.B. at 20-21.

**b. ALJ’s Recommendation**

In his Recommended Decision, the ALJ stated his agreement with the City and recommended that the proposed adjustment to overtime expenses be denied. The ALJ concluded that the City’s expense is justified to insure the provision of water service to jurisdictional customers in accordance with the Code. R.D. at 53.

**c. Exceptions and Replies**

In its Exceptions, I&E asserts that the ALJ erred by focusing only on the HTY cost of overtime. I&E notes that the City’s use of its HTY amount of overtime expense results in a claim of $43,534 for the WTP and $34,397 for the T&D system. Instead, I&E recommended an averaging of these costs due to their variable nature over time. I&E avers that the ALJ misstated the facts and did not fairly gauge the nature of this highly variable expense as the overtime expenses incurred by the City has varied significantly each year since the last rate case. I&E opines that given the inconsistent nature of this expense, it is wholly inaccurate and harmful to customers to claim the most expensive year is representative of the need going forward. I&E claims that it is particularly egregious to do so in cases when the expense has more than doubled from the previous year. I&E Exc. at 6-7.

 I&E included the following breakdown of the City’s overtime expenses over the last three years:

|  |  |  |
| --- | --- | --- |
| **Year** | **WTP** | **T&D** |
| 2013 | $35,840 | $22,694 |
| 2014 | $40,005 | $16,856 |
| 2015 | $43,534 | $34,397 |
| **Average** | **$39,793** | **$24,649** |

I&E recommends adoption of the average amounts listed above to provide a more accurate projection of the overtime needs going forward. According to I&E, the incorporation of more evidence and historical data through this historical average more accurately predicts expenses and also ensures that ratepayers do not pay for overtime that will not actually occur. Accordingly, I&E requests that the Commission apply the adjustments it has recommended to reflect WTP overtime expense of $39,793 and T&D system overtime expense of $24,649. I&E Exc. at 7.

 In reply, the City states that I&E’s proposal ignores the clear upward trend of these expenses since 2013. DuBois notes that its overtime expenses for the WTP account rose from $35,840 in 2013 to $43,534 in 2015, an increase of 21%. Similarly, overtime expenses under the T&D account totaled $22,694 in 2013, decreased in 2014, but rose to $34,397 in 2015, an increase of 34% over three years. The City avers that precedent indicates that the Commission previously approved the practice of relying upon recent cost data over historical averages if the historical data demonstrates an upward trend rather than fluctuations. citing *Pa. PUC v. Philadelphia Electric Company*, 1985 Pa. PUC LEXIS 67, \*59. 58 Pa. PUC 743, 767 (January 24, 1995). The City states that as a result of this clear historical upward trend of the overtime expenses, I&E’s recommendation to average overtime costs over three years should be denied. City R. Exc. at 15-16.

**d. Disposition**

 Based upon our review of the evidence of record, we are convinced by the argument of the City that the overtime expense amounts at issue have shown a significant upward trend over the past three years and that the I&E proposal ignores this trend. As such, we are in agreement with the ALJ’s recommendation that the adjustments recommended by I&E to the City’s overtime expense claim should not be adopted. Therefore, we shall deny the Exceptions filed by I&E on this issue.

 **9. Payroll/FICA Tax Adjustment**

 **a. Positions of the Parties**

In conjunction with the foregoing overtime adjustment, I&E recommended that there must be a corresponding adjustment to the City’s claim for payroll & FICA taxes, which is based off of percentages of employees’ gross wages plus overtime and vacation pay less certain healthcare expenses. I&E’s modifications to overtime expenses outlined *supra* would necessitate a downward adjustment of $1,031 in total. I&E M.B. at 22-23.

**b. ALJ’s Recommendation**

The ALJ recommended denial of I&E’s proposed adjustment to payroll/FICA tax expense consistent with his recommended denial of I&E’s suggested overtime expense adjustment. According to the ALJ, the City’s expense is justified to insure the provision of water service to jurisdictional customers in accordance with the Code. R.D. at 54.

**c. Exceptions and Replies**

In its Exceptions, I&E states that this adjustment goes hand-in-hand with the recommended overtime adjustment as reduction of the overtime expenses requires a corresponding adjustment to payroll and FICA tax. I&E explains that this is due to the fact that these taxes are based on a percentage of employees’ gross wages plus overtime and vacation pay with the removal of certain healthcare expenses. Based upon the validity of I&E’s overtime adjustment, I&E avers that a payroll and FICA tax reduction of $1,031 be adopted by the Commission. I&E Exc. at 8.

 In reply, the City states that because it disputes I&E’s recommended overtime adjustment, the City also rejects I&E’s proposed Payroll and FICA tax adjustment. The City avers that the Commission should ignore I&E’s erroneous recommendation to reduce this expense category. City R. Exc. at 16.

**d. Disposition**

Consistent with our determination with regard to I&E’s recommended adjustment to overtime expenses, we shall adopt the ALJ’s recommendation to deny this adjustment as well. Accordingly, we shall deny the Exceptions filed by I&E on this issue.

**G. Taxes**

The City does not claim any taxes for ratemaking purposes.

**H. Rate of Return**

**1. Introduction**

 It has been determined in this Commonwealth that a public utility is entitled to an opportunity to earn a fair rate of return on the value of its property which is dedicated to public service. *Pennsylvania Gas & Water Company v. Pennsylvania Public Utility Commission,* 341 A.2d 239 (Pa. Cmwlth. 1975). This is consistent with longstanding decisions by the Supreme Court of the United States, including *Bluefield Water Works and Improvement Company v. Public Service Commission of* West Virginia (*Bluefield)*, 262 U.S. 679, 690-93 (1923) and *Federal Power Commission v. Hope Natural Gas Company (Hope Natural Gas),* 320 U.S. 591, 603 (1944). In *Bluefield*, *supra,* the Supreme Court of the United States provided criteria by which regulators are guided for purposes of determining a fair rate of return for a public utility. The Court said:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. 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 maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment and business conditions generally.

 The Court focused particularly upon the equity return in *Hope Natural Gas*, stating:

. . . It is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends.

. . . [T]he return to the equity owner should be commensurate with risks on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.

 The overall rate of return position of the Parties is summarized in the following tables:

**CITY OF DUBOIS**

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **Capital Structure** | **Cost Rate** | **Weighted Cost** |
| **Long-Term Debt** | 50% | 3.02% | 1.51% |
| **Common Equity** | 50% | 10.50% | 5.25% |
| **Total** | 100% |  | **6.76%** |

**I&E**

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **Capital Structure** | **Cost Rate** | **Weighted Cost** |
| **Long-Term Debt** | 70.0% | 3.02% | 2.11% |
| **Common Equity** | 30.0% | 7.05%[[29]](#footnote-29) | 2.12% |
| **Total** | 100% |  | **4.23%** |

**OCA**

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **Capital Structure** | **Cost Rate** | **Weighted Cost** |
| **Long-Term Debt** | 70.0% | 3.02% | 2.11% |
| **Common Equity** | 30.0% | 6.60%[[30]](#footnote-30) | 1.98% |
| **Total** | 100% |  | **4.09%** |

 **2. Capital Structure**

Capital structure is the type and percentages of capital supplied by investors and involves a determination of the appropriate proportions of long-term debt and common equity used to finance the rate base. This is crucial to developing the weighted cost of capital, which, in turn, determines the overall rate of return in the revenue requirement equation. OCA M.B. at 49.

**a. Positions of the Parties**

 The City proposed a capital structure of 50% debt and 50% equity. Both I&E and the OCA proposed a capital structure of 70% debt, 30% equity. All three parties base their capital structure recommendations on substantially similar comparable groups of utility companies with actively traded stock. The City used a comparable group consisting of American Sales Water Co., American Water Works Co., Inc. Aqua America, Inc., California Water Service, Middlesex Water, SJW Corp. and York Water Co. (Water Group). SeeCity St. No. 4 at 10. I&E used the same proxy group as the City, while the OCA added one additional company, Artesian Resources. See City St. No. 4-R at 18; City M.B. at 35.

The City recommended that a hypothetical capital structure of 50% debt/50% equity be used because it claimed that the City’s per books capital structure is 0% debt/100% equity. City St. 4 at 14. The OCA and I&E recommended 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 M.B. at 49; I&E M.B. at 27-28.

The OCA stated that the City’s actual capital structure is 99.5% debt/0.5% equity. According to the OCA, 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. However, the OCA asserted that the hypothetical capital structure proposed by the City, if adopted, would unreasonably increase costs to ratepayers. OCA M.B. at 46-48.[[31]](#footnote-31) The OCA maintained that 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 *E**mporium Water v. Pa. Pub. Util. Comm’n*, 955 A.2d 456 (Pa.Cmwlth. 2008) *appeal denied* 599 Pa. 702, 961 A.2d 860 (2008); OCA M.B. at 49-50; OCA R.B. at 28-29.

I&E stated that in this case, because the City operates under cash basis accounting, an exact percentage of debt to equity is unable to be calculated. I&E claimed that a very close model of actual capital structure can be calculated by analyzing the original cost measure of value on December 31, 2016, which should approximate the total amount of capital financing outstanding at that time. According to I&E, total debt service can be subtracted from this original cost measure of value and an implied equity can be calculate therefrom. According to I&E, based upon the debt outstanding and the implied equity, the estimated actual capital structure of the City is 71.8% long-term debt and 28.2% equity. I&E explained that when faced with another debt-heavy actual capital structure of a municipal water utility in a case similar to this one, the Commission has held that “the actual capital structure must be used for ratemaking purposes to achieve a fair balance between consumers and the City…the use of a hypothetical capital structure will produce an inflated overall rate of return that would adversely affect consumers.”[[32]](#footnote-32) It was the position of I&E that utilizing the City’s actual capital structure best protects the public interest in this proceeding. I&E M.B. at 27-29.

**b. ALJ’s Recommendation**

The ALJ stated that he agreed with the intervening Parties that the City’s arguments for a hypothetical capital structure of 50% debt and 50% equity are flawed. Instead, the ALJ found that it would be fair and reasonable to both the utility and the ratepayers to adopt the capital structure recommended by the OCA and I&E, rather than the City’s capital structure, thus complying with the principles most recently enunciated by the Commission in *L**ancaster Water*. According to the ALJ, in reviewing the City data as of the end of the future test year, it is clear that the capital structure recommended by both the OCA and I&E is reasonable and more closely tracks the actual capital structure of the test year. The ALJ asserted that debt ratios change over time, however, the relevant time period in this rate case is the future test year, ending December 31, 2016. As such, the ALJ recommended that the proposed capital structure of both I&E and the OCA (70% debt/30% equity), the estimated actual capital structure, is appropriate for ratemaking purposes and should be adopted here. The ALJ reiterated that this ratio reflects the basis upon which the financing has been done for the City’s rate base. The ALJ concluded that, for the City, it is reasonable for ratemaking purposes. R.D. at 58, 62-63.

**c. Exceptions and Replies**

In its Exceptions, the City states that the ALJ inappropriately adopts the I&E and OCA recommendations to adopt a debt/equity capital structure based on the financing of the City’s rate base. In doing so, the City avers that the ALJ unreasonably analogizes the City’s circumstances to those observed in *Lancaster Water*. The City maintains that the record on this proceeding differs materially from *Lancaster Water*, and requests that the Commission invoke its discretion to adopt the City’s proposed 50% debt/50% equity hypothetical capital structure to balance the interests of the City and its customers. According to the City, the Commission denied use of a hypothetical capital structure in *Lancaster Water* out of a concern that use of a hypothetical capital structure would result in excessive costs to customers. The City submits that such concerns are unwarranted in this case. The City explains that in *Lancaster Water* the municipality sought to increase rates by 100%, which would have increased the jurisdictional revenue requirement by $8.6 million. In this proceeding, the City notes that it proposed a comparatively minor 36% rate increase of $257,604, which it further reduced to $229,551. Therefore, the City asserts that use of a hypothetical capital structure in this proceeding would not present equivalent cost concerns as those raised in *Lancaster Water*. City Exc. at 15-16.

Additionally, the City claims that the ALJ recommendation fails to balance the interests of the utility and its customers. The City points out that in *Lancaster Water*, the Commission acknowledged its use of a capital structure differing from market norms to necessitate upward adjustment to the cost of common equity. citing *Lancaster Water* at 73 (establishing that a “higher cost of equity is necessitated by our adoption of the City’s actual capital structure”). Similarly, the City points out that in a prior case, the Commission approved a hypothetical capital structure after confirming “it has long been the policy of the Commission to employ a hypothetical capital structure when the use of the actual capital structure would not provide an appropriate balance between shareholder (or in the case of a municipality, an asset holder) and consumer interests” citing *Lancaster Sewer 2005* at 146*.* The City notes that the Commission indicated there that use of an actual capital structure is appropriate where the utility benefits from extraordinarily low-debt due to Pennsylvania Infrastructure Investment Authority (Pennvest) funding, which the City has no Pennvest debt citing *Id.* at 147. City Exc. at 16-17.

Finally, the City asserts that approval of the ALJ’s recommendation results in a failure to reasonably balance the important interests in this case as it derives from an improper comparison of the City’s rate proposal to vastly different situations in prior cases. According to the City, it has not proposed to increase rates by 100% and the City does not benefit from 1% Pennvest debt. Accordingly, the City avers that the Commission should reject the ALJ’s capital structure recommendation, adopt the reasoning from *Lancaster Sewer 2005,* and approve the 50% debt/50% equity capital structure proposed by the City. City Exc. at 17.

In reply, the OCA first states that the City’s actual capital structure is 99.5% debt/0.5% equity as revised in OCA surrebuttal testimony. See OCA St. 1S at 6. The OCA explains that the ALJ adopted 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. The OCA asserts that in arguing for the use of its hypothetical capital structure, the City, without any legal precedent, appears to argue that the utilization of a capital structure of 70%debt/30% equity is dependent on the percentage of the rate increase sought by a municipality. The OCA points out that the City does not provide any support for a threshold, besides noting that Lancaster sought to increase rates by 100%, for which the capital structure adopted by the ALJ would be appropriate. According to the OCA, the percentage of the proposed increase in rates does not, in any way, determine the appropriate capital structure nor does it discredit the ALJ’s recommended capital structure or draw its reasonableness into question. OCA R. Exc. at 17-18.

Next, the OCA references the City’s argument that the ALJ failed to balance the interests of the utility and its customers citing to Commission decisions in *Lancaster Water* and *Lancaster Sewer 2005*. However, the OCA points out that the citation provided by the City cites to a discussion of the parties’ positions in the case and not to the disposition citing *Lancaster Water* at 73. The OCA notes that the disposition section of the case regarding cost rate models includes the language noted parenthetically by the City, but also includes additional clarifying language and states as follows:

We note that a higher cost of equity is necessitated by our adoption of the City’s actual capital structure, but it is important to note that our allowance of a 10.00% return on equity falls squarely within the range of the DCF results as calculated by the OTS (8.53 to 10.87%).

*Lancaster Water* at 73. Furthermore, the OCA points out that the Commission rejected Lancaster’s 50% debt/50% equity capital structure because it would impose excessive costs on consumers and required consumers to pay equity returns of over 10% on debt that costed, on average, 4.66%. *Id.* at 55; OCA R. Exc. at 18.

 Next, the OCA notes that the City further attempts to support its argument for the City’s proposed hypothetical structure by citing to a disposition in *Lancaster Sewer 2005*. The OCA explains that the question of the appropriate capital structure is not limited to those situations where Pennvest debt is present. According to the OCA, the actual capital structure should be used unless it is atypical. The OCA avers that the use of the City’s proposed hypothetical capital structure is not a proper balancing of ratepayer and City’s interests because the City is asking the Commission jurisdictional customers to pay an equity return of 10.5% on debt that has a weighted cost of 3.02%. The OCA maintains that the City, through its proposed capital structure, is attempting to take low cost debt and get equity returns for it. The OCA opines that generally, the use of a hypothetical capital structure should not increase costs to ratepayers. The OCA asserts that 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. Citing *Emporium Water v. Pa. PUC*, 955 A.2d 456 (Comm. 2008) *appeal denied* 599 Pa. 702, 961 A.2d 860 (2008). OCA R. Exc. at 19.

 Finally, the OCA states that the ALJ’s capital structure is appropriate and reasonable for ratemaking purposes as it reflects the basis upon which the financing has been done for the City’s rate base. OCA R. Exc. at 19.

 In its Replies to Exceptions, I&E states that the ALJ correctly applied Commission precedent and sound ratemaking principles in utilizing the capital structure proposed by I&E and the OCA. I&E notes that while the Bureau of Water’s capital structure is atypical of the investor-owned water utility industry, the low cost of debt that the Bureau of Water is able to obtain through the City is also atypical of the investor-owned water utility industry. I&E explains that, as a result, the ALJ found that the City’s claimed hypothetical capital structure simply shifted low cost debt into higher cost equity and would unreasonably increase costs to ratepayers. Additionally, I&E states that when the actual capital structure was recalculated through the end of the future test year, the resulting 67% debt/33% equity is nearly identical to the 70% debt/30% equity recommended by the ALJ. I&E R.Exc. at 10-11.

 Next, I&E references the City’s argument that the ALJ unreasonably analogized the City’s circumstances to those observed in *Lancaster Water* by stating that its hypothetical capital structure would not impose excessive costs on consumers. I&E claims that in *Lancaster Water*, the Commission held that when faced with a debt-heavy municipal water utility, “the actual capital structure must be used for ratemaking purposes to achieve a fair balance between consumers and the City…the use of a hypothetical capital structure will produce an inflated overall rate of return that would adversely affect consumers.” citing *Lancaster Water* at 51. Furthermore, I&E notes that the Commission stated that the use of a hypothetical capital structure when Lancaster was not traded as a separate entity would result in excessive costs to consumers, but the use of an actual capital structure would not. citing *Id.* at 55.

 In response to the City’s argument that its hypothetical capital structure was prudent because it was similar to ratios employed by other investor-owned water companies, I&E explains that the City is a municipality and not an investor-owned utility. According to I&E, the Commission has held that publicly traded companies need to meet market norms for capital structure ratios and the use of a hypothetical capital structure would impose excessive costs on customers. According to I&E, the City’s claimed hypothetical capital structure would result in an extra $224,330 yearly expense to ratepayers and was properly rejected by the ALJ. I&E R. Exc. at 12.

 Next, I&E notes that as the ALJ recognized, since the City’s status as a municipally-owned utility provides it with the opportunity to obtain debt at a low cost rate as a result of the City’s ability to tax, this low cost debt should not be shifted to higher cost equity at the expense of the ratepayers. Therefore, according to I&E, the use of a hypothetical capital structure in this proceeding would have the equivalent cost concerns as those raised in *Lancaster Water* and would result in an excessive cost to consumers. Also, I&E claims that the City’s position that the ALJ fails to balance the interests of the utility and its customers is unwarranted. I&E opines that the Commission has discretion in whether to use a hypothetical capital structure and must always balance the interest of the utility and the customers when considering the appropriate capital structure. I&E further opines that in this case, the use of the hypothetical capital structure requested by the City would serve only to unjustly enrich the Bureau of Water to the detriment of its customers. I&E asserts that the use of the hypothetical capital structure would merely shift 20% of the City’s capital from low cost debt to higher cost equity, allowing the City to charge its customers a higher cost rate for a misplaced portion of debt. I&E R. Exc. at 12-13.

**d. Disposition**

Upon our consideration of the Recommended Decision and the Exceptions and Replies to Exceptions filed by the Parties, we are persuaded by the arguments of the OCA and I&E to adopt the City’s estimated actual capital structure, as calculated by I&E, and, therefore, shall adopt the recommendation of the ALJ on this issue. Consistent with our recent determination in *Lancaster Water*, we conclude that based upon the unique circumstances in this proceeding that the actual capital structure must be used for ratemaking purposes to achieve a fair balance between consumers and the City. The OCA and I&E have correctly argued that the use of a hypothetical capital structure will produce an inflated overall rate of return that would adversely increase costs to the customers of the City.

It is important to note that the instant proceeding is much like *Emporium 2006, Emporium 2001* and *Western Utilities*,as in those cases it seemed that the concern of the Commission was in shifting low cost debt into higher cost equity. While the disparity between the debt cost and the claimed equity return in those cases may have been larger than it is in this case, there would still be a substantial portion of low cost debt that would have to be shifted to higher cost equity should the Commission utilize the hypothetical capital structure. We note that the City’s debt cost rate in this proceeding is at 3.02%, which reflects the City’s ability to tax. This illustrates that the City’s taxing power lowers the City’s financial risk when compared to an investor-owned utility. Since DuBois’ status as a municipally owned utility provides it with the opportunity to obtain debt at this low cost rate as a result of the City’s ability to tax, this low cost debt should not be shifted to higher cost equity at the expense of the City’s customers. As a result, we do not find that the City has to be treated like an investor owned utility for ratemaking purposes.

Accordingly, we shall deny the Exceptions of the City on this issue and adopt the recommendation of the ALJ that the estimated actual capital structure proposal of both the OCA and I&E be utilized for ratemaking purposes in this proceeding.

 **3. Cost of Debt**

Long term debt is based upon a company’s contractual obligations to acquire capital to finance its rate base. The City claimed a cost rate of long term debt of 3.02% as that is the actual cost and is below the implied cost rates for the mutually agreed-upon proxy group. This cost of debt was accepted by the Parties performing a cost of capital analysis and was unopposed by any Party. I&E M.B. at 29; OCA M.B. at 58. The ALJ recommended that the Commission accept the City’s 3.02% actual embedded cost of debt rate for use in this case. R.D. at 64. No Exceptions were filed on this issue. Finding the recommendation of the ALJ to be reasonable, we adopt it without further comment.

 **4. Return on Common Equity**

**a. Introduction**

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. The DCF model assumes that the market price of a stock is the present value of the future benefits of holding that stock. These benefits are the future cash flows of holding the stock, *i.e.*, the dividends paid and the proceeds from the ultimate sale of the stock. Because dollars received in the future are worth less than dollars received today, the cash flow must be “discounted” back to the present value at the investor’s rate of return.

**b. Summary**

In the instant proceeding, three of the active Parties (the City, the OCA and I&E) presented a cost of equity position. The Parties’ positions were generally developed through comparison groups’ market data, costing models, reflection or rejection of risk, size and leverage adjustments, and a tax savings adjustment, as will be further addressed, *infra*. The following table summarizes the cost of common equity claims made and the methodologies used by the Parties in this proceeding.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|   | **DCF****(%)** | **CAPM****(%)** | **RP****(%)** | **ROE****(%)** | **Risk****(%)** | **Leverage****(%)** | **ROE** **(%)**  | **Tax Adjusted****(%)** |
| **CITY** | 9.3 | 10.3[[33]](#footnote-33) | 10.3 | 10.25 | 0.25 | 0.7 | 10.50 | 9.50 |
|  |  |  |  |  |  |  |  |  |
| **OCA** | 7.5 – 9.0 | -------- | --------- | 8.25 | 0 | 0 | 8.25 | 6.60 |
|  |  |  | - |  |  |  |  |  |
| **I&E** | 8.2 to 8.9 | 7.76 to 8.97 |  | 8.62 | 0 | 0 | 8.62 | 7.05 |
|  |  |  |  |  |  |  |  |  |

The City, proposed a recommended common equity cost rate of 10.50%, based on the results of three models. The City conducted DCF, Capital Asset Pricing Model (CAPM) and Risk Premium (RP) studies and factored in size (110 basis points), leverage (60 basis points) and risk (25 basis points) adjustments. After adjusting the common equity cost rate for a 9% tax adjustment factor, the City’s resulting cost of equity is 9.50%. City M.B. at 43-49.

The OCA proposed a common equity cost rate of 8.25%, which is the midpoint of the range of 7.5-9% developed solely upon the results of its DCF analysis. The OCA then adjusted the 8.25% cost of equity by a 20% tax factor to reflect the tax exempt status of the City which it contends is consistent with Commission holdings. The OCA’s resulting cost of equity is 6.60% (4.09% overall). OCA M.B. at 58-65; OCA R.B. at 32.

I&E proposed a common equity cost rate of 8.62%, based on the DCF results and the use of CAPM as a check, with no additional risk, size or leverage adjustment. I&E then adjusted the 8.62% common equity cost rate by a 18.22% tax adjustment factor. The I&E’s resulting cost of equity is 7.05% (4.23% overall). I&E M.B. at 29-44.

**c. Cost Rate Models**

 **1. Positions of the Parties**

The City’s proposed cost of common equity reflects the results of three widely recognized models, the DCF, CAPM and RP models. According to the City, the financial community encourages use of numerous valuation methods to assign a cost of common equity. The City further states that the Commission has long supported use of the DCF analysis, with reference to the results of other models as a check. More recently, the City asserts that the Commission approved a proposed cost of equity developed from the same three models used by the City in this proceeding. citing *Pennsylvania Public Utility Commission v. Emporium Water Company*, Docket No. R-2014-2402324 (Order entered January 28, 2015). The City stated that it finds it appropriate to assign equal weight to multiple equity cost valuations. At a minimum, the City states that the Commission should continue its historic practice of using other valuation models as a check against the DCF. City M.B. at 43-45.

The City noted that a market DCF calculation requires a determination of both a dividend yield and a share price growth rate. Based upon the proxy Water Group, DuBois calculated a dividend yield of 2.5%. To determine a growth rate, the City referenced various published growth rates including: (1) historic growth rates; (2) projected growth rates from First Call, Reuters, Zacks Investment Research and Value Line; (3) Earnings Per Share (EPS) growth rates reflecting changes in return rates on book common equity over time; (4) and industry-specific growth rates from Zacks and First Call. Based on the range of published growth rates, the City calculated an expected 6.7% growth rate for the Water Group, which as applied to the 2.5% dividend yield, produced an overall market value DCF estimate of 9.3%. City M.B. at 45.

Regarding the CAPM analysis, the City indicated that the CAPM is based on the assumption that investors hold diversified portfolios and that the market only rewards non‑diversifiable risk when determining the price of a security because company-specific risk is removed through diversification. Further, investors are assumed to require higher returns for additional risk. The City estimated a risk free rate of 2.7% based upon the recent and forward long-term Treasury yields. The City additionally used an average beta of 0.71 for the comparison group. City M.B. at 47.

The City further calculated an average projected market premium for its CAPM of 9.9%, based upon Value Line’s average projected total market return for the next three to five years of 12.6% less the risk-free rate of 2.7%. The City also reviewed market premiums developed from Ibbotson Associates’ most recent publication concerning asset returns and concluded that the Value Line market premium has been on the low side reflective of the higher interest rate environment observed during their study. The City’s CAPM shows a market cost rate of 8.8% for the Water Group, inclusive of a size premium adjustment to reflect the risks associated with companies as comparatively small to those in the Water Group. According to the City, the CAPM based on projected market returns shows a 10.8% cost rate for the Water Group. As a result, the City calculated an average market value CAPM of 10.3% based 25% on the results of the historical market returns and 75% on the projected market returns. Finally, the City adjusted the market value CAPM to account for the difference in leverage between market value capitalization and book value capitalization resulting in a cost rate of 11.0% for the Water Group (10.3% + 0.7% = 11.0%). City M.B. at 47-48.

In its RP analysis, the City determined that the estimated future long-term borrowing rate for the comparison group to be 4.3%, based upon the credit profiled supporting an “A” bond rating. Adding the risk premium of 6.0% to the prospective cost of newly issued long term debt of 4.3% resulted in a market value risk premium derived cost of equity of 10.3% (4.3% + 6.0% = 10.3%). The City then added a 0.7% leverage adjustment, for an 11.0% book value cost of equity. City M.B. at 48-49.

The City claimed that the three methods resulted in an equity cost rate ranging from 10.0% to 11.0%. Based upon that range, the City assigned a common equity cost rate of 10.25%. Additionally, to account for the City’s small size, visibly lower credit rating and other factors, the City recommended a common equity cost rate of 10.5% for the Bureau of Water. City M.B. at 49.

The OCA’s DCF evaluation showed a required cost of capital between 7.5% and 9.0% for the proxy group. The OCA used the median adjusted dividend yield of 2.2%, but stated that the growth rate component of the DCF is the most crucial and controversial element involved in using the DCF methodology. The OCA explained that it used five indicators of growth, as follows: (1) historical earnings retention, or fundamental growth; (2) five-year average historic growth in 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. The OCA summarized its analysis of the five different growth rate indicators stating that the average of each was in the range of 3.8% to 6.5% and the median of each was in the range of 3.5% to 6.8%. Given these results, the OCA found an appropriate growth rate range of 5.2% to 6.7%. Based on the range of results in both historic and projected growth rates when added to the average adjusted dividend yield, the OCA determined that a proper DCF cost of equity in the range of 7.5% to 9.0%. OCA M.B. at 60-61.

 I&E utilized the DCF method to determine recommended cost rate of common equity and verified the reasonableness of the cost of equity with the CAPM method and the reasonableness of the overall return by analyzing the Debt Service Coverage. I&E stated that the fundamental concept behind the DCF is that the receipt of dividends in addition to expected appreciation is the total return requirement determined by the market. I&E’s DCF analysis utilized a forecasted growth rate and expected dividend yield, which allows the time-value of money to be considered and causes the results to be forward-looking. According to I&E, the use of a growth rate and dividend yield allows the DCF, unlike alternative methodologies, to measure the cost of equity directly which makes it the superior method for determining rate of return. I&E asserted that this market-based DCF methodology has traditionally been endorsed by the Commission. I&E M.B. at 31citing *inter alia Pennsylvania Public Utility Commission v. PPL Electric Utilities Corp.,* Docket No. R-2012-2290597 (Order entered December 28, 2012); *Pennsylvania Public Utility Commission v. Consumers Pennsylvania Water Company - Roaring Creek Division,* 87 Pa. PUC 826 (1997); *Pennsylvania Public Utility Commission v. Roaring Creek Water Company,* 81 Pa. PUC 285, 323, 150 PUR 4th 449, 483-488 (1994); *Pennsylvania Public Utility Commission v. York Water Co.*, 75 Pa. PUC 134, 153-167 (1991); *Pennsylvania Public Utility Commission v. Equitable Gas Company*, 73 Pa. PUC 345-346 (1990); *Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company*, 71 Pa. PUC 593, 623-632 (1989).

I&E employed the standard DCF model, k = D1/P0 + g, where D1 is the dividend expected during the year, P0 is the current price of the stock, and g is the expected growth rate of dividends. Through the methodologies outlined in the testimony of I&E witness Rachel Maurer, I&E calculated that the DCF methodology produces a cost of common equity of 8.62% prior to the tax rate adjustment used for municipal utilities. I&E M.B. at 31-32.

I&E also included a CAPM analysis as a result of previous Commission Orders expressing an increased interest in confirming DCF results in base rate cases through the use of the CAPM. For its analysis, I&E employed the standard CAPM model as portrayed in the following formula:

 k = R + β(Rm – Rf)

Where:

k = Cost of equity

Rf = Risk-free rate of return

Rm = Expected rate of return on the overall stock market

β = Beta measures the systematic risk of an asset

Using this analysis, I&E derived CAPM results of 7.76% forecasted, and 8.97% historic. According to I&E, this result confirms the validity of I&E’s DCF analysis which resulted in 8.62% Cost of Equity. I&E M.B. at 32.

 **2. ALJ’s Recommendation**

The ALJ recommended adoption of the cost of equity DCF analysis of I&E concluding that this was the most accurate in the record. I&E recommended the adoption of an 8.62% return on equity. R.D. at 66.

 **3. Exceptions and Replies**

In its Exceptions, the City avers that the ALJ’s adoption of I&E’s proposed cost of equity fails to reflect the City’s cost of capital or provide a reasonable return on the City’s public utility infrastructure. Also, the City asserts that I&E’s cost of equity recommendation incorporates a DCF analysis with an improperly narrow growth rate. The City states that a critical component of the DCF analysis is the growth rate, which measures investors’ expectations for appreciation of share prices. The City asserts that in prior cases, the Commission approved growth rates based on historic and projected growth rates published by market analysts. The City points out that in this case, I&E recommended a 6.31% growth rate based solely on forecasted EPS growth rates while the City recommended a 6.7% growth rate, which reflects consideration of the 10.9% historical earnings growth rate for the proxy group. Also, the City claims if I&E had averaged historical and projected growth rates, its 6.31% growth rate would increase to 8.61%. As such, the City opines that its proposed 6.7% growth rate is appropriate and should be approved. City Exc. at 17, 25-26.

In reply, the OCA states that it supports the ALJ’s rejection of the City’s DCF analysis. Concerning the City’s criticism of I&E’s DCF analysis as “overly narrow” due to I&E’s growth rate, the OCA asserts that investors do not all use the same growth rate or apply the same weight to the various growth estimates. According to the OCA, analyst projections of growth may be overstated, while historical growth may not equal future growth rates. The OCA pointed out that its analysis considered both historic and projected growth rates to develop its DCF based cost of equity range. The OCA states that the record evidence includes a range of growth rates in addition to I&E’s growth rate analysis, including evidentiary support of growth rates below the City’s proposed growth rates. According to the OCA, its growth rate range of 3.5% to 6.8% was reasonably calculated and recommended a range of growth rates in which I&E’s growth rate falls. OCA R. Exc. at 22-23.

Next, the OCA claims that the City’s application of the DCF model is flawed because it relies only on projected growth rates and does not consider historical growth rates. The OCA states that the City admitted that investors have access to information about historical growth rates that shows negative growth rates, yet the City did not consider that in its DCF analysis. Also, the OCA avers that the City misstates the published historical earnings growth rate, stating that it is 10.9% but provided no citation for this statement. In fact, the OCA claims that the average historical earnings growth rate for the proxy group is 4.7%. Therefore, the OCA opines that the City’s characterization of the ALJ’s adoption of I&E’s growth rate as “overly narrow” is flawed and should be rejected.

In its Replies to Exceptions, I&E states that the DCF analysis is accepted by the Commission and is the most appropriate method to calculate the cost of equity. I&E notes that the City took exception only with the growth rate utilized in I&E’s DCF methodology, implicitly waiving other issues with the DCF calculations and utilization. I&E claims that its forecasted growth rate and expected dividend yield allows the time-value of money to be considered and causes the results to be forward-looking. According to I&E, the use of a growth rate and dividend yield allows I&E’s DCF, unlike alternative methodologies, to measure the cost of equity directly which makes it the superior method for determining rate of return. I&E Exc. at 19.

Next, I&E notes that the City inaccurately claims that I&E’s forecasting method is ‘overly narrow” and seeks to introduce historical growth rates. I&E maintains that historical growth in earnings is not indicative of future growth for the water utility industry as demonstrated by the need for a significant amount of funds to be invested in capital improvements. Instead, I&E claims that relying upon forecasted growth rates produces a more accurate result since the forecasting analysts consider both historic events of each company along with anticipated events at a company and industry level. With this in mind, I&E requests that the City’s Exception on this issue be dismissed. I&E Exc. at 20.

 **4. Disposition**

Upon our consideration of the Recommended Decision and the Exceptions and Replies to Exceptions filed by the Parties, we shall adopt the recommendation of the Parties on this issue that the City’s cost of equity in this proceeding should be based upon the use of the DCF methodology, with the other methodology results used as a check on the reasonableness of the DCF results. We note that we have primarily relied upon the DCF methodology in arriving at previous determinations of the proper cost of equity and utilized the results of methods other than DCF, such as the CAPM and RP methods, as a check upon the reasonableness of the DCF derived equity return calculation, tempered by informed judgment. We are not persuaded by the arguments of the City that we should assign equal weight to the multiple methodologies.

We note that the record in this proceeding provides an appropriate cost of equity, as calculated by the City, the OCA and I&E, in the range of 8.25% to 9.3% based solely on DCF results for a proxy group of investor owned water utilities. The DCF results vary mainly due to the use of different growth inputs although the dividend yield values utilized by the Parties varied from 2.2% to 2.5%. Also, we take notice that the cost of equity results of the CAPM and RP studies performed by I&E and the City ranged from 7.76% to 10.3%. The administrative determination of an appropriate cost of equity is as much an art as it is a science, especially when the Commission establishes a cost of equity for a municipal corporation which does not have publicly traded equity shares. Nonetheless, there are a number of means that the Commission can take into consideration to make an informed judgment on an appropriate cost of equity determination.

Based upon our analysis and review of the record evidence, we are not convinced that the ALJ’s recommendation to adopt I&E’s recommended 8.62% cost of equity fairly balances the interests of the City and its customers. Instead, and based upon our prior determination to utilize the City’s actual capital structure to determine an appropriate cost structure, and informed judgment, we find it reasonable and appropriate to adjust the City’s cost of equity upward to 9.3% in this proceeding. We conclude that a higher cost of equity is necessitated by our adoption of the City’s actual capital structure, but it is important to note that our allowance of a 9.3% return on equity falls within the range of the cost of equity results as calculated by the Parties in this proceeding (8.25 to 10.3%). We conclude that 9.3% is the appropriate cost of equity allowance in this proceeding. We also find that, based on our other conclusions to be discussed *supra,* that this cost of equity should not be further adjusted. It is important to note that while our recommended cost of equity of 9.3% is equal to the City’s DCF analysis result, this should not be interpreted that we are endorsing the entirety of the City’s calculations. Rather, we conclude that a cost of equity of 9.3% strikes an appropriate balance that can foster strong credit for the City, while not overly burdening the Commission jurisdictional customers of the City with excessive rates.

Based upon the foregoing discussion, we shall grant, in part, the Exceptions of the City, and adopt the finding and recommendation of the ALJ, in part, and adopt a cost of equity for the City of 9.30% as being reasonable and appropriate under the circumstances in this proceeding.

**d. Adjustments to Cost of Equity**

 **1. Positions of the Parties**

The City proposed the addition of several adjustments to its cost of equity calculation results. First, in its DCF, CAPM and RP analysis, the City proposed a leverage adjustment to correct for the financial risk difference resulting from market capitalization ratios differing from book value capitalization ratios. The City claimed that its analysis supported an adjustment to the Water Bureau’s proposed common equity cost rate of at least 70% or 70 basis points. City M.B. at 45-49. The City also added an additional 25 basis points due to an alleged “investment risk” within its DCF, CAPM and RP analysis. City St. No. 4 at 60. The City further applied a 110 basis point adjustment into its CAPM results for a size effect. City Exh. HW-1, Schedule 20 at 1.

I&E pointed out such adjustments have been explicitly rejected by the Commission before. citing *Lancaster Water* at 79. I&E stated that therein, the Commission noted, “any adjustment to the results of the market based DCF as we have previously adopted are unnecessary and will harm ratepayers.” *Id.* I&E maintained that these adjustments should be categorically denied as they are unreasonable and unsupported. I&E M.B. at 35-40.

 **2. ALJ’s Recommendation**

The ALJ agreed with the position of I&E that based upon Commission precedent and upon the individual invalidity of each of these adjustments, the City’s Risk Adjustment, Size Adjustment and Leverage Adjustment all unfairly harm ratepayers, are unnecessary and are contrary to the public interest. As such, the ALJ recommended rejection of these adjustments. R.D. at 71.

 **3. Exceptions and Replies**

In its Exceptions, the City avers that the ALJ’s recommendation to adopt I&E’s cost of equity determination is flawed as it fails to include appropriate adjustments, particularly where the Commission has previously recognized cost of equity adjustments to be appropriate and even necessary when using an actual capital structure. The City states that the ALJ references the Commission’s decision in *Lancaster Water* claiming the Commission rejected cost of equity adjustments as harmful to ratepayers. However, the City avers that the Commission stated “any adjustment to the results of the market based DCF as we have previously adopted are unnecessary and will harm ratepayers.” citing *Lancaster Water* at 79. The City claims that the Commission referenced only the specific market-based DCF calculation from that proceeding, which resulted in a 10% cost of equity. Also, the City points out that the ALJ also failed to note that the Commission in *Lancaster Water*, rejected further adjustments after it first modified the DCF recommended by I&E in that case. To the contrary, the City states that the Commission applied a significant 0.31% adjustment to I&E’s DCF results in that case and affirmed “a higher cost of equity be adopted to reflect our adoption of the City’s actual capital structure. *Id.* at 76. Therefore, the City opines that the ALJ’s dismissal of equity adjustments as disfavored should be rejected as contrary to Commission precedent. City Exc. at 17-19.

Next, the City states that the risk and leverage adjustments it proposed are necessary and consistent with Commission precedent. Also, the City claims that the ALJ failed to reflect the City’s clarification that the size analysis is a component of the risk adjustment, not a separate adjustment. The City opines that consistent with Commission precedent and its proposal, both the proposed risk adjustment and leverage adjustment should be approved. The City specifically asserts that its 25 basis point risk adjustment should be approved as the ALJ unreasonably dismissed the straightforward reality that smaller utilities generally operate at a higher risk than larger utilities. In support of its proposed risk adjustment, the City states it identified numerous risk factors differentiating its operations from the larger utilities in the proxy group, including size, debt service coverage, capital intensity and numerous others. City Exc. at 19.

Contrary to the representations of the ALJ, the City maintains that the risk adjustment it proposed is not a novel or unprecedented measure. According to the City, similar adjustments have been proposed by the state advocates in prior proceedings, citing *Lancaster Water* at 67, wherein is described a 25 basis point size adjustment proposed by the OCA. The City posits that by relying on a proxy group composed of water utilities of a materially different size and scale than the City and calculating a cost of equity without correcting for risk differences, the Commission would abdicate its duty to provide the City with an opportunity to earn a reasonable rate of return on the utility plant dedicated to public service. To avoid such an untenable result, the City opines that the Commission should approve its proposed 25 basis point size adjustment. City Exc. at 23.

Next, the City claims that the ALJ erred in denying its proposed leverage adjustment without directly addressing the City’s proposal. First, the City notes that the Commission has adopted leverage adjustments in the past while excluding them based solely on the individual circumstances in specific cases. According to the City, the Commission has accepted leverage adjustments in cases such as *Pa. PUC v. Philadelphia Suburban Water Company*, 219 PUR 4th 272 (2002) and *Lancaster Sewer 2005* at 162-163. Moreover, the City points out that even when rejecting leverage adjustments, the Commission has emphasized that such decisions are discretionary and based on the specific circumstances of each case. Citing *Aqua 2008* and *Lancaster Water* at 79. For example, the City states that in *Aqua 2008*, the Commission directly clarified that it rejected the leverage adjustment because the market-based DCF in that case produced results significantly in excess of prior equity returns. In this case, the City asserts that the Parties’ DCF produced results far below the Commission’s most recently litigated water utility return on equity of 10%. As such, the City opines that the Commission should exercise its discretion and approve the City’s proposed leverage adjustment. The City asserts that its 70 basis point leverage adjustment is appropriate to accurately reflect the cost to attract capital in an economic environment driving market values above book value. City Exc. at 23-25.

In response, the OCA states that while the City claims that the ALJ’s rejection of specific equity adjustments proposed by the City are unreasonable and completely divorced from prior Commission decisions, the City provides no citation to support this overall claim. According to the OCA, the ALJ cited to Commission precedent, conducted a reasonable evaluation of each individual adjustment and concluded that the three adjustments are unnecessary. The OCA states that the City’s 70 basis point leverage adjustment and its 25 basis point risk adjustment should be rejected. The OCA pointed out that the Commission has denied similar leverage and risk adjustments in *Lancaster Water*. The OCA further maintains that the City’s risk adjustment is not necessary because it serves to inflate a return on equity that is determined by the DCF model. The OCA avers that individually or jointly, the results of the City’s cost methods, as applied to its proxy group, are not appropriate to determine a cost of common equity for the City. OCA R. Exc. at 20-22.

The OCA further agrees with the ALJ’s rejection of the City’s leverage adjustment. The OCA asserts that the City’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. The OCA reiterates that in *Lancaster Water*, the Commission also rejected any market to book or leverage adjustment. The OCA notes that the City did not adjust its recommendation for the fact that its 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 R. Exc. at 22.

In its Replies to Exceptions, I&E first states that the City improperly interprets Commission precedent regarding cost of equity adjustments. I&E notes that the City attempts to claim that the quote “any adjustment to the results of the market based DCF as we have previously adopted are unnecessary and will harm ratepayers”[[34]](#footnote-34) equates to “dismissal of equity adjustments as disfavored should be rejected as contrary to Commission precedent.”[[35]](#footnote-35) In support of this claim, I&E points out that the City relied heavily on an excerpt from the *Lancaster Water* case. I&E explains that in that case, the Commission made a single adjustment to the I&E (then OTS) recommended cost of equity but stated that its adjusted cost of equity remained within the range of the two DCF analyses put forth by I&E and explicitly disclaimed all other adjustments. I&E states that what the City failed to note about its excerpted portion of the *Lancaster Water* case is that the lower number in the range (8.53%) was the product of the DCF analysis utilizing a growth rate forecasted by a log-linear regression analysis, which is a method no longer used by I&E. According to I&E, the higher number (10.87%) was the product of the DCF with the methodologies currently utilized by I&E in this proceeding. I&E explains that this means that the method that produced the higher number in the *Lancaster Water* is the only method utilized in this proceeding, making additional upward adjustments to the equity return inappropriate. I&E R. Exc. at 14-15.

I&E avers that inflating the market-based DCF analysis is improper, will harm ratepayers and is contrary to the public interest. Despite this, I&E states that the City attempts to force multiple arbitrary inflations into its cost of equity calculations. In response to the City’s 25 basis point risk adjustment, which I&E asserts that the City provided no precedent in support of, I&E notes that it is based on the City’s implied BBB bond rating. However, I&E opines that risk can be demonstrated in the cost rates of long-term debt, and for the City, not only are the interest rates lower for public utility bonds than for municipal bonds by rating, but the interest rates for each of the City notes are lower than the average public utility bond. I&E avers that the City’s notes are also lower than the average municipal bond and even lower than the implied interest rate for the proxy group. I&E maintains that, as noted by the ALJ, this renders the City’s risk adjustment entirely unnecessary and invalid. I&E R. Exc. at 15.

Next, I&E asserts that the City’s 70 basis point leverage adjustment is neither valid nor applicable. I&E claims that the ALJ correctly determined that this adjustment was improper as it has been rejected by the Commission, is not applicable in the case at hand and would unfairly harm ratepayers. I&E notes that generally, leverage is the use of debt capital to supplement equity capital. However, I&E avers that what the City terms a “leverage” adjustment, is actually an adjustment to account for a supposed discrepancy in applying the market value cost rate of equity to the book value of the utility’s equity. I&E opines that this would be more accurately termed a “market-to-book” adjustment. I&E explains that the basis for the City’s adjustment is a comparison of the average proxy group (noted to be large investor-owned utilities) market-to-book average, which was done to address the concern that DCF methodology will understate common equity cost rate since the results of the DCF are applied to a book value rate base while investor returns are measured relative to stock price levels. I&E R. Exc. at 17.

I&E states that this idea is flawed in many ways, but is particularly so, given that this investment information is widely available to investors in today’s markets, which makes this adjustment obsolete. I&E further notes that beyond that, the City asserts that the leverage adjustment is necessary “to correct for the financial risk difference resulting from market capitalization ratios differing from book value capitalization ratios;” however, financial risk resides in the income statement, not market capitalization as the City asserts. According to I&E, rating agencies assess financial risk based upon the company’s booked debt obligations and the ability of its cash flow to cover the interest payments on those obligations, not on how the company’s investments are valued in the market place. I&E R. Exc. at 17-18.

Next, I&E points out that the City’s leverage adjustment has been repeatedly rejected by this Commission. I&E notes that in *Lancaster Water*, the Commission expressly determined that the proposed leverage adjustment “will harm ratepayers.” I&E also opines that it is not aware of any academic literature that supports the City’s leverage adjustment. I&E claims that the research the City cites to as support for its adjustment actually supports just the opposite given that it concludes that the market value of any firm is independent of its capital structure. Next, I&E states that the City mistakenly claims that the leverage adjustment is warranted because it has “dutifully rebutted the arguments relied upon in the R.D. in opposition to the proposed leverage adjustment.” I&E posits that this is wholly inaccurate as the flaws in the City’s 70 basis point leverage adjustment are glaring and the burden lies with the city to prove that this adjustment is warranted, which it has failed to do. I&E requests that the ALJ’s recommendation to reject the leverage adjustment should be adopted by the Commission. I&E R. Exc. at 18-19.

 **4. Disposition**

Based upon the evidence of record, we are in agreement with the recommendation of the ALJ that the risk, size and leverage adjustments proposed by the City are not appropriate in this proceeding. We are persuaded by the arguments of the OCA and I&E that these adjustment are simply unnecessary and are contrary to the public interest. We further note that we have concluded *supra* that a higher cost of equity be adopted to reflect our adoption of the City’s actual capital structure. As such, we conclude that no additional adjustment is warranted in this instance. Finding the ALJ’s conclusion that the various City recommended adjustments be rejected as reasonable, appropriate and in accordance with the record evidence, it is adopted. Accordingly, we shall deny the Exceptions of the City on this issue.

**e. Tax Rate Adjustment**

As stated by the Commission in *Lancaster Sewer 2005*, 2005 Pa. PUC LEXIS \*44 at 148, this particular issue arises due to the fact that interest paid to municipal bond holders is exempt from taxation. Thus, a tax savings factor has been recognized based upon the premise that investors will accept a lower return in exchange for the tax exemption.

 **1. Positions of the Parties**

The City stated that to the extent the Commission deems it necessary to adjust the proposed cost of common equity to reflect the maximum income tax status of investors, it recommended the reflection of a 9% maximum income tax adjustment. The City stated that its maximum tax adjustment reasonably approximates the spread between public utility bonds and General Obligation (GO) municipal bonds with similar credit ratings. City M.B. at 44, 52-54.

The OCA stated that in *Lancaster2011*, the Commission adopted a tax factor of 20% based on the marginal tax rates of the largest block of municipal investors. The OCA concluded that the 20% tax factor adjustment was still appropriate because income tax rates have not changed materially since the Commission’s Order in *Lancaster2011*. OCA M.B. at 62.

I&E utilized an implied tax rate of 18.22%, which resulted in a reduction in its recommended common equity rate from 8.62% to 7.05%. I&E explained that this is derived from I&E’s comparison of Moody’s Monthly Municipal Bond Yields to Moody’s Monthly Public Utility Bond Yields for all bond grades from August 2014 through July 2016. According to I&E, this ranged from 8.16% to 28.43% with an average of 18.22%, which is the number recommended by I&E. Notably, I&E asserted that this simple and straightforward methodology has been accepted by the Commission and it has been found to be “reasonable” and “appropriate” in similar circumstances. citing *Lancaster Water* at 81. I&E M.B. at 41-43.

 **2. ALJ’s Recommendation**

The ALJ stated his agreement with I&E’s methodology on this issue and, as such, recommended that an implied tax adjustment factor of 18.22% is appropriate. R.D. at 73. This results in a tax adjusted return on equity of 7.05% based upon application of the 18.22% tax adjustment factor to the ALJ recommended 8.62% return on equity calculation of I&E.

 **3. Exceptions and Replies**

In its Exceptions, the City states that the ALJ appears to approve I&E’s recommended tax adjustment out of a severe misunderstanding of the City’s proposal. Contrary to the statements of the ALJ, I&E and the City used the same methodology to calculate a tax adjustment. Therefore, the City avers that the criticisms of its calculation are entirely unwarranted. According to the City, the only reason I&E and itself arrive at proposed tax adjustments of 18.22% and 9%, respectively, is a correction by the City to an objective flaw in I&E’s calculation. Therefore, the City opines that if the Commission finds it necessary to apply a tax adjustment, it should adopt the maximum 9% tax adjustment proposed by the City. City Exc. at 26.

The City notes that the ALJ falsely states that the City failed to propose alternatives to I&E’s flawed tax adjustment calculation. In comparing the I&E and City proposals to develop a tax rate based on the spread between GO bonds and public utility bonds, the City claims that the ALJ dismissed the City’s proposal by claiming that while its witness alleged that the bonds must have corrections made so that they are matched in terms of credit quality and term length, he makes no attempt to present a correction or alternative. City Exc. at 26 citingR.D. at 73. The City avers that the ALJ further and inexplicably claims that the City’s witness does not reference any instances of this methodology being used before. According to the City, both allegations are plainly untrue, as the city witness implemented all reasonable practical corrections in accordance with Commission precedent. City Exc. at 26.

Next, the City explains that it and I&E’s proposed tax adjustments are based on the spread between GO bonds and public utility bonds, as supported by the Commission in prior cases. However, the City asserts that only its witness fully complies with Commission precedent by taking all reasonable steps to measure spreads between comparable corporate and municipal bonds. citing *Lancaster Sewer 2005*. The City notes that in *Lancaster Sewer 2005*, I&E proposed a tax adjustment of 25% based on the average difference between municipal and corporate bonds. citing *Id.* at 149. According to the City, the Commission modified I&E’s recommendation in part to ensure the tax adjustment reflects comparable bond yields, and thus adjusted I&E’s tax adjustment down to 18%. City Exc. at 26-27.

In this case, the City states that I&E’s recommended tax adjustment again failed to incorporate comparable bonds and, as such, I&E’s proposed 18.22% tax adjustment reflects credit mismatches. The City posits that correcting I&E’s tax adjustment calculation to match similarly rated municipal bonds to similarly rated corporate bonds reduces I&E’s recommended tax adjustment to 9.06%, consistent with the City’s recommended maximum 9% adjustment. City Exc. at 27.

In its Replies to Exceptions, the OCA first points out that 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. The OCA notes that the Commission applied a 20% tax factor in *Lancaster Water*. While the City recommended a 9% tax factor adjustment if such an adjustment is made by the Commission, the OCA claimed that the City calculated an average 13% tax rate by comparing the yields of similarly rated general obligation municipal bonds to investor-owned public utility bonds for a two year period of May 2014 to May 2016. According to the OCA, the resulting comparison resulted in effective tax rates ranging from -1% to +30%, with the average being 13%. Next, the OCA avers that the 9% tax factor recommended by the City has numerous flaws as the City did not consider that there are multiple other reasons for differences in yields between general obligation bonds and similarly rated investor-owned public utility bonds. According to the OCA, it is not reasonable to calculate the income tax effect by comparing the yields of the two types of bonds. OCA R. Exc. at 23‑24.

Additionally, the OCA notes that the City cites to *Lancaster Sewer 2005* to support its contention that only it complied with Commission precedent by taking all reasonable steps to measure spreads between comparable corporate and municipal bonds. However, the OCA points out that *Lancaster Sewer 2005* states as follows: “We observe that the methodology of comparing the tax differential between corporate and municipal bonds is not an issue.” According to the OCA, a tax factor adjustment is appropriate for ratemaking purposes in this case just as it was in *Lancaster Water* and in cases before that where a higher tax factor adjustment was used. The OCA opines that the City’s Exceptions should be rejected. OCA R. Exc. at 24-25.

In its Replies to Exceptions, I&E states that to determine the appropriate tax factor, I&E compared Moody’s Municipal Bond Yields to Moody’s Monthly Public Utility Bond Yields for all bond grades from August 2014 through July 2016. I&E states that the resulting range was 8.16% to 28.43%, with an average of 18.22%, which is the number it recommends, and avers that the ALJ correctly adopted this methodology. I&E avers that the City’s Exceptions on this issue are comprised of entirely incorrect assertions. I&E notes that the City wrongly asserts that the only reason it arrived at a 9% tax adjustment instead of I&E’s recommended 18.22% tax adjustment is due to “a correction by the City to an objective flaw in I&E’s calculation.” I&E points out that the City claims it “implemented all reasonable practical corrections in accordance with Commission precedent” but conspicuously fails to cite a single time when the City’s methods have been adopted by the Commission. I&E R. Exc. at 20-21.

I&E posits that the City deduced that the appropriate tax adjustment is 9.00%, which is simply the lowest of his averaged yield spreads and is less than half of the amount utilized by I&E and the OCA. According to I&E, this is not a “correction,” as asserted by the City, but rather this exercise is nothing more than the City’s witness manufacturing an unprecedented and unsupported method to benefit his client. Also, I&E notes that in the *Lancaster Sewer 2005* case cited by the City, which included an adjustment to I&E’s (then OTS) tax factor but fails to note that this adjustment was simply the incorporation of updated bond yields. According to I&E, this was not tampering with the methodology employed, as the City seeks to do here, but rather the incorporation of updated market data not available at the time testimony was drafted. I&E notes that the incorporation of yields from August through November of 2016, as was done in the *Lancaster Sewer 2005* case, would result in the tax factor for this case increasing to 19.57% instead of the ALJ’s 18.22%. According to I&E, the ALJ rightly adopted the I&E’s straightforward methodology in calculating an appropriate tax adjustment in this matter, which was approved in previous Commission decisions. As such, I&E asserts that the City’s Exception should be denied. I&E R. Exc. at 22-23.

 **4. Disposition**

Based upon the evidence of record, and Commission precedent, we are in agreement with the recommendation of the ALJ that adoption of the I&E methodology and resulting tax adjustment factor of 18.22% is the most reasonable and appropriate on the record of this proceeding. We further conclude that the City’s position that a 9% tax factor should be adopted, is inherently flawed and understates the value of this adjustment. We are further convinced by the argument of I&E that the City’s position on this issue is simply an attempt by the City to develop an unprecedented and unsupported methodology that only benefits the City.

Accordingly, we shall deny the Exceptions of the City on this issue and adopt the ALJ’s recommendation to accept the I&E recommended tax adjustment rate of 18.22%.

**f. Conclusion**

Based on the foregoing, the Commission concludes that the City’s estimated actual capital structure should be used for determining the weighted cost of capital in this proceeding. The City’s cost of equity capital is appropriately determined by the DCF analysis performed by I&E, the OCA and the City, with the other methods utilized as a check on the reasonableness of the DCF results. As such, the Commission adopts a recommended cost of equity rate of 9.30%, exclusive of any tax adjustment. In addition, the market-to-book adjustment of 70 basis points is not granted and the City’s proposed 25 basis point adjustment for financial and business risk is rejected. The tax savings factor to be used is the 18.22% factor appropriately supported by I&E, for a tax-adjusted equity return of 7.61% (9.30 x 0.8178 = 7.61%).

 The following table summarizes our determinations concerning the City’s capital structure, cost of debt and cost of common equity, as well as the resulting weighted costs and overall tax adjusted rate of return of 7.61%:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Capital Type** | **Ratio** | **Cost Ratio** |  | **Tax Adjusted** | **Weighted Cost** |
| **Debt** | 70.00 | 3.02 |  | 3.02 | 2.11 |
| **Equity** | 30.00 | 9.30 |  | 7.61 | 2.29 |
| **Total** | 100.00 |  |  |  | **4.40** |

**I. Rate Structure**

 **1. Cost of Service**

**a. Positions of the Parties**

The City filed a class Cost of Service Allocation Study (COSS) at Exhibit CEH-2 for the purpose of allocating the total cost of service to the several customer classifications served both inside and outside the City. The COSS provides a basis for determining the extent to which the revenues to be derived from each service area and customer classification are aligned with the cost of serving that classification. The City utilized the Base-Extra Capacity Method of cost allocation in its COSS claiming that this method is a recognized method and generally accepted as a sound method for cost allocation which has been accepted by this Commission. City St. No. 2 at 13-14.

According to the OSBA, the City utilized the same COSS methodology in this proceeding as it did in its previous base rate case at Docket No. R-2013-2350509. The OSBA explained the Base-Extra Capacity methodology, as follows:

In general, the BEC methodology consists of two major steps.

First, the utility’s system-wide revenue requirement is classified into functional cost categories (i.e., base, extra-capacity, customer and fire protection). Extra-capacity costs are further classified as either maximum-day (Max-Day) or maximum-hour (Max-Hour) related.

Second, as discussed below, each functional cost category is allocated to rate classes in accordance with a factor that reflects relative cost responsibility.

The BEC classification and allocation steps combine to produce a measure of total cost of service, by rate class.

By comparing allocated cost responsibility to actual revenue levels, one can determine whether a given rate class is contributing above or below its cost-of-service indications.

OSBA St. No. 1 at 3; OSBA M.B. at 5.

The OSBA and I&E supported the City’s proposed COSS. OSBA M.B. at 6; I&E M.B. at 45. The OCA did not take a position regarding the City’s COSS. OCA M.B. at 77.

Sandy Township was the only Party that opposed the City’s COSS. Sandy Township recommended that the Commission should “look carefully at the costs claimed and allocated by the City for its water service to make sure that the City is not double recovering costs in the first instance through its water charges and, in the second instance, through its wastewater charges.” Sandy Township M.B. at 11-12, 15.

The City opposed Sandy Township’s recommendation claiming that wastewater charges are not within the purview of this proceeding nor are they subject to the Commission’s jurisdiction. The City stated that under Section 1102(a)(5) of the Pennsylvania Consolidated Statutes, the Commission may only regulate municipal corporations that provide public utility services beyond their corporate boundaries. 66 Pa. C.S. § 1102(a)(5). The City maintained that it does not provide wastewater service outside of its corporate boundaries, which therefore limits this rate investigation solely to the City’s water service. Moreover, DuBois opined that Sandy Township’s attempts to bring the City’s wastewater service into this proceeding violates Section 5.401 of the Commission’s Regulations, 52 Pa. Code § 5.401, by raising, among other things, irrelevant information that is likely to confuse the issues and waste the Commission and the Parties’ resources. City R.B. at 56-57.

**b. ALJ’s Recommendation**

The ALJ recommended that the City’s COSS should be approved and that Sandy Township’s wastewater COSS request should be denied. R.D. at 77.

**c. Exceptions and Replies**

In its Exceptions, Sandy Township states that the Commission should require the City to present a complete COSS in its next base rate filing which includes a full explanation and allocation of plant and expenses used to provide the City’s wastewater services. Sandy Township avers that the ALJ’s recommendation fails to address its concern that costs the City is seeking to recover through its regulated water service are also being recovered though the City’s unregulated wastewater service. Sandy Township states that the ALJ inaccurately concluded that the Township is seeking to make the City’s wastewater rates an issue in this proceeding. Sandy Township asserts that it is not asking the Commission to address the City’s wastewater rates, only to address cost allocation to determine if the City is double recovering costs through its water and wastewater service charges. Sandy Township Exc. at 9.

Sandy Township avers that it has a legitimate concern that the City may be double recovering costs through the rates charged by the City to the Township and its residents. Sandy Township claims that the City’s wastewater charges to the Township are significant and are increasing, noting that since May of 2016, City invoices for wastewater service to the Township have risen from approximately $80,000 to $130,000. Sandy Township opines that the way to get to the bottom of its legitimate cost allocation concern is to require the City to present a complete COSS that includes allocation of wastewater costs in its next base rate filing. Sandy Township Exc. at 9-11.

In reply, the City states that the ALJ correctly determined that wastewater charges do not fall under the purview of this proceeding, nor are they subject to the Commission’s jurisdiction. The City asserts that because it does not provide wastewater service to customers outside of its municipal limits, this rate proceeding may only review the City’s water service. The City states that Sandy Township paradoxically claims that it is not seeking Commission review of the City’s wastewater rates, but then requests that the Commission order the City to submit a COSS of its wastewater operations before the next rate proceeding. The City states that the only reason provided by the Township for this request is an increase in the Township’s wastewater costs, not any specific allegation of water costs that are being double recovered. The City claims it already provided the parties with its procedures and methodologies for allocating water and wastewater costs and should not be required to provide further studies on issues outside of the scope of its rate proceedings and outside of the Commission’s authority. City R. Exc. at 9-10.

**d. Disposition**

Upon our review of the evidence of record, we are in agreement with the recommendation of the ALJ that the City’s COSS study should be approved and that the request of Sandy Township is not approved at this time. Despite this determination, we would encourage Sandy Township to further analyze this issue in the context of the City’s next base rate filing and encourage the City to assure the Township that no costs related to its inside-City wastewater service are collected from outside-City water customers.

Accordingly, we shall deny the Exceptions of Sandy Township on this issue and adopt the ALJ’s recommendation.

 **2. Revenue Allocation**

 **a. Positions of the Parties**

The basic factor in allocating revenue is to have the rates reflect the cost of service. *Lloyd v. Pa. Pub. Util. Comm’n,* 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006) (*Lloyd*). The City stated that its proposed revenue allocation is based directly on its COSS.

The OSBA supported the City’s proposed revenue allocation since it moves all of DuBois’ outside-City customer classes to their respective cost of service. The OSBA pointed out that the City’s COSS was performed at a revenue requirement level that reflects DuBois’ original requested increase of $257,604. The OSBA noted that it did not take a position as to the amount of the revenue increase that should be awarded in this proceeding. OSBA M.B. at 7.

If a revenue increase less than the City’s originally requested amount of $257,604 is approved, the OSBA’s witness recommended the following methodology to determine class rate increases:

In that event, I would recommend that DuBois’ proposed outside-City class increases . . . be reduced proportionately. For example, if the Commission were to award DuBois a final outside-City increase of $128,800, then all of the City’s proposed outside-City class increases should be reduced by the ratio of $128,800 to $257,600 or 50.0%.

OSBA St. No. 1 at 5. OSBA M.B. at 7.

The OSBA claimed that its proportional scale back methodology has the advantages of being simple to understand, simple to execute, and provides a just and reasonable result for all outside-City customer classes. OSBA M.B. at 8.

The OCA did not take a position regarding revenue allocation. OCA M.B. at 77. I&E recommended that any scale back of rates applicable in this case be applied to the usage proportion of rates. This is agreed to by the City.[[36]](#footnote-36) I&E M.B. at 45.

Sandy Township asserted that the City “failed to support an increase in rates that would require allocation.” Sandy Township M.B. at15.

The City responded that as Sandy Township proposed no alternative revenue allocation or credible position on the City’s proposed revenue allocation independent of the revenue requirement issues, its statement amounts to a meaningless aversion requiring no response from the City. City R.B. at 56-57.

**b**. **ALJ’s Recommendation**

 The ALJ concluded that a scale back of the rates which is proportional to the reduction in revenues and maintains the increase in customer charges would require the creation of separate volumetric rates for each customer class. According to the ALJ, if separate rates were not established for each customer class, a proportional scale back of the volumetric rates which maintained the City’s proposed increase in the customer charge would result in greater than allowable revenues. R.D. at 80.

Therefore, the ALJ recommended approval of the customer charge increases requested by the City. He further recommended that the volumetric rates be scaled back to attain the desired revenue while maintaining the standard volumetric rate structure and the proposed increases to the customer charges.  The ALJ explained that to accomplish this, the volumetric rate increase was adjusted to $5.68 per thousand gallons for consumption up to 100,000 gallons and $4.30 per thousand gallons for consumption greater than 100,000 gallons.  *See* Appendix A to the Recommended Decision. According to the ALJ, this adjustment achieves the desired revenue increase while maintaining the revenue allocation as close to the cost of service as reasonably achievable. R.D. at 80.

**c. Exceptions**

In its Exceptions, the OSBA states that the ALJ erred by recommending a rate design that is inaccurate and not cost based. The OSBA notes that it recommended that the City’s proposed revenue allocation be proportionately scaled back if a revenue award was granted that was less than that originally requested by DuBois. However, the OSBA states that the ALJ decided that the City’s proposed customer charges should be approved, as filed, and not scaled back. The OSBA points out that the ALJ did not include a proof of revenue using his recommended rate design. The OSBA asserted it attempted to verify that the ALJ’s recommended rate design produces a total revenue increase of $97,534 for the City, as recommended by the ALJ. However, the OSBA claimed that its calculations demonstrated that the ALJ’s proposed rate design is thousands of dollars off target on a total City basis. OSBA Exc. at 2-3.

Also, the OSBA claims that the individual class increases that result from the ALJ’s proposed rate design are not cost based, in that such increases do not reflect a proportional scale back of the City’s filed class increases. In fact, the OSBA opines that the rate design in this proceeding is driving the revenue allocation, which is exactly backwards. According to the OSBA, the inflexibility of the rate design is causing the revenue allocation to be inaccurate. The OSBA maintains that a rate design that is thousands of dollars off in connection with a recommended revenue award of $97,534 is not just and reasonable, nor is it in compliance with the requirements of *Lloyd.* OSBA Exc. at 3.

**d. Disposition**

Based upon the evidence of record, we are in agreement with the recommendation of the ALJ that the City proposed customer charges should be approved and that a proportional scale back of the consumption charges be performed to attain the Commission allowed revenue increase per this Opinion and Order. We are not convinced that the concerns of the OSBA have merit. Nevertheless, we shall direct the City to provide calculations, a tariff supplement and a proof of revenue which shall demonstrate to the Parties’ satisfaction that the filed tariffs with the adjustments comply with the provisions of this Opinion and Order.

Accordingly, we shall deny the Exceptions of the OSBA on this issue and adopt the ALJ’s recommendation.

 **3. Tariff Structure**

**a. Positions of the Parties**

Sandy Township asserted that the City did not provide enough support to justify a change in rates or a change to its tariff structure. Sandy Township M.B. at 15. I&E endorsed the City’s proposal to withdraw Tariff Rule 36. I&E M.B. at 45. The OCA did not take any position on the City’s tariff structure. OCA M.B. at 77.

The OSBA did not provide any evidence, opposition or concern with the City’s tariff structure beyond a recommendation that the City should pursue certain tariff issues in its next base rate filing. The OSBA requested that the Commission order the City to revise its tariff rate structure if the City finds it is unable to implement a cost-based class revenue allocation in its next base rate case. OSBA M.B. at 8-10.

The City claimed that similar to its position on the City’s proposed revenue allocation, Sandy Township offered no specific or credible positions on the City’s proposed tariff structure independent of the revenue requirement issues. Therefore, the City asserted that Sandy Township’s statement on tariff structure amounts to a meaningless aversion requiring no response from the City. City R.B. at 56-57.

Regarding the OSBA recommendation, the City replied that the tariff structure concerns raised by the OSBA pertain to future rate cases and should not be addressed at this time. City M.B. at 57.

**b. ALJ’s Recommendation**

 The ALJ agreed with the City that the OSBA’s concerns are premature and speculative. The ALJ concluded that upon receipt of the City’s next base rate filing, the OSBA will have the right to review the filing and, if deemed necessary, propose its preferred revenue allocation. The ALJ further stated that he also agreed with the City’s withdrawal of Tariff Rule 36 in this proceeding. R.D. at 81.

**c. Exceptions**

In its Exceptions, the OSBA claimed that the ALJ erred by dismissing

its recommendation to revise the City’s rate structure. However, the OSBA pointed out that the ALJ had noted in his decision that granting the City its desired customer charge increases created problems and that he recognized the limitations inherent in his recommended rate design. The OSBA opined that the ALJ’s proposed standard of “reasonably achievable” does not satisfy the requirements of *Lloyd.* The OSBA posits that it explained the problems caused by the overly simplistic rate structure employed by the City. The OSBA noted that the ALJ ran into these problems when he tried to construct a rate design that would implement cost-based class increases while simultaneously adopting the customer charge increases requested by the City. OSBA Exc. at 4-5.

 **d. Disposition**

Upon our review of the record evidence, we are in agreement with the recommendation of the ALJ that the OSBA’s concerns are speculative at this point in time and premature. As noted by the ALJ, the issue of a proper cost based class allocation may or may not become an issue in the next base rate filing of the City, but it is not necessary for the Commission to direct the City to revise its rate structure in that proceeding based on the instant record evidence.

 As such, we shall deny the Exceptions of the OSBA on this issue and shall adopt the ALJ’s recommendation.

**J. Miscellaneous Issues**

**1. Stipulation**

As previously mentioned, the City and the OCA entered into the following Stipulation regarding UFW, which was an issue in this proceeding:

1. In future rate cases, the City will provide Unaccounted-For-Water (UFW) calculations in the format shown on Exhibit TLF-1 that is used by water utilities in submission of their Annual PUC Reports.

2. 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.

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

4. 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.

5. 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.

The City/OCA Stipulation also included three additional sections as follows:

6. 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.

7. 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.

8. 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.

The ALJ reviewed the Stipulation and concluded that compliance by the City to the Stipulation will certainly be relevant in the City’s next base rate proceeding and that evidence related to compliance will be needed to support expenses related to UFW. R.D. at 81-82.

No Exceptions were filed in response to the City/OCA Stipulation. As such, we shall recommend approval of the Stipulation and direct the City to comply with the agreed upon provisions of this Stipulation.

 **2. Sales to Shale Gas Companies**

In a 2013 Settlement, which addressed the City’s most recent base rate case before the instant 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.” *Pennsylvania Public Utility Commission v. City of DuBois – Bureau of Water*,Docket No. R-2013-2350509 (Order entered December 5, 2013) (*Joint Petition for Settlement of Rate Investigation*) at 6; OCA M.B. at 72-73.

The OCA stated that 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. According to the OCA, the volumes and sales revenues for the driller sales is relevant because the City charges above-tariff rates for these sales. OCA M.B. at 73.

I&E requested that the Commission order the continued reporting of revenue received by the City of DuBois from Marcellus Shale Drillers and that the City be ordered to report if any new developments start taking service from the City. According to I&E, the City witness testified that he had no objections to these reporting requirements.[[37]](#footnote-37) I&E M.B. at 8.

The ALJ recommended that the City should continue to report sales to shale gas companies in its annual reports to the Commission. The ALJ found that this information will be useful to the Commission in future rate proceedings. R.D. at 89.

No Exceptions to the ALJ’s recommendation on this issue were submitted. Therefore, we shall adopt the ALJ’s recommendation as our own.

 **3. 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 but later admitted that this extension would not be completed as originally anticipated. As such, the City removed the expense from rate base. According to the OCA, 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 M.B. at 73.

As service to Falls Creek would potentially create additional revenue, the OCA recommended that the City be required to inform the Commission when it connects Falls Creek and begins service. The OCA recommended that the City be required to provide the following information:

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.
5. A copy of the contract with Falls Creek.

OCA M.B. at 74.

I&E requested that the Commission order the continued reporting of revenue received by the City of DuBois from Marcellus Shale Drillers and that the City be ordered to report if any new developments start taking service from the City. I&E M.B. at 8.

The ALJ agreed with the OCA that the City should report the above requested information if and when it connects to Falls Creek. The ALJ concluded that these reporting requirements are not onerous and will provide useful information to the Commission. R.D. at 91.

No Exceptions were filed by the Parties on this recommendation. Consistent with our previous conclusion on this issue, and finding the ALJ’s recommendation to be reasonable, we shall adopt it as our own.

**IV. Conclusion**

We have reviewed the record as developed in this proceeding, including the ALJ’s Recommended Decision and the Exceptions and Replies to Exceptions filed thereto. The City initially requested an overall revenue increase of $257,604, or 33.6%. The City subsequently revised its requested revenue increase to $229,551, as a result of various agreements. The ALJ found that the City’s proposed Supplement No. 22 to Tariff Water- Pa. P.U.C. No. 4 should be rejected. According to the ALJ, the rates contained in the Supplement are not just and reasonable or otherwise in accordance with the Public Utility Code and applicable regulations. The ALJ, based upon adjustments to the rate base, expenses and rate of return made in his Recommended Decision recommended that a maximum revenue increase of $97,534 be permitted. The ALJ stated that this represents an approximate 12% increase in the City’s rates. As previously discussed, due to some inadvertent errors in the Tables in Appendix A attached to the Recommended Decision, the actual, correct increase in rates recommended by the ALJ is $63,939. R.D. at 1.

Based on our review, evaluation and analysis of the record evidence, we have adopted the ALJ’s recommendations in all areas except for the allowable cost of equity, as discussed *infra*. The resulting revenue increase is $71,133 or about 8.89 percent. As such, the Exceptions filed by the various Parties hereto, are granted or denied, as discussed *infra.* Accordingly, the ALJ’s Recommended Decision is adopted, as modified, consistent with this Opinion and Order; **THEREFORE;**

**V. ORDER**

 **IT IS ORDERED:**

1. That the Exceptions filed by the City of DuBois – Bureau of Water, the Commission’s Bureau of Investigation and Enforcement and the Office of Consumer Advocate on or before February 2, 2017, to the Recommended Decision of Administrative Law Judge Mark A. Hoyer are granted or denied, consistent with this Opinion and Order.

 2. That the Exceptions filed by Sandy Township and the Office of Small Business Advocate on February 2, 2017, to the Recommended Decision of Administrative Law Judge Mark A. Hoyer are denied, consistent with this Opinion and Order.

 3. That the Recommended Decision of Administrative Law Judge Mark A. Hoyer, issued on January 13, 2017, is adopted, as modified, to the extent it is consistent with this Opinion and Order.

 4. That the City of DuBois – Bureau of Water shall not place into effect the rules, rates and regulations contained in Supplement No. 22 to Tariff Water-Pa. P.U.C. No. 4.

 5. That the City of DuBois – Bureau of Water is hereby authorized to file tariffs, tariff supplements or tariff revisions containing rates, rules and regulations, consistent with the findings herein, to produce annual revenues not in excess of $871,375 or an increase over present revenues of $71,133.

 6. That the City of DuBois – Bureau of Water tariffs, tariff supplements and/or tariff revisions may be filed on at least one-day’s notice to be effective for service rendered on and after March 29, 2017.

 7. That the City of DuBois – Bureau of Water shall file detailed calculations with its tariff filing, which shall demonstrate to the Parties’ satisfaction that the filed tariffs with the adjustments comply with the provisions of this Opinion and Order.

 8. That the City of DuBois – Bureau of Water shall allocate the authorized increase in operating revenue in accordance with the recommendations contained in the Revenue Allocation section of this Opinion and Order.

 9. That the City of DuBois – Bureau of Water shall file its current contract for water service provided to Union Township with the Commission within 30 days of the entry of this Opinion and Order.

 10. That the City of DuBois – Bureau of Water shall file a report with the Commission when a contract is entered into between the City of DuBois – Bureau of Water and Falls Creek Borough for the provision of water service which includes the date service began, the annual gallons to be sold, the rate to be charged per thousand gallons, the expected annual customer charge revenue and the contract.

 11. That the City of DuBois – Bureau of Water shall continue to report sales to shale gas drillers in its annual report to the Commission as agreed to in the previous base rate case at Docket No. R-2013-2350509.

 12. That the City of DuBois – Bureau of Water shall comply fully with the Stipulation between the City of DuBois – Bureau of Water and the Office of Consumer Advocate regarding unaccounted for water and set forth in this Opinion and Order.

 13. That upon acceptance and approval by the Commission of the tariffs, tariff supplements or tariff revisions filed by the City of DuBois – Bureau of Water, consistent with this Order, this proceeding shall be marked closed.

14. That the Complaint of the Office of Small Business Advocate docketed at C-2016-2556342, the Complaint of the Office of Consumer Advocate docketed at C-2016-2556376 and the Complaint of Sandy Township docketed at C-2016-2557459 are sustained, in part, and denied, in part, consistent with this Opinion and Order.

15. That the City of DuBois – Bureau of Water shall comply with all directives, conclusions and recommendations contained in the Commission’s Opinion and Order that are not the subject of individual ordering paragraphs as fully as if they were the subject of specific ordering paragraphs.

16. That the record in this proceeding shall be marked closed.

**BY THE COMMISSION,**

 Rosemary Chiavetta

 Secretary

(SEAL)

ORDER ADOPTED: March 16, 2017

ORDER ENTERED: March 28, 2017

APPENDIX A

Tables as Corrected







**City of DuBois – Bureau of Water**

**R-2016-2554150**

**Commission Corrections Made to the Inputs on Tables I and II Attached to the Recommended Decision as Appendix A:**

1. Depreciation expense at 12/31/15 was changed based upon the jurisdictional adjustment of ($1,643) listed on Exhibit CEH-3RJ. Used $107,126 as of 12/31/16 as Depreciation expense amount.

2. Rate base at 12/31/16 was changed to $4,317,704. Used adjustment of ($173,364) as shown on Exhibit CEH-3RJ to calculate Rate Base at 12/31/15 of $4,493,848.

3. CWC adjustment on Table II recalculated to be ($8,697) based on 1/8 of expense adjustment of $69,575.

4. Added High Street Mains Rate Base adjustment of ($14,531) to Table II that was inadvertently omitted by the ALJ.

5. Rate case expense adjustment was corrected to ($47,920). ALJ inadvertently utilized the rate case expense allowance of $42,282.

6. Allocation of Admin. Benefits Expenses adjustment was recalculated to be ($3,862) not ($3,885).

APPENDIX B







1. The City’s Motion to Strike portions of the testimony of OCA witness Terry L. Fought made on November 10, 2016 (OCA Statement No. 2S, Tr. at page 135, beginning on line 6, through page 137, ending on line 7; OCA Statement No. 2S on page 3, “beginning on line 19, through page 4, ending on line 17.” Tr. at page 135, lines 6-8), was granted in the Second Interim Order. All other Motions to Strike made at the hearing on November 10, 2016, were denied. [↑](#footnote-ref-1)
2. Upon our review, we have determined that due to some inadvertent errors in the Tables in Appendix A that is attached to the Recommended Decision, the actual increase in rates recommended by the ALJ is $63,939. This represents an increase of approximately 8% instead of the approximately 28% requested by the City. We have attached the corrected Tables to this Order, along with a list of the identified corrections based upon the record evidence, as Appendix A. [↑](#footnote-ref-2)
3. We duly note the City’s position concerning the short-term nature of the projects that do not, as a general matter, require long term planning. *See* R.D. at 14. [↑](#footnote-ref-3)
4. The City’s acknowledged the proper procedural vehicle to request a reopening of the record to address its claimed rate base additions. R.D. at 16, referencing, City R.B. at 6. [↑](#footnote-ref-4)
5. The City’s revised jurisdictional rate base of $4,317,704 is a result of an adjustment of $176,144 made to the City’s initial claim of $4,493,848. The $176,144 also includes a jurisdictional cash working capital adjustment of $2,780. City M.B. at 6; Appendix A. [↑](#footnote-ref-5)
6. We note that the total adjustment to the City’s claimed additions to rate base should have been $23,895. The ALJ inadvertently omitted the $14,531 adjustment made to the High Street Mains Additions Project in his calculations. *See,* updated adjustments in Table 1. [↑](#footnote-ref-6)
7. As noted, the City avers that the property only became vacant recently due to the death of the City’s WTP Superintendent, and that the property is being held for future use until the City can ascertain its use in the future. Exc. at 6. [↑](#footnote-ref-7)
8. *Pa. PUC v. West Penn Power Co*., 1979 PaPUC LEXIS (*West Penn*). [↑](#footnote-ref-8)
9. The OCA’s adjustment of $38,870 is comprised of $26,273 adjustment for the City’s rate base additions, $3,334 adjustment for the vacant home and $9,264 for CWC. OCA M.B. at 8-17; OCA Table II. [↑](#footnote-ref-9)
10. The City initially included the cost of a waterline extension intended to be used to serve Falls Creek, but did not include the revenues from the sales to Falls Creek. The City however, removed this expense from its claims stating that the extension would not be completed during the test year as initially anticipated. OCA St. 1 at 46; OCA M.B. at 73. [↑](#footnote-ref-10)
11. Sandy Township avers that based on existing reports, the expectation is that the sales level will be approximately 80,000 gallons per day at a contracted rate of $4.05 per 1,000 gallons. Sandy Township Exc. at 3. [↑](#footnote-ref-11)
12. The City and the OCA reached a Stipulation regarding how the City would address its Unaccounted-for-Water (UFW) issues going forward. The City/OCA Stipulation will be addressed in greater detail later. [↑](#footnote-ref-12)
13. The OCA proposed a total claim of $92,148 for this expense based on the historical annual expenses of $129,587 for 2013, $14,087 for 2014, and $132,771 for 2015. ($129,587 + $14,087 + $132,771 = $276,445/3 = $92,148). OCA St. 1 at 29. [↑](#footnote-ref-13)
14. According to the OCA, the City had the opportunity to modify its test year claims if it believed that the City/OCA Stipulations would create significant expense but failed to do so. OCA Exc. at 6. [↑](#footnote-ref-14)
15. The City avers that in 2013, it incurred T&D contractual expenses of just $9,837.15 through June 2013, with the remaining $119,749.85, incurred between August and December 2013. City R. Exc. at 12 (citing City Exh. 2, Schedule 7 at 2-3). Similarly, in 2015, the City incurred T&D contractual expenses of just $15,920 through June 2015, with the remaining $116,851 incurred between August and December 2015. City R. Exc. at 12 (citing City Exh. 2, Schedule 7 at 4-5). [↑](#footnote-ref-15)
16. The OCA’s reduction of this expense item resulted in a $13,985 downward adjustment. OCA St. 1 at 32; OCA M.B. at 23. [↑](#footnote-ref-16)
17. The City agrees with ALJ’s normalization of its Watershed Inventory Management Plan and Herbicide Application expense claim. City’s Exc. at 13-14. [↑](#footnote-ref-17)
18. The historical expenses based on the City’s claim for “other expense” from 2013 to 2015 are as follows: 2013: $1,825; 2014: $865; and 2015: $22,323. OCA R. Exc. at 15. [↑](#footnote-ref-18)
19. *Pa. PUC v. Borough of Quakertown*, Docket No. R-2011-2251181 (Order entered September 13, 2012) (*Quakertown*)at 24-25. [↑](#footnote-ref-19)
20. *Pa. PUC v. Borough of Media Waterworks*, 72 Pa. P.U.C. 144, Docket No. R-891289 (Order entered February 1, 1990) (*Media Borough*)at 24-25. [↑](#footnote-ref-20)
21. The OCA asserts that at the evidentiary hearing, the City Manager stated “I think 60 percent is probably at the low end.” OCA R. Exc. at 12 (citing Tr. at 26). The City, on the other hand, determined that the total City Manager salary allocated to the Water Fund is 55.7%. OCA R. Exc. at 12 (citing City Exh. CEH-2R at lines 13-17). [↑](#footnote-ref-21)
22. The ALJ also found as persuasive on the disposition of the issue, the Commission’s decision in *Media Borough,* in which the Commission determined that the Borough’s allocation methodology was unsupported, and reduced the allocation factor because there were no records of actual hours worked or the type of work performed. *Quakertown* at 22-23 (citing R.D. at 16-17). [↑](#footnote-ref-22)
23. *Pa. PUC v. Lemont Water Company*, 1994 Pa. PUC LEXIS 44, \*18-19 (1994) (*Lemont Water*). [↑](#footnote-ref-23)
24. *Popowsky v. Pa. PUC*, 674 A.2d 1149, 1154 (1996) (*Popowsky*). [↑](#footnote-ref-24)
25. The last three cases were filed on the following dates: August 27, 1996; October 28, 2005; and March 1, 2013. The current case was filed on June 30, 2016. [↑](#footnote-ref-25)
26. The OCA cites to *Popowsky; Pa. PUC v. Columbia Water Company*, 2009 Pa. PUC LEXIS 1423 (2009); *Pa. PUC v. National Fuel Gas Distribution Corporation*, 84 Pa. P.U.C. 134, 175 (1995); *Pa. PUC v. Roaring Creek Water Company*, 73 Pa. P.U.C. 373, 400 (1990); and *Pa. PUC v. West Penn Power Company*, 119 P.U.R. 4th 110, 149; Pa. P.U.C. 1990. [↑](#footnote-ref-26)
27. The City/OCA Stipulation includes additional commitments unrelated to UFW. SeeCity/OCA Stipulation. [↑](#footnote-ref-27)
28. 52 Pa. Code § 65.20(4). [↑](#footnote-ref-28)
29. This represents the I&E recommended return on equity rate of 8.62% adjusted with the I&E proposed 18.22% income tax adjustment. [↑](#footnote-ref-29)
30. This represents the OCA recommended return on equity rate of 8.25% adjusted with the OCA proposed 20% income tax adjustment. [↑](#footnote-ref-30)
31. 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. [↑](#footnote-ref-31)
32. *Pennsylvania Public Utility Commission v. City of Lancaster – Bureau of Water*, Docket No. R-2010-2179103 (Order entered July 14, 2011) (*Lancaster Water*). [↑](#footnote-ref-32)
33. Includes a 110 basis point size adjustment to the CAPM result. [↑](#footnote-ref-33)
34. *Lancaster Water* at 79. [↑](#footnote-ref-34)
35. City Exc. at 19. [↑](#footnote-ref-35)
36. City St. No. 2-R at 25-26. [↑](#footnote-ref-36)
37. Tr. at 32. [↑](#footnote-ref-37)