Whitney E. Snyder
(717) 236-1300 x260
wesnyder@hmslegal.com

Thomas J. Sniscak
(717) 236-1300 x224
tjsniscak@hmslegal.com

Phillip D. Demanchick Jr.
(717) 236-1300 x225
pddemanchick@hmslegal.com

100 North Tenth Street, Harrisburg, PA 17101 Phone: 717.236.1300 Fax: 717.236.4841 www.hmslegal.com

September 21, 2023

Via Electronic Filing

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street – Second Floor North
Harrisburg, PA 17120

Re: Columbia Water Company; 2023 General Base Rate Increase Filing; Docket No. R-2023-3040258; **COLUMBIA WATER COMPANY'S REPLY BRIEF**

Dear Secretary Chiavetta:

Enclosed for filing with the Commission is the Reply Brief of Columbia Water Company in the above-referenced matter. Copies of the Company's Reply Brief have been served in accordance with the attached Certificate of Service, as well as upon Administrative Law Judges Mary D. Long and Charece Collins.

Copies of this filing are being provided via e-mail as indicated on the attached Certificate of Service.

Very truly yours,

/s/ Phillip D. Demanchick Jr.

Thomas J. Sniscak
Whitney E. Snyder
Phillip D. Demanchick Jr.

Counsel for Columbia Water Company

PDD/das
Enclosure
cc: Administrative Law Judge Mary D. Long (malong@pa.gov)
Administrative Law Judge Charece Collins (charcollin@pa.gov)
Per certificate of service

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2023-3040258
	:	
	:	
Columbia Water Company	:	

**REPLY BRIEF OF
COLUMBIA WATER COMPANY**

Before Administrative Law Judges
Mary D. Long
Charece Z. Collins

Whitney E. Snyder, Attorney I.D. 316625
Thomas J. Sniscak, Attorney I.D. 33891
Phillip D. Demanchick Jr., Attorney I.D. 324761
Hawke McKeon & Sniscak LLP
100 North Tenth Street
P. O. Box 1778
Harrisburg, PA 17105-1778
(717) 236-1300
wesnyder@hmslegal.com
tjsniscak@hmslegal.com
pddemanchick@hmslegal.com

*Counsel for
Columbia Water Company*

Dated: September 21, 2023

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I. INTRODUCTION

A. BACKGROUND

On September 12, 2023, in accordance with the Prehearing Order dated June 26, 2023, and the Interim Order on Briefs and Closing of the Record dated August 30, 2023, issued by Administrative Law Judges Mary D. Long and Charece Z. Collins (the "ALJs"), Columbia Water Company ("Columbia Water" or the "Company"), the Pennsylvania Public Utility Commission's ("Commission") Bureau of Investigation and Enforcement ("I&E"), the Office of Consumer Advocate ("OCA"), and the Office of Small Business Advocate ("OSBA") submitted Main Briefs in this proceeding.

In several instances, the Company's position is fully set forth in its Main Brief and further response is not necessary. Certain arguments presented by other parties in their briefs, however, require further response.

B. COLUMBIA HAS APPROPRIATELY REFLECTED ITS MULTIPLE RATE ZONES AND DEBT FINANCING

In its Main Brief, the OCA states that in evaluating the Company's revenue requirement claim, the Commission "must consider the fairness of the Company's allocation and use of certain constructs for ratemaking." OCA M.B. at 4. Specifically, the OCA argues that because the Company excluded the revenues, capital assets, and expenses associated with its East Donegal Municipal Township Authority ("EDTMA") Rate District and reflected the taxable impacts associated with the Company's PENNVEST[1] surcharge, the Company has drawn unreasonable lines for ratemaking. OCA M.B. at 4-5. The OCA, thus, unreasonably argues that the Commission should consider these issues when determining what level of revenues and rates are reasonable for Columbia Water. OCA M.B. at 5. The Company strongly disagrees with the OCA and its

[1] "PENNVEST" refers to the Pennsylvania Infrastructure Investment Authority.

argument is without merit. The Company has appropriately addressed its EDTMA Rate District and PENNVEST revenues in this filing.

With respect to the exclusion of the EDTMA Rate District, the Company revised its initial filing to exclude the revenues, plant assets, and expenses associated with the EDTMA Rate District.[2] The Company removed these items from the rate case, in part, because in the acquisition of the EDTMA water system and territory, which was approved by the Commission based upon a finding that it is in the public interest, the transaction provided for maintaining the rates of EDTMA Rate District customers for a period of three (3) years from the date of acquiring the system, or until March 31, 2025.[3]

Removing these items from the Company's rate case increase filing is consistent with Commission guidance. Specifically, as part of the Commission's Order approving the acquisition of EDTMA, the Commisssion required the Company to conduct an original cost study of the assets it acquired.[4] Moreover, the Commission required that at the time of filing its next base rate case that proposes to include the EDTMA assets in rate base, the Company must provide testimony that, *inter alia*, justifies any amount claimed in rate base and any utility plant acquisition adjustment claims pursuant to Section 1327 of the Public Utility Code ("Code").[5] The Commission also has a policy statement stating that:

> …the acquiring utility should not include any revenues or expenses related to the acquisition, including the requested acquisition adjustment in its proposed rate base unless it includes the original

[2] Exhibit GDS No. 1 at 1-2 (Revised).

[3] CWC St. 1 at 3:10-16.

[4] *Application of Columbia Water Company for approval of the right to: (1) acquire, by sale, substantially all the water system assets of East Donegal Township Municipal Authority; and (2) offer, render, furnish or supply water service to the public in additional portions of East Donegal Township, Lancaster County, Pennsylvania, et al*., Docket Nos. A-2021-3027134 (Order entered Feb. 3, 2023) ("That Columbia Water Company shall file copies of its original cost study of the water system assets acquired from East Donegal Township Municipal Authority with the Secretary's Bureau, with copies served upon the Bureau of Technical Utility Services, the Bureau of Audits, the Bureau of Investigation and Enforcement, the Office of Consumer Advocate, and the Office of Small Business Advocate, upon completion of said study at Docket No. A-2021-3017134.").

[5] *Id*.

cost valuation with the rate filing and one of the following circumstances applies:

> (i) A compelling reason exists for requesting the acquisition adjustment in the current rate filing.
>
> (ii) The acquisition was requested or otherwise directed by the Commission.
>
> (iii) No statutory party objects to the inclusion of the acquisition adjustment to the proposed rate base of the acquiring utility.[6]

Thus, because the Company has an agreement to maintain EDTMA's existing rates until March 31, 2025, and must complete an original cost study before it can seek to include these assets in rate base, the Company appropriately removed the revenues, expenses and capital assets associated with the EDTMA Rate District consistent with Commission guidance. The Company also used the same reasonable approach in its 2013 rate case by excluding the expenses, revenues and capital assets associated with the purchase of the Marietta Gravity Water System in that filing.[7]

The Company has also discussed in its Main Brief why it is appropriate and required by law for the Company to reflect the tax impacts associated with the PENNVEST revenues in this rate case. Company M.B. at 44-45. The Company's PENNVEST surcharge is designed to only recover the debt service, *i.e.*, principal and interest, associated with its PENNVEST loans.[8] The Commission's PENNVEST policy statement further states that "[o]ther expenses incurred by the water company, for example, additional operating and maintenance expenses and depreciation, association with the DER-approved [sic] project, should be evaluated in a separate Section 1308 proceeding," and that is precisely what the Company did in this Section 1308 rate case.[9] As Mr. Shambaugh testified:

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6 52 Pa. Code § 69.711(e)(2).

7 *Pa. Pub. Util. Comm'n, et al. v. Columbia Water Co.*, Docket Nos. R-2013-2360798, *et al*., 2014 WL 316891, at *1 (Opinion and Order entered Jan. 23, 2014) ("On April 25, 2013, Columbia filed Supplement No. 60 to Tariff—Water Pa. P.U.C. No. 7, which contained proposed changes in rates, rules, and regulations calculated to recover an estimated annual increase in base rate revenues of $773,210 from customers of its Columbia Division.") (*CWC 2013*)

8 52 Pa. Code § 69.361; *see also* CWC St. 2-RJ at 14:2-23..

9 52 Pa. Code § 69.364.

> The revenues the Company receives from its customers to pay the PENNVEST loans are taxable dollars just like any other revenue the Company receives from its customers.[10]

Thus, the revenues collected from customers for the PENNVEST surcharges are generating state income taxes for the Company, which it has a right to recover but is not currently recovering through the PENNVEST surcharge.[11] Thus, consistent with the Commission's policy statement, the Company has appropriately sought recovery of the associated income tax impacts in this rate case.

Moreover, contrary to the OCA's attempt to portray the Company's position as unreasonable, the Company has, in fact, sought inclusion of the PENNVEST-related interest expense in the calculation of state income tax liability to reduce rates consistent with the Company's obligation under Section 1301.1 of the Code.[12] The OCA even agreed with this adjustment, which appears to have reduced the OCA's annual revenue requirement by approximately $39,165.[13] Thus, the Company's treatment of the tax impacts associated with collecting the PENNVEST surcharge from customers is manifestly reasonable.[14]

Moreover, the OCA's suggestion that the Commission weigh the "fairness" and "use of certain constructs for ratemaking" when assessing the appropriate increase in this case, is itself contrary to traditional ratemaking principles. In *Pennsylvania Public Utility Commission, et al. v. Columbia Gas of Pennsylvania, Inc.*, the OCA recommended that the Commission deny the rate

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[10] CWC St. 2-R at 22:5-9.

[11] *Pa. Pub. Util. Comm'n v. Riverton Consol. Water Co.*, Docket No. R-842675, 1985 WL 1203874 (Opinion and Order entered Mar. 21, 1985) ("As noted in these cases, we are required to approve as just and reasonable, rates which will produce revenues sufficient to enable the utility to recover all reasonable operating and maintenance expenses, depreciation and taxes.") (internal citations omitted).

[12] 66 Pa. C.S. § 1301.1.

[13] *Compare* OCA St. 1SR, Sch. JLR-1, Pg. 1 (revenue requirement of $696,984) *with* OCA M.B., App. A, Table I (revenue requirement of $657,819). $696,984 - $657,819 = $39,165.

[14] If, however, the Commission decides to exclude the tax impacts associated with the PENNVEST revenues, the Company reserves its right to modify the PENNVEST surcharge to seek recovery of these costs from its customers. The Company must recover these reasonable and prudently incurred taxes. Otherwise, it would be a clear case of confiscation by denying any recovery of a tax expense. The OCA cannot also seek to both exclude these costs from this case and oppose recovery of these costs in the PENNVEST surcharge.

increase request of Columbia Gas of Pennsylvania, Inc. ("Columbia Gas") due to the impacts of the pandemic.[15] In denying the OCA's recommendation, the Commission appropriately held that it is the Commission's "responsibility…under the applicable legal and constitutional standards to weigh evidence and unique considerations…in setting just and reasonable rates, and our continued use of traditional ratemaking methodologies permit our consideration of important ratemaking principles."[16]

In other words, the Commission adheres to a set of ratemaking norms, where it can give consideration to certain factors based upon the evidence before it, such as determining whether a utility's projected expenses are reasonably necessary to provide service during the prospective period or whether a rate of return is too high or low due to current market conditions.[17] However, the notion that the Commission should reduce the Company's requested increase on the basis of nebulous factors raised by the OCA because the OCA disagrees with certain aspects of the Company's filing should be disregarded. This would be tantamount to departing from the traditional ratemaking methodologies that the Commission has relied upon in assessing rate increase requests of public utilities.

Lastly, the OCA's request ignores the record evidence of the Company's decision to significantly reduce its requested revenue requirement by almost $300,000 for the benefit of its customers, Company M.B. at 4-5, and its exemplary performance over the past five years, as demonstrated by, *inter alia*, the Company's ability to meet all federal and state water quality testing standards, the lack of customer complaints, its recent acquisition of EDTMA as approved by the

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[15] *Pa. Pub. Util. Comm'n, et al. v. Columbia Gas of Pennsylvania, Inc.,* Docket Nos. R-2020-3018835, *et al.*, 2021 WL 757073 (Opinion and Order entered Feb. 19, 2021) (*Columbia Gas 2020*).

[16] *Id*, at *30.

[17] *Id*, at *31-32.

Commission, and its significant efforts to replace aging infrastructure and continued improvement of its facilities, Company M.B. at 86-87.

For all these reasons, the OCA's request should be denied. The Company has reasonably presented its position based on sound ratemaking principles supported by substantial evidence in the record.

II. SUMMARY OF ARGUMENT

Columbia Water's request for rate relief in this proceeding is just and reasonable, driven by the need to replace aging infrastructure, and conservative in light of the evidence before this Commission and due to the Company's decision to reduce its requested rate increase by approximately $300,000 to mitigate the impact of the rate increase on its customers. Yet, I&E and the OCA ignore these realities and facts and propose drastic reductions in Columbia Water's requested increase. As demonstrated in the Company's Main Brief, the OCA and I&E achieve their inappropriate and unreasonable results by ignoring the Public Utility Code, appellate precedent, Commission regulations and prior rate case orders, and well-established principles of utility ratemaking. If the ALJ and the Commission fairly consider the evidence and follow the well-established precedent identified by the Company, they should reject the adjustments and recommendations of OCA and I&E and approve Columbia Water's requested increase.

RATE OF RETURN. As expressed in the Company's Main Brief, the biggest area of contention in this proceeding is the OCA and I&E's unreasonable position on rate of return. Company M.B. at 51-58. Both I&E and the OCA unreasonably recommend that the Commission adopt a hypothetical capital structure despite the Company's actual capital structure being very near its capital structure the ALJs and the Commission approved in its 2008 and 2013 rate cases. Company M.B. at 55. The proposed hypothetical capital structure under such circumstance is not fair and was proposed for one purpose— to significantly reduce the Company's requested

increase—which was already reduced by the Company in its filing by $300,000 from its actual revenue requirement. Company M.B. at 84. The hypothetical capital structure proposals would significantly impair the Company's ability to earn a fair rate of return on its plant investment.

Indeed, the OCA and I&E's hypothetical capital structure recommendation, in combination with its unreasonably low return on equity ("ROE") recommendations, is significantly unreasonable, highly prejudicial, and violates the tenets of *Bluefield Water Works & Improvement Company v. P.S.C. of West Virginia*, 262 U.S. 679 (1923) (*Bluefield*) and *Federal Power Commission v. Hope Natural Gas*., 320 U.S. 591, 603 (1944) (*Hope*). Under I&E's recommended rate of return, the Company would receive an overall cost of capital of 5.5%. I&E M.B. at 14.[18] Under the OCA's recommended rate of return, the Company would receive an overall cost of capital of 6.31%. OCA M.B. at 34.[19] Such a deficient return would harm the Company's ability to attract investors, force the Company to take on additional debt to finance Company operations, and potentially cause a default of the Company's loan obligations, resulting in higher interest rates and higher costs to customers. Rather, the Company has provided substantial evidence that its actual capital structure is not uneconomic or unreasonable, that it benefits ratepayers, and it is consistent with past Commission decisions approving the use of the Company's actual capital structure. The Company has likewise supported its recommended ROE of 11.25% in this proceeding. Accordingly, the recommendations of OCA and I&E should be denied.

EXPENSES. The various adjustments to the Company's revenues and expenses that were advanced by the OCA and I&E are without merit. Certain of those adjustments are highlighted here, but each has been addressed in the Company's Main Brief and in further detail below.

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[18] Citing I&E Statement No. 1-SR, at 7, 34.
[19] Citing OCA St. 2 at 7; App. A, Table I(A).

The Company has shown that the OCA's decision to allocate additional expenses to the Company's EDTMA Rate District is without merit. The OCA is recommending duplicate adjustments and inappropriately allocating expenses from the Company's materials and supplies account to the EDTMA Rate District. Incredulously, the OCA has also recommended an average adjustment to materials and supplies that relies, *in part*, on cost data from 2020 and 2021, well *before* the Company had even acquired EDTMA. Company M.B. at 29. Moreover, in the Company's 2013 rate case proceeding, the Commission rejected the OCA's recommendation to remove broad categories of expenses related to the Company's then-recent acquisition of the Marietta Gravity Water System on the basis of abstract allocation factors.[20] The OCA's EDTMA adjustment is likewise premature, unreasonably confiscatory, does not represent the true cost to operate the EDTMA Rate District, and should not be adopted by the Commission.

The Commission should also reject the OCA's confiscatory adjustments to the Company's materials and supplies expense and other-maintenance expense. At its most basic, the OCA is arguing that costs will decrease, returning to pre-pandemic levels based on speculative and inconclusive evidence. Company M.B. at 27-29. The Company has demonstrated that such speculative evidence either does not support their position or suffers from confirmation bias. By comparison, the Company has presented evidence of actual costs it has incurred and will incur in the Historic Test Year ("HTY") and Future Test Year ("FTY"), and such actual costs should not be dismissed, discounted, or ignored based on the OCA's unfounded speculation. Company M.B. at 29.[21] As was the case in the Company's 2008 rate case, evidence of actual costs from the most recent year, which the Company has provided here, is substantial evidence.[22] The Company is

[20] *CWC 2013*, 2014 WL 316891, at *41-54.

[21] Citing CWC St. 2-R at 15:14-21.

[22] *Pa. Pub. Util. Comm'n v. Columbia Water Co*., Docket Nos. R-2008-2045157, *et al*., 2009 WL 1708836 (Opinion and Order entered Jun. 10, 2009) (*CWC 2009*).

entitled to recover in its rates all legitimate expenses incurred in the rendition of its public utility service – it should be no different in this rate case. The OCA's adjustments should be denied.

QUALITY OF SERVICE. The OCA recommends that the Commission require the Company to establish a strict and onerous schedule for exercising isolation valves on a going forward basis. If approved, the recommendation would require the Company to either reduce its efforts in other areas or hire more people to accomplish these tasks and incur significant incremental costs. Company M.B. at 89 – 90.[23] The OCA, however, made no allowance for the Company in its revenue requirement to pay for these additional costs. As a party proposing an adjustment and advocating a position, the OCA has an obligation, which it failed, to provide a complete and fair basis for its recommendation. Establishing a significant unfunded mandate shows its proposal is incomplete, unjust, and unreasonable ratemaking. The evidence also shows that the OCA and its witness are unfamiliar with Company procedures when repairing its system, the fact that isolation valves are designed to remain open, and the Company's industry-standard ArcGIS data.[24] Ultimately, the OCA has not demonstrated that the Company's current frequency and reporting efforts surrounding exercising isolation valves is unreasonable or an abuse of the Company's managerial discretion.[25] The Commission should likewise not interfere where the Company has reasonably and adequately managed its own operations. The Commission should allow the Company to continue exercising its valves consistent with the commitments from the 2017 rate case proceeding, which it is substantially on par to comply with.

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[23] Citing CWC St. 1-R at 5:3-20.

[24] CWC St. 1-R at 4:6-19, 6:9-19; 8:16-8.

[25] *Nat'l Fuel Gas Dist. Corp. v. Pa. Pub. Util. Comm'n,* 464 A.2d 546 (Pa. Cmwlth. 1983) (*NFGD 1983)*; *see also Emporium Water Co. v. Pa. Pub. Util. Comm'n,* 955 A.2d 456 (Pa. Cmwlth. 2008), *app. den.* 961 A.2d 860 (Pa. 2008) (*Emporium 2008*).

Additionally, the Commission should reject the OCA's recommendation concerning the Company's complaint log. The OCA's concerns are unfounded as the Company provided the information required under the Commission's regulations. Company M.B. at 92-93. To the extent the OCA wants additional information after receiving the complaint log in the next base rate case, it can do so during the discovery process.

REVENUE ALLOCATION AND RATE DESIGN. The OCA, I&E, and OSBA all set forth different rate design proposals than the Company. The two biggest disputes between the parties are the Company's customer cost analysis and the allocation of the revenue requirement to the volumetric rates. The OCA, I&E, and OSBA's arguments to remove certain costs from the calculation of the Company's customer charge should be denied. The Company has provided sufficient evidence demonstrating that it is appropriate and reasonable to reflect certain costs, such as transmission and distribution operations and maintenance expense in the customer charge, because these costs are essential for providing service to customers, especially with regard to maintaining facilities, services, and meters, and should not be limited to only "direct" costs associated with connecting and maintaining a customer's account. Company M.B. at 102-103.[26] Moreover, the Company's proposed volumetric rates, which propose to increase the higher volume tiers at a larger percentage increase, is reasonable, sends a stronger pricing signal to customers for conservation purposes, and is consistent with the declining block rates of other Pennsylvania water public utilities. Company M.B. at 105-106.[27] For all these reasons, the Company's proposed revenue allocation and rate design should be approved.

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[26] Citing CWC St. 3-R at 8:17 – 9:2.

[27] Citing CWC St. 3-R at 11:6-13; *see also* OCA M.B. at 60-62.

III. RATE BASE

The Company's position on rate base is set forth in its Main Brief. Company M.B. at 12-19. The OCA indicated in its Main Brief that the negative net salvage issue has been resolved as the OCA withdrew its adjustment. OCA M.B. at 9. The only remaining issue between the parties is related to the Company's claim for cash working capital. All parties are in agreement with the Company's use of the 1/8th operating and maintenance expense ("O&M Expense) method. *See* OCA M.B. at 11; I&E M.B.at 7. The parties disagree only to the extent each party recommends a different level of O&M Expense for the FTY. The Company continues to disagree with the cash working capital adjustments of the other parties to the extent the Company disagrees with each parties' adjustments to the Company's claimed O&M Expense.

For these reasons, the Company's claimed measures of value for the FTY of $18,750,106 should be adopted by the Commission.

IV. REVENUES

The Company's position on revenues is set forth in its Main Brief. Company M.B. at 19-20. No party has opposed or contested the Company's claimed level of revenues for the FTY of $7,244,926. *See* OCA M.B. at 11-12; I&E M.B. at 8; OSBA M.B. at 3.[28] Accordingly, the Company's claim for FTY revenues at present rates should be adopted.

V. EXPENSES

The remaining O&M Expense issues among the parties include the following: (1) the allocation of EDTMA expenses, (2) materials and supplies expense, (3) other-maintenance

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[28] The Company disagrees with the OSBA's phrasing that the Company's correction to its revenues in its rebuttal testimony "significantly altered the course of the proceeding." OSBA M.B. at 3. Company witness Shambaugh explained in his rebuttal testimony that the Company inadvertently omitted the additional $222,555 in PENNVEST revenue in proposed revenues at present rates, which impacted the Company's cost of service study, resulting in an under recovery under proposed rates. CWC St. 2-R at 5:2 – 6:8. Accordingly, the Company corrected this to ensure it receives its requested increase in this proceeding. None of the parties objected or contested this correction. *See* OCA St. 1SR at 2:10-14; I&E St. 1-SR at 3:7-11; OSBA St. 1-S at 1:16 – 2:3.

expense, (4) rate case expense, and (5) office expense. The Company will address the arguments of the parties in greater detail below. To the extent an issue is not addressed in its Reply Brief, the Company incorporates its argument and position as set forth in its Main Brief.

It is well known that in the process of determining just and reasonable rates, "a public utility is entitled to recover in rates those expenses reasonably necessary to provide service to its customers and to earn a fair rate of return on the investment in plant used and useful in providing service."[29] As stated more succinctly by the Commonwealth Court:

> We are of the opinion that as a matter of constitutional law a utility is entitled to recover in its rates all legitimate expenses incurred in the rendition of its public utility service.[30]

Importantly, the Commonwealth Court recognized in *UGI* that expenses are recoverable when they are "a direct and clearly prudent step in providing public service."[31] In *UGI*, the Court reversed a Commission order denying recovery of expenses associated with feasibility studies related to the company's participation in certain natural gas storage projects, which the company ultimately elected not to join.[32] The Court explained that these studies were "reasonably calculated" to achieve safe, reasonable, and adequate service and, therefore, reasonably and prudently incurred.[33]

Here, many of the Company's claimed expenses, which are largely only opposed by the OCA, are legitimate expenses that are necessary and "reasonably calculated" to provide public service. Therefore, the Company's claimed expenses should be recoverable.

A. EDTMA EXPENSES

The OCA recommends that the Commission adopt the OCA's adjustment totaling $48,987 to reflect the removal of indirect and general costs attributable to the EDTMA Rate District. OCA

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[29] *Butler Township Water Co. v. Pa. Pub. Util. Comm'n*, 473 A.2d 219, 221 (Pa. Cmwlth. 1984).
[30] *UGI Corp. v. Pa. Pub. Util. Comm'n*, 410 A.2d 923, 931 (Pa. Cmwlth. 1980) (*UGI Corp.*)
[31] *Id.*, at 932.
[32] *Id.*
[33] *Id.*

M.B. at 30. Citing to the Company's 2013 rate case proceeding, the OCA argues that the Commission must ensure that Columbia and Marietta Rate District customers are not burdened with the inclusion of the Company's indirect and general costs attributable to the EDTMA Rate District. OCA M.B. at 25-26. While the Company agrees that Columbia and Marietta Rate District customers should not be responsible for costs attributable to the EDTMA Rate District, the OCA's adjustments are unreasonably duplicative, unduly prejudicial, confiscatory, and not reflective of the actual costs to operate the EDTMA Rate District. If adopted, the OCA's adjustment will prevent the Company from recovering expenses reasonably calculated to provide service to its Columbia and Marietta Rate Districts.

As stated in the Company's Main Brief, the Company made a number of significant O&M Expense adjustments to remove costs that were directly incurred to provide service to EDTMA Rate District customers. Company M.B. at 22. This includes the following expenses and amounts as set forth in Exhibit GDS No. 1-R at 1-5:

Account Description	Amount
Employees (HTY & FTY)	$73,000
Purchased Power (HTY)	$27,487
Chemicals (HTY)	$33,808
Engineering (HTY)	$1,640
Other-Maintenance (HTY)	$12,339
Transportation (HTY)	$2,758
General Liability (HTY)	$7,264
Office Expenses & Utilities (HTY)	$869
Management Fees (Bank Charges) (FTY)	$5,925
Testing (FTY)	$3,400
Rental Property (HTY & FTY)	$4,500
Total	**$172,990**

All the costs were directly identified and attributed to providing service to the Company's EDTMA Rate District. As such, they were removed from the Company's rate case filing. Company M.B. at 22.

In turn, the OCA recommended that the following ***additional*** adjustments be made to the Company's claimed level of expense[34]:

Account Description	**Amount**
Officers, Directors, & Majority Stockholders	$1,359
Materials and Supplies	$22,193
Accounting	$2,287
Legal	$2,027
Management Fees (Bank Charges)	$8,128
Testing	$1,939
General Liability	$1,447
Workmen's Compensation	$73
Bad Debt Expense	$582
Membership Dues	$841
Stockholders Expenses	$117
Uniforms	$376
Director's Fees and Expenses	$7,097
Mailing	$257
Travel	$31
Education	$233
Total	**$48,987**

As set forth above, the OCA is recommending duplicate adjustments to the Company's claim for management fees (bank charges), testing expense, general liability, and mailing expense, even though the Company already reduced those accounts to reflect costs that are directly attributable to the Company's EDTMA Rate District.

Moreover, the OCA inappropriately adjusts the Company's materials and supplies account, even though the OCA has recommended an average adjustment that relies, *in part*, on cost data

[34] OCA St. 1SR at 21; App. A, Table II, col. G, ln. 37.

from 2020 and 2021, well *before* the Company even acquired EDTMA on March 31, 2022. Company M.B. at 24.[35] In other words, the OCA's recommendations are unreasonably duplicative in that they recommend reductions by averaging costs from years prior to the acquisition of EDTMA and then use arbitrary allocation factors to further reduce these pre-EDTMA expenses by allocating them to the EDTMA Rate District and removing them from this filing, which is further compounded by not taking into account the EDTMA expenses that the Company already removed from the filing. These adjustments are patently unreasonable and do not reflect the actual costs of operating the EDTMA Rate District.

The OCA also misconstrues the Company's 2013 rate proceeding and the Commission's ultimate holding in that case. In 2013, the Company had filed for a rate increase approximately seven months after acquiring the Marietta Gravity Water System.[36] The Company's filing did not seek a rate increase from the customers of the former Marietta Gravity Water System, instead requesting an increase only from its Columbia Rate District.[37] As such, the Company allocated certain expenses to the Marietta Rate District and removed them from the filing.[38] Notwithstanding, the OCA recommended additional adjustments to several Company expense accounts on the basis of broad and speculative allocation factors to reflect expenses that, in the

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35 Citing CWC St. 2-RJ at 5:15-18.

36 *See Joint Application of Columbia Water Company and Marietta Gravity Water Company for: approval of the transfer of the rights, service obligations, water system and assets used and useful in the operation of the water system of the Latter lo the Former; the abandonment of service by the Latter; and, All Other Approvals Or Certificates Appropriate, Customary or Necessary Under the Public Utility Code to Carry Out The Transactions Described in the Application*, Docket Nos. A-2012-2282219, *et al*., Letter re: Transaction Completion Notification (filed Oct. 9, 2012), available at https://www.puc.pa.gov/pcdocs/1194789.pdf (indicating that Columbia Water consummated its acquisition of the Marietta Gravity Water Company on Oct. 5, 2012); *see also CWC 2013*, 2014 WL 316891, at *1 ("On April 25, 2013, Columbia filed Supplement No. 60 to Tariff—Water Pa. P.U.C. No. 7, which contained proposed changes in rates, rules, and regulations calculated to recover an estimated annual increase in base rate revenues of $773,210 from customers of its Columbia Division.").

37 *CWC 2013*, 2014 WL 316891, at *1.

38 *See, Id*., at *41 ("The Company claimed $820,483 in Salaries and Wages. An allocation of $25,597 to Marietta reduced the amount claimed in this proceeding to $794,886.").

OCA's opinion, should have been allocated to the Marietta Rate District.[39] In almost each instance, the Commission denied the OCA's proposed allocations.[40] In discussing its denial of the OCA's adjustment to salaries and wages, the Commission stated:

> It is very difficult to develop a precise estimate for the allocation of personnel costs to the Marietta Division based on the initial few months following the October 2012 acquisition. Under these circumstances, we shall defer to the Company's claim based on the general manager's experience until such time that more comprehensive sets of employee time sheets are available and the allocation of staff resources to the Marietta Division becomes more routine. Accordingly, we shall reject the OCA's estimates and corresponding adjustment.[41]

Similarly, in rejecting the OCA's adjustment to worker's compensation insurance, the Commission stated:

> [C]onsistent with our disposition of the OCA's other proposed reallocations of personnel costs to the Marietta Division, we find that it is premature to make any adjustments to the Company's proposed allocation of worker's compensation insurance. Accordingly, we shall reject both of the OCA's proposed adjustments to the Company's claim for worker's compensation insurance.[42]

The Commission concluded its Order by stating it expects, in future proceedings, the Company will be in a position to provide information regarding the time spent by its officers and directors and other Company personnel on Columbia Rate District and Marietta Rate District issues.[43]

The instant case shares many similar characteristics as *CWC 2013*. The Company filed its rate case approximately 13 months after acquiring EDTMA.[44] Furthermore, as explained by

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39 *See, Id.*, at *41-54 (recommending that additional salaries and wages, pensions and benefits expense, disability and life insurance, vehicle insurance, worker's compensation insurance, accounting expense, and office and utilities expense, and Officer salaries and Director fees be allocated to the Marietta Rate District.).

40 *Id.*

41 *Id.*, at *43.

42 *Id.*, at *51.

43 *Id.*, at *59.

44 CWC St. 1 at 3:13-16 (CWC acquired EDMTA on March 31, 2022). The Company filed its rate increase on April 28, 2023.

Company witness Shambaugh, since the acquisition of EDTMA, the Company has been able to separately track and identify all specific expenses associated with the EDTMA Rate District, including all expenses that increased in the FTY as a result of providing service to the EDTMA Rate District, and each expense was specifically removed from the Company's rate filing.[45] Yet, now the OCA recommends unreasonable adjustments based on speculative allocation factors that do not reflect the actual costs to the Company to operate the EDTMA Rate District.

The OCA's adjustment should be denied for these reasons. The Company has verified the costs it has spent and will spend on the EDTMA Rate District. The OCA's adjustments are premature, unreasonably confiscatory, and should not be adopted by the Commission.

B. MATERIALS AND SUPPLIES

In its Main Brief, the OCA continues to recommend that the Commission unreasonably and detrimentally reduce the Company's claim for materials and supplies expense despite evidence demonstrating the Company will, in fact, actually exceed its claimed materials and supplies expense that was projected for the FTY. The OCA specifically argues that the Company's claimed HTY and FTY expense for materials and supplies does not represent a normal level of expense, OCA M.B. at 14-16, that a portion of the Company's FTY claim does not withstand scrutiny, OCA M.B. at 16-18, and that the Company's alternative recommendation is subject to the same flaws and should not be adopted, OCA M.B. at 18-19. The OCA is wrong on each of these points and their position is contrary to the record evidence. Accordingly, as discussed below, the OCA's adjustments to the Company's claim for materials and supplies should be rejected in its entirety.

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[45] CWC St. 2-R at 11:8-12.

1. The OCA's Average Adjustment is Without Merit

The OCA makes several arguments as to why the Company's claimed level of materials and supplies expense is abnormal compared to previous years and should be averaged using three years of the most recent materials and supplies expense (2020, 2021, and 2022). Specifically, the OCA argues that: (1) the Company's HTY and FTY level of materials and supplies expense is unreasonably high compared to years 2018, 2019, 2020, and 2021, OCA M.B. at 14; (2) inflation will slow and supply chain pressures will alleviate such that prices will fall compared to present levels, OCA M.B. at 15; and (3) normalization is appropriately used to reduce abnormal expenses, OCA M.B. At 15-16. These arguments are without merit.

The OCA's comparison to cost data from as early as 2018 through 2021 is not appropriate and should not be a valid basis to conclude that the level of materials and supplies expense during the HTY is abnormal. As Company witness Shambaugh testified, cost data from 2020 no longer represents the costs to operate the Company.[46] This statement is likewise applicable to cost data from 2018 and 2019. As the Company demonstrated, prices have been substantially affected (*i.e.*, prices have substantially increased) by the general conditions of the economy since 2020, having been plagued by historic inflation and supply chain pressures.[47] Moreover, the Company provided explicit evidence that the Company is on pace to (1) substantially exceed HTY materials and supplies expense and (2) even *exceed* its FTY claim in this case:

> Moreover, the Company has taken a conservative approach in setting its claimed level of materials and supplies expense. The Company is already on track to exceed the claimed level of materials and supplies expense based on current levels of spend. For example, for the period January 1, 2023 through August 7, 2023, the total expensed was $293,841. That is an average of $1,348 per day ($293,841 / 219 days = $1,342 per day). Annualized, that works out to $489,830 ($1,348 x 365 days = $489,830). The $489,830 is about

[46] CWC St. 2-RJ at 9:12-15.
[47] CWC St. 2-RJ at 7:15 – 8:10.

> $112,440 more than the HTY 2022 amount of $377,390 and $57,430 more than the FTY 2023 amount of $432,400.[48]

Conversely, the OCA makes vague and speculative judgments about the future of the economy without any compelling evidence. As the Company indicated in its Main Brief, the little evidence the OCA provided either does not support the OCA's position or is merely a politically motivated report designed to reinforce a biased narrative about current supply chain pressures. Company M.B. at 27-28. Ms. Rogers certainly is not qualified to make such general claims about the future of the economy[49], nor has the OCA presented any independent study or analysis that would lead a decision maker to reasonably conclude the OCA is correct. The OCA's suggestion that cost data that pre-dates the worst economic effects of the pandemic now represents a 'normal' level of expense strains credulity and is not reasonable.

Lastly, the Commission should reject the OCA's statement that normalization is appropriate in this instance. OCA M.B. at 15-16. To be clear, the OCA is recommending that the Commission average three years of stale cost data (2020, 2021, and 2022). The OCA is then also recommending a normalization adjustment, in addition to its average adjustment to materials and supplies, to spread $18,000 associated with reasonable roadway restoration costs over approximately five years to reduce the Company's FTY claim for materials and supplies even further. This is unnecessarily duplicative as it effectively reduces costs twice for the same unreasonable purpose.

Nevertheless, as the record evidence demonstrates, the Company's claimed level of materials and supplies expense of $432,400 actually understates the Company's actual, going-forward costs for materials and supplies. Company M.B. at 29. Contrary to the OCA's claims,

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[48] CWC St. 2-R at 15:14-21.

[49] OCA M.B. at 2-3; *see also* OCA St.1, App. A.

where the Company has provided reasonable evidence that such costs represent a normal level of cost going forward, averaging costs from previous years is not appropriate. For example, in *Pennsylvania Public Utility Commission v. Columbia Water Co.*, the Office of Trial Staff ("OTS") recommended that the Commission average the Company's claim for office expense and utilities over a period of three years.[50] In rejecting OTS' recommendation and adopting the Company's claim, the Commission stated, "Columbia's rebuttal claim is known and measurable, using actual 2008 figures."[51]

In the instant case, the Company has submitted its actual 2023 expenses incurred for and properly recorded in its materials and supplies expense account. The listing of the individual expenses incurred was presented in Exhibit GDS No. 3-R (Confidential). Accordingly, what the record reveals is that the individual expenses recorded in the materials and supplies expense account are properly recorded therein, that the actual known and measurable expense for the account to date is on pace to exceed the Company's claim in this proceeding, and that the reasonableness and prudence of such incurred expenses is neither questioned nor challenged. Under these facts, there is simply no legitimate basis for the OCA's recommended average adjustment and the Company's claimed level of $432,400 for the FTY should be recognized by the Commission for ratemaking purposes.

2. The OCA's Normalization Adjustment is Without Merit

The OCA continues to support its adjustment of the Company's Kinderhook Road restoration project, which spreads the $18,000 cost over a period of five years and reduces the Company's claimed level of materials and supplies expense. OCA M.B. at 16-18. The OCA argues that this is not an annually recurring cost, such costs should have already been reflected in

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[50] *CWC 2009*, 2009 WL 1708836.
[51] *Id.*

the HTY to the extent the Company incurs such costs annually, and that reference to an additional roadway restoration project of $29,000 is improper cherry picking and should not be relied upon to set rates. OCA M.B. at 16-18. The OCA's adjustment is unwarranted for several reasons.

As Company witness Shambaugh testified:

> [T]he recommendation to normalize the $18,000 cost to repair a roadway should be rejected. Although the project itself may have been a one-time occurrence, the Company undertakes projects that are similar in scope and effort from year to year. Normalizing these costs would be inappropriate and at odds with the purpose of materials and supplies expense, which reflects various one-time projects and costs the Company undertakes on a yearly basis to maintain adequate, efficient, safe, and reasonable service. To assume the Company will not have future main breaks and, therefore, no road repair expense, is not realistic.[52]

In other words, the Company undertakes such restoration projects on a yearly basis. The Company has also provided evidence of it undertaking a similarly-scoped restoration project this year costing the Company $29,000 that is not reflected in the Company's claim for materials and supplies expense.[53] This is not cherry picking, but demonstrates these costs recur annually and represent a normal level of expense that does not need to be normalized, as stated by Mr. Lewis:

> I continue to stand by my rebuttal testimony that a roadway repair of this nature is not a one-time event and will recur in the future. We have maintenance and repair work that routinely results in roadway repairs. While many roadway repairs only require a patch; it is not unusual for the Company to experience roadway repairs of a greater magnitude on an annual basis. The cost comparison I presented in my Rebuttal testimony shows that the estimate in the going level adjustment including for roadway repair is a conservative estimate. Thus, I also continue to believe the going level adjustment the Company proposed for materials and supplies expense is very conservative.[54]

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[52] CWC St. 2-R at 16:1-8.
[53] CWC St. 1-R at 2:9-11.
[54] CWC St. 1-RJ at 3:10-17.

Company witness Lewis is the President and General Manager of the Company and is eminently familiar with the Company's yearly projects. Thus, the Company is not engaging in "cherry picking," but is seeking recovery of prudently incurred expenses necessary to provide safe, reasonable, and adequate service.

Lastly, the OCA's suggestion that such costs should already be reflected in the Company's HTY claim to the extent they are 'normal' costs should be rejected. It is not uncommon for a public utility's expenses to increase on a yearly basis for various reasons. The Company has already provided significant evidence that its other expense accounts have increased due to known and measurable changes, many of which are not contested by the parties to this proceeding. The Company's materials and supplies expense is no different. Rather, the OCA is the party engaged in cherry picking certain project expenses to further reduce the Company's materials and supplies claim.

3. The Company's Alternative Recommendation Is Appropriate

Lastly, the OCA argues that if the Commission decides to apply an average adjustment, the Company's alternative recommendation to average materials and supplies costs over the years 2021, 2022, and 2023 should not be adopted by the Commission as it contains the same flaws as the Company's primary position. OCA M.B. at 18-19.

While the Company continues to submit that the OCA's materials and supplies adjustments should be denied, the Company submits that its alternative recommendation is more reasonable and reflective of the actual costs to operate the Company than the OCA's adjustments. As the Company demonstrated, 2020 costs simply do not represent a reasonable level of expense to currently operate the Company.[55] It is more appropriate to average the most recent data, which

[55] CWC St. 2-RJ at 9:12-15; *see also* OCA M.B. at 29.

includes data from the FTY. As the Commission stated regarding an I&E recommendation to exclude the test year from a proposed average adjustment to storm damages expense:

> We find that the actual costs incurred by the Company for storm damage during the year 2018, although a partial year, accurately reflect the actual storm damage costs to be calculated using the five-year historic average of actual costs. We are not persuaded by I&E's rationale that expenses incurred for a partial year are *per se* inaccurate for purposes of averaging five-years' actual costs. I&E does not dispute that the Company's 2018 figures pertaining to actual expenses and concedes that the figures do not overstate the Company's 2018 expenses. In fact, in this case, precluding the Company from using actual figures of expenses during the most recent fiscal year, 2018, would direct a calculation that *understates* the Company's actual expenses. Further, we reject the OCA's position that it is inappropriate to calculate a five-year historic average based on the actual storm damage expenses incurred by the Company over the period from 2014 to 2018. The OCA's proffered calculation would underestimate the average actual expense incurred by the Company for storm damage and is rejected.[56]

While storm damages expense represents an abnormal cost to a public utility given the unexpected timing and scope of storm weather, and, thus, should be averaged, unlike materials and supplies, the principle remains the same - precluding the Company from using actual figures of expenses during the most recent year, 2023, would *understate* – indeed misstate - the Company's actual expenses.

For these reasons, if the Commission were to average the Company’s materials and supplies expense, which it should not, it should use the Company’s alterative recommendation set forth in its Main Brief. Company M.B. at 31.

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[56] *Pa. Pub. Util. Comm’n v. UGI Utilities Inc. – Electric Division*, Docket Nos. R-2017-2640058, *et al*., 2018 WL 5620905, at *31 (Opinion and Order entered Oct. 25, 2018).

4. Conclusion as to Materials and Supplies Expense

For the reasons set forth above, the OCA's various materials and supplies adjustment should not be adopted by the Commission. Furthermore, the Company is highly concerned with the level of expense adjustments the OCA is proposing to the Company's materials and supplies expense, which, when taken together, substantially reduce the Company's claim in this proceeding, such that its ability to recover reasonably prudent expenses from customers is significantly harmed. In total, the OCA has recommended that the Company's materials and supplies account be reduced by $59,017 to reflect the average adjustment, by $14,440 to reflect the normalization adjustment, and by $22,193 to reflect the OCA's recommended allocation of EDTMA expense. That would reduce the Company's materials and supplies expense by approximately $100,000. This is simply wrong and unreasonable, and the adjustments should not be adopted separately or collectively.

C. OTHER-MAINTENANCE EXPENSE

The OCA also continues to recommend an average adjustment to the Company's claim for other-maintenance expense. Based upon the same flawed reasons it recommends an adjustment to the Company's materials and supplies expense, the OCA states that the Company's claim for other-maintenance expense should be averaged over the years 2020, 2021, and 2022, which reduces the Company's claim for other-maintenance expense by approximately $28,600. OCA M.B. at 20-22. The OCA reasons that an average adjustment is necessary to prevent overcollection from customers due to high costs in 2022, that the Company did not provide any analysis to show the actual impact of inflation and supply chain shortages, and that the burden of proof should lie with the Company to demonstrate recovery of these costs. OCA M.B. at 20-22.

The OCA's arguments fail for the same reasons set forth above in response to the OCA's materials and supplies adjustments. However, there are some additional points the Commission should consider. First, it is well-settled that the Company is entitled to recover known and

measurable changes to reasonably incurred and prudent expenses from its customers.[57] Here, the Company has shown that its increased costs to other-maintenance expense and its other expenses are known and measurable. The OCA has not and cannot challenge the level of expense that was incurred by the Company in the HTY. Such costs are consistent with and currently understate what the Company is currently incurring to provide service to its customers in the FTY.

In addition, the Company has provided substantial evidence in this proceeding demonstrating that its costs have increased throughout the years. The Company indicated that these increases were the result of economic inflation and supply chain shortages.[58] To suggest the Company's evidence of it actual costs during the HTY and to date in the FTY is insufficient proof is inconsistent with Commission precedent acknowledging that evidence of actual costs is sufficient.[59]

The OCA's average adjustment also completely ignores the Company's claim for the FTY and substantially discounts the Company's actually incurred HTY claim for other-maintenance expenses. This position directly conflicts with the general convention of the test year. Section 315(a) of the Code specifically allows a public utility to utilize a FTY to set rates in a general rate proceeding.[60] The OCA's invitation to look backward to such an extent is at odds with the convention of the test year and substantially impairs the Company's ability to provide safe, reasonable, and reliable service.

Moreover, while the Company must prove its case by a preponderance of the evidence, the OCA nonetheless has the burden of production to demonstrate why its arguments should persuade the Commission:

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[57] *UGI Corp.*, 410 A.2d at 931.
[58] CWC St. 1-R at 3:4-19; *see also* CWC Exhibit DTL-1R.
[59] *CWC 2009*, 2009 WL 1708836.
[60] 66 Pa. C.S. § 315(a).

> The burden of production, also called the burden of producing evidence or the burden of coming forward with evidence, determines which party must come forward with evidence to support a particular proposition. This burden may shift between the parties during the course of a trial. If the party (initially, this will usually be the complainant) with the burden of production fails to introduce sufficient evidence the opposing party is entitled to receive a favorable ruling. Once the party with the initial burden of production introduces sufficient evidence to make out a prima facie case, the burden of production shifts to the opposing party. If the opposing party introduces evidence sufficient to balance the evidence introduced by the party having the initial burden of production, the burden then shifts back to the party who had the initial burden to introduce more evidence favorable to his position. The burden of production goes to the legal sufficiency of a party's case.[61]

Here, the OCA has the burden of production to demonstrate the legal sufficiency of its claims that the prices of the Company's goods and services will decrease in future years due to reduced supply chain pressures and decreasing inflation.

In response, the Company provided reasonable and credible evidence refuting the OCA's evidence that the recent economic impacts of the pandemic, which are generally known to the public, will somehow seemingly reverse and return to pre-pandemic levels that do not reflect the realities of today. Company M.B. at 27-29. Accordingly, the Company has credibly rebutted the evidence of the OCA and it should not be relied upon by the Commission.

Lastly, for the reasons set forth above in materials and supplies expense, to the extent the Commission adopts the OCA's average adjustment, which it should not, the Commission should adopt the alternative recommendation of the Company as it is more reflective of the costs to provide service by the Company. Company M.B. at 34.

[61] *Leonard Springer v. Metropolitan Edison Co.*, Docket No. C-2013-2396794, 2014 WL 3834564, at *5 (Initial Decision entered Jul. 22, 2014), *aff'd* (Final Order entered Sept. 15, 2014).

D. RATE CASE EXPENSE

I&E and the OCA proposed adjustments to the Company's recommended rate case normalization period based on pure historical rate case filing dates. *See* OCA M.B. at 12-13; I&E M.B. at 8-11. I&E proposed a normalization period of 59 months and the OCA proposed 60 months, both based on the average time between the Company's last four rate case filings. I&E M.B. at 10; OCA M.B. at 12.

The Company's Main Brief provided clear evidence that a filing gap of the length proposed by the OCA and I&E is extremely unlikely. See Company M.B. at 34-37. Consistent with the Commission's previous holdings that rate case expense normalization period may be based on future expectations, the Company's proposed 36-month normalization period should be approved. Company M.B. at 35-36.[62]

E. OFFICE EXPENSES

The OCA and the Company do not dispute that the billing software upgrade costs represent one-time costs that should be normalized and recovered over a period of years. OCA M.B. at 24. However, both the Company and the OCA recommend a different normalization period, with the OCA recommending five years and the Company recommending three years. OCA M.B. at 25; Company M.B. at 37.

For the reasons set forth in its Main Brief regarding the Company’s proposed three-year normalization of rate case expense, the Company’s proposed three-year normalization of office expense should be adopted. Company M.B. at 35-37.

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[62] *See Pa. Pub. Util. Comm’n v. Emporium Water Co.*, Docket No. R-2014-2402324 (Order Entered Jan. 18, 2015), slip op. at 48-49 (citing *Pa. Pub. Util. Comm’n v. PPL Electric Utilities Corp*., Docket Nos. R-2012-2290597, *et al*., 2012 WL 6758304 (Opinion and Order entered Dec. 28, 2012) (*PPL 2012*)).

F. CONCLUSION

For the reasons identified above, the various disallowances to the Company's expenses proposed by the other parties in this proceeding should be rejected, and the Company's total expenses of $4,079,604 should be accepted. *See* Company M.B. at 20-21.

VI. <u>TAXES</u>

The Company addressed its claimed level of taxes at length in its Main Brief. Company M.B. at 41-48. The only remaining issues in dispute are the Company's claim for regulatory assessments, the tax impacts associated with the Company's revenue from the PENNVEST surcharge, reflecting interest expense associated with the payment of its PENNVEST loans, and the state income tax rate. The Company will address each below:

A. TAXES OTHER THAN INCOME TAXES

1. Regulatory Assessments

As set forth in the Company's Main Brief, the Company, the OCA, and I&E disagree on the claimed level of regulatory assessments because each party recommends a different revenue requirement in this proceeding. Company M.B. at 41. The Company continues to recognize that a final determination of regulatory assessments will occur upon a final Commission determination of the total proposed revenue requirement amount in this proceeding.[63]

B. INCOME TAXES

1. PENNVEST Surcharge Revenue

I&E did not address this topic in its Main Brief. Nevertheless, I&E's rate case tables continue to reflect PENNVEST revenue as non-taxable income. *See* I&E M.B., App. A, Table I

[63] CWC St. 2-R at 24:5-7.

(reflecting PENNVEST loan payments as O&M Expense). The Company continues to disagree with I&E for the reasons set forth in its Main Brief. Company M.B. at 44-45.

2. Interest Synchronization

In its Main Brief, the OCA adopts the Company's requested level of interest expense when calculating state income tax liability in this proceeding. As the OCA stated:

> For briefing, the OCA has accepted the Company's position regarding inclusion of the interest expense associated with the PENNVEST loans in the interest synchronization adjustment. The OCA interest synchronization method as modified is shown in Appendix A, Table III, column B, lines 17 to 19.

OCA M.B. at 32. Accordingly, this issue appears to be resolved. However, as stated above, to the extent the Commission determines that the revenues associated with its PENNVEST surcharge are not taxable as recommended by I&E, a concomitant adjustment should be made to remove the interest expense deduction associated with the payment of the Company's PENNVEST loans.[64]

3. State Income Tax Rate

The OCA continues to recommend that a state income tax rate of 8.49% be used to calculate the Company's state income tax liability. OCA M.B. at 31. The Company's position on this issue in support of its 8.99% corporate net income tax ("CNIT") is set forth in its Main Brief. OCA M.B. at 47. The Company continues to submit that this is the appropriate CNIT rate as it is the rate in effect during the test year.

C. CONCLUSION

For the reasons set forth above, the Company's claimed level of taxes for the FTY should be approved by the Commission.

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[64] If the Commission were to remove all tax impacts associated with the Company's PENNVEST loans, the Company reserves the right to modify its PENNVEST surcharge to recover the associated tax impacts through the PENNVEST surcharge.

VII. <u>RATE OF RETURN</u>

A. INTRODUCTION

In their respective Main Briefs, both OCA and I&E continue advocating for Commission approval of a hypothetical capital structure and returns on common equity that would eviscerate the principal benchmarks for a fair rate of return set forth in *Bluefield* and affirmed by *Hope* and *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989). *See* OCA M.B. at 33-56; I&E M.B. at 12-36. The OCA and I&E's efforts that would unreasonably reduce the Company's cost of capital to such a deficient amount should be rejected.

The Company has proposed and supported an overall cost of capital of 8.28% in this case, based upon its pro form capital structure and capital component cost rates, including a return on common equity of 11.25%. Company M.B. at 48-84. The Company has demonstrated, through the testimony of Company witness D'Ascendis, that his recommended cost of capital for the Company is reasonable and should be approved by the Commission.

B. CAPITAL STRUCTURE

The Company has reflected in the case its projected actual FTY capital structure of 63.34% common equity and 36.66% long-term debt. Company M.B. at 51. The OCA and I&E, however, propose a hypothetical capital structure based upon average capital structure ratios of its proxy group and nationwide averages. OCA M.B. at 40; I&E M.B. at 15.

I&E and the OCA's proposals to adopt a hypothetical capital structure is contrary to long-standing Commission precedent that the choice of capital structure is within the discretion of utility management and is not to be changed absent proof that the capital structure is atypical or heavily weighted to one side. Their proposal to restructure Columbia Water's capital structure to an average of their proxy groups is wrong and should be rejected.

1. The Advocates Fail to Distinguish Past Commission Precedent

The legal standard in Pennsylvania for deciding whether to use a hypothetical capital structure in setting rates is simple and straightforward:

> Absent a finding by the Commission that a utility's actual capital structure is atypical or too heavily weighted on either the debt or equity side, we would not normally exercise our discretion with regard to implementing a hypothetical capital structure.[65]

Specifically with respect to Columbia Water, the Commission found in two previous cases that the Company's capital structure was not too heavily weighted on the equity side.[66] In both cases, the Company had a capital structure that was similar to, but slightly higher than Company's requested capital structure in this case, yet, in both instances the Commission held that the Company's "capital structure is not unreasonable or uneconomical under the rationale of the *Carnegie* decision."[67] The *Carnegie* decision stands for the proposition that it is the right of the Commission:

> to protect the consumer from excessive wages ... and other such things including excessive costs of capital. On the other hand, the right, while always there, should be exercised sparingly, since the problems of corporate finance are extremely intricate and complex, and are best known to the utility which lives with these problems from day to day." … [t]he Commission has the duty to regulate utilities in a manner which provides customers with reliable service at reasonable cost. This is not to say that we may mandate to regulated utilities the proportion of debt and equity contained in their capital structures. Rather, the actual capital structure is a matter within the discretion of corporate management; however, this does not preclude the commission from determining that a particular utility's capital structure is unreasonable and uneconomical when balancing the goals of safety, prudent management, and economy

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65 *See Pa. Pub. Util Comm'n v. Aqua Pennsylvania, Inc.*, Docket Nos. R-2021-3027385, *et al*., 2022 WL 1732770, at *80-81 (Opinion and Order entered May 16, 2022) (quoting *PPL 2012*, 2012 WL 6758304 (*Aqua 2021*).

66 *CWC 2009*, 2009 WL 1708836; *see also CWC 2013*, 2014 WL 316891, at *25.

67 *CWC 2009*, 2009 WL 1708836 (citing *Pa. Pub. Util. Comm'n v. Carnegie Natural Gas Company*, Docket Nos. R-79100977, *et al*., 1980 WL 140939, at *11 (Opinion and Order entered Jul. 25, 1980) (*Carnegie*)).

> and utilize a hypothetical capital structure for rate-making purposes.[68]

In both the 2008 and 2013 Columbia Water rate case, the Commission found that the Company's capital structure did not violate the *Carnegie* decision, as the capital structure was not found to be unreasonable or uneconomic.

I&E fails to mention the Commission's decisions in 2008 and 2013 in its Main Brief. The OCA briefly mentions the Company's 2008 and 2013 rate cases, arguing this case is distinguishable because here there is evidence that CWC's proposal to use its actual capital structure would impose unreasonably increased costs to ratepayers. OCA M.B. at 41. While the OCA's premise is incorrect as discussed in more detail below, this is not a proper distinguishing factor from past cases. Indeed, similar arguments were made in each case:

> The OCA and the OTS concluded that their recommended 50%/50% hypothetical capital structure is reasonable for Columbia and avoids burdening Columbia's ratepayers with the excessive rates that would result from using Columbia's atypically high common equity ratio.[69]

And, as I&E argued in the Company's 2013 rate case:

> In its Reply Exceptions, I&E reiterates that the capital structure utilized by Columbia is not in line with its historical capital structure, but is in fact more heavily weighted toward equity than the Company has been in any of the past five years. I&E also contends that Columbia's actual capital structure is not in line with the industry average, and places an unfair financial burden upon customers.[70]

In both instances, the Commission rejected these arguments, finding in the Company's 2013 rate case that "adopting a hypothetical 50/50 capital structure, rather than the Company's actual capital

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68 *Carnegie*, 1980 WL 140939, at *11 (*citing* Garfield and Lovejoy, "Public Utility Economics. Prentis-Hall, 1964, p.130).

69 *CWC 2009*, 2009 WL 1708836.

70 *CWC 2013*, 2014 WL 316891, at *24.

structure, would be somewhat arbitrary, and would fail to recognize the benefits to ratepayers of the Company having ready access to capital markets due to its strong capital structure."[71]

For these reasons, the OCA and I&E do not sufficiently distinguish the facts of this case from the previous Commission holdings. Thus, there is no proper basis for the Commission to depart from its previous decisions finding that the Company's actual capital structure is appropriate.[72]

2. Use of a Hypothetical Capital Structure Should Be Rejected

In its Main Brief, the OCA justifies its recommended hypothetical capital structure of 50.6% common equity and 49.4% long-term debt by arguing that adopting Mr. Garrett's hypothetical capital structure ensures that wealth is not unfairly transferred from ratepayers to stockholders and stating that adopting a hypothetical capital structure would reduce the Company's revenue requirement by more than one-quarter. OCA M.B. at 40-41. The OCA, thus, argues that adopting the Company's actual capital structure imposes unreasonable costs on ratepayers. OCA M.B. at 41. The OCA further states that adopting a hypothetical capital structure does not require a change to the Company's actual capital structure, but merely demonstrates that the Company's capital structure is not reasonable for purposes of ratemaking. OCA M.B. at 41. For its part, I&E argues that its hypothetical capital structure is closer to the industry norm than the Company's actual capital structure and that adopting its recommendation would save ratepayers $279,480. I&E M.B. at 16. These arguments are without merit.

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[71] *CWC 2013*, 2014 WL 316891, at *25.

[72] The PUC is not required by law to follow its decisions or "precedent" (a doctrine known as "*stare decisis*"). However, if it does rule differently in like circumstances the Commission must explain why a different result or conclusion is warranted. *PECO Energy Co. v. Pa. Pub. Util. Comm'n*, 791 A.2d 1155, 1166 (Pa. 2002).

First, while the Commission can balance the goals of safety, prudent management, and economy as set forth in *Carnegie*, it cannot engage in arbitrary decision-making that the OCA and I&E request here. As stated by the Commonwealth Court regarding rate of return:

> As the Superior Court said in *Pittsburgh v. Pennsylvania Public Utility Commission*, 182 Pa.Super. 376, 392, 126 A.2d 777, 785 (1956): 'Although the Commission, within the limits of the statute, has certain discretionary powers (*Philadelphia v. Pennsylvania Public Utility Commission*, 164 Pa.Super. 96, 103, 63 A.2d 391), it is not justified in making any finding as to rate of return to be allowed a utility without substantial and competent evidence presented to support it.'"[73]

Moreover, as discussed by the Commission in a recent Order, the Commission should not engage in arbitrary decision-making to justify an end result but must weigh the evidence before it using traditional ratemaking methodologies in setting just and reasonable rates consistent with *Bluefield* and *Hope*.[74]

The OCA and I&E's reasoning to reach an end result on the basis of cost savings is inappropriate and inconsistent with long-held precedent that a fair return on rate base is one that is "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 . . ."[75] Thus, the Commission's decision should be confined to whether, based upon the record evidence, the Company's capital structure is unreasonable or uneconomic when balancing the goals of safety, prudent management, and economy.[76]

In this case, the Company has provided sufficient evidence demonstrating that the use of the Company's actual capital structure is appropriate and does not impose unreasonable costs on

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[73] *U.S. Steel Corp. v. Pa. Pub. Util. Comm'n*, 390 A.2d 849, 863 (Pa. Cmwlth. 1978).

[74] *Pa. Pub. Util. Comm'n v. PECO Energy Co. – Gas Division, et al.*, Docket Nos. R-2020-3018929, *et al.*, 2021 WL 2645922, at *21-23 (Opinion and Order entered Jun. 22, 2021).

[75] *Bluefield*, 262 U.S. at 692-93

[76] *Carnegie*, 1980 WL 140939, at *9.

ratepayers. As Mr. D'Ascendis testified, the actual capital structure of the Company benefits customers:

> To the contrary, CWC's relatively strong capital structure benefits both the Company and its ratepayers by providing financing flexibility and access to capital when required as evidenced by its lower cost of debt than the much larger Utility Proxy Group. In view of all of the above, the Commission should continue to approve the Company's actual capital structure for ratemaking purposes.[77]

The Company's capital structure allows the Company to maintain a healthy balance sheet so that the Company has access to capital on reasonable terms in order to make necessary investments. As further stated by Mr. D'Ascendis:

> Safe and reliable service cannot be maintained at a reasonable cost if utilities do not have the financial flexibility and strength to access the competitive markets on reasonable terms. The authorization of a capital structure other than the Company's actual capital structure will weaken its financial condition and adversely impact the Company's ability to address expenses and investment, to the detriment of customers and shareholders. Safe and reliable service for customers cannot be sustained over the long term if the interests of shareholders and bondholders are minimized such that the public interest is not optimized.[78]

In other words, as Mr. D'Ascendis noted, the Commission must balance the needs of both the Company and the customers, not just the customers as the OCA and I&E have proposed here.

That is why, contrary to the OCA's claims, adopting a hypothetical capital structure would be detrimental to the Company's ability to provide safe, reasonable, and adequate service. It would unreasonably reduce an investor's expected return on a portion of their investment in the Company, leaving Columbia Water as an unattractive investment and investors potentially walking away.[79] As Mr. D'Ascendis testified this could be problematic because it would require the Company to

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[77] CWC St. 4-R at 6:10-14.
[78] CWC St. 4 at 17:16-23.
[79] CWC St. 4-RJ at 8:5-11.

increase its financial risk and obtain more debt financing at higher, detrimental interest rates, potentially default on existing loan obligations, which would impact the Company's ability to raise capital and borrow money at reasonable terms.[80] Such a result would be detrimental to both the Company and its customers.

Lastly, although the Company's capital structure is slightly more equity rich than the proxy group, as discussed in the Company's Main Brief, the OCA and I&E have failed to show that the Company's actual capital structure is uneconomic or unreasonable, nor that the Company has abused its discretion in managing its capital structure. Company M.B. at 56. The Company was acting in accord with previous Commission decisions, has benefitted from its capital structure in the form of lower interest rates, and has made an appropriate financial risk adjustment in its ROE analysis to appropriately recognize that the Company has slightly less financial risk than the proxy group.

For all these reasons, the recommendations of OCA and I&E regarding adopting a hypothetical capital structure should be denied.

C. RETURN ON COMMON EQUITY

1. Response to I&E's Position on Cost of Common Equity

The Company will address specific responses to each of the claims made by I&E in its Main Brief regarding the cost of common equity. For the reasons set forth below, I&E's position should be denied.

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[80] CWC St. 4-RJ at 6:5-21; *see also* CWC St. 1-RJ at 4:11 – 5:11.

a. *I&E's Exclusion of Essential Utilities, Inc. From its Barometer Group Should Be Rejected*

I&E witness Keller applied different selection criteria than Company witness D'Ascendis.[81] I&E M.B. at 19. Mr. Keller's and Mr. D'Ascendis' proxy groups differed in that Mr. Keller excluded Essential Utilities, Inc. ("Essential") and Mr. D'Ascendis' proxy group ("Utility Proxy Group") included Essential. I&E witness Keller excluded Essential "because it violated his criteria that 50% or more of the company's revenues be generated from regulated water utility operations." I&E M.B. at 19.

The Company discussed why Essential is appropriate to include in Mr. D'Ascendis' Utility Proxy Group – the better measure is earnings, not revenue as Mr. Keller suggests. Company M.B. at 61-62. Measures of income are far more likely to be considered by the financial community in making credit assessments and investment decisions than are measures of revenue.[82] It should be noted that the OCA also relies on the Utility Proxy Group of Mr. D'Ascendis. OCA M.B. at 44. Moreover, as recently as 2021, I&E included Essential in its proxy group.[83] Company M.B. at 62. Thus, the Company continues to submit that the Commission should accept the Utility Proxy Group set forth in Mr. D'Ascendis' Direct Testimony.[84]

b. *I&E Failed to Place Reliance on Multiple Financial Models*

Of all the cost of equity witnesses in this proceeding, Company Witness D'Ascendis was the only one to use a full array of methodologies available to estimate the cost of common equity, including the Discounted Cash Flow ("DCF") method, the Risk Premium Model ("RPM"), and the Capital Asset Pricing Model ("CAPM"), including the Empirical CAPM ("ECAPM"), to evaluate

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[81] *Compare* CWC St. 4 at 14:14 – 15:6 *with* I&E St. 2 at 9-10.
[82] CWC St. 4-R at 85:3-11.
[83] *Aqua 2021*, 2022 WL 1732770, at *77.
[84] CWC St. 4 at 15:7-9.

the market cost of capital for the Utility Proxy Group. Company M.B. at 62-69. Mr. D'Ascendis also selected a group of twenty domestic, non-price regulated companies ("Non-Utility Proxy Group") comparable in total risk to his group of six water companies and applied the same three cost-of-equity models as additional data points to consider. Company M.B. at 67-69.

I&E criticized Mr. D'Ascendis' use of multiple models in its Main Briefs. I&E states in its Main Brief that I&E witness Keller's DCF-only analysis, while using a CAPM for comparison, is consistent with the methodology commonly endorsed by the Commission in base rate proceedings. I&E M.B.at 26. I&E also criticizes Company witness D'Ascendis' concerns with the DCF that it has a tendency to understate the return required by investors because the market-to-book ratio for the proxy group companies is above 1.0. I&E M.B. at 31-32.

I&E, however, fails to recognize that all cost of common equity models have underlying assumptions that are not true in reality and that to gain the most insight into the investor-required return on common equity, an analyst must look at multiple models and using their judgment, arrive at their opinion. Mr. D'Ascendis supplied a number of references from the financial literature supporting his use of multiple models.[85]

Indeed, Company witness D'Ascendis provided adequate evidence demonstrating the flaws inherent in the DCF model, particularly where market value exceeds book value:

> CWC Exhibit No. DWD-1R, page 1 demonstrates how Mr. Keller's market based DCF cost rates, when applied to a book value substantially below market value, will understate investors' required return on market value. As shown, there is no realistic opportunity to earn the expected market-based rate of return on book value. Using Mr. Keller's DCF cost rate, for example, in Column [A], investors expect a 7.84% return on an average market price of $88.04 for Mr. Keller's proxy group. Column [B] shows that when Mr. Keller's 7.84% return rate is applied to a book value of $28.57, 32 the total 1 annual return opportunity is $2.24. After subtracting dividends of $1.77, the investor only has the opportunity for $0.47

[85] CWC St. 4 at 18:10-19:23; CWC St. 4-R at 17:1 – 22:28.

> in market appreciation, or 0.53%. The magnitude of the understatement of investors' required return on market value using Mr. Keller's 7.84% cost rate is 5.30%, which is calculated by subtracting the market appreciation based on book value of 0.53% from Mr. Keller's expected growth rate of 5.83%.[86]

I&E does not dispute the underlying premise that market-to-book ratios for utilities often significantly exceed unity, (*i.e.,* a market-to-book ratio of 1.0) but alleges that this relationship should not impact the Commission's analysis because investors are aware that regulators assess utility returns based on book value. *See* I&E M.B. at 32. Other than a conclusory statement from its witness with no reference to financial literature or empirical analysis, I&E offers no support for its assertion that the Commission should disregard the impact of higher market-to-book ratios on the reasonableness of DCF results.

Moreover, the Commission most recently determined that it was appropriate to utilize other financial models, like the CAPM, because the DCF has certain limitations. As stated in *Aqua 2021*:

> We are persuaded by the arguments of Aqua that the ALJ erred by concluding I&E used its DCF and CAPM results to determine Aqua's ROE. In this regard, we note that although I&E did use its CAPM as a comparison to its DCF result, it made no CAPM based adjustment to its final ROE recommendation. I&E M.B. at 47. As Aqua points out, infra, the U.S. economy is currently in a period of high inflation. To help control rising inflation, the Federal Open Market Committee has signaled that it is ending its policies designed to maintain low interest rates. Aqua Exc. at 9. *Because the DCF model does not directly account for interest rates, consequently, it is slow to respond to interest rate changes. However, I&E's CAPM model uses forecasted yields on ten-year Treasury bonds, and accordingly, its methodology captures forward looking changes in interest rates*.[87]

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[86] CWC St. 4-R at 18:23 – 19:6.

[87] *Aqua 2021,* 2022 WL 1732770, at*89 (emphasis added).

Thus, the Commission, in fact, rejected I&E's stated position in this case and signaled that consideration of multiple financial models is more appropriate. For these reasons, Mr. D'Ascendis' proposal is more appropriate as it uses a greater number of models as applied to a greater number of regulated and non-regulated companies that are similarly situated to the Company. Based on these results, Mr. D'Ascendis used his reasonably informed judgment to develop an ROE range and then set the Company's ROE at the lower end of his range.[88]

c. *I&E's CAPM Analysis Contains Several Flaws*

In its Main Brief, I&E states that its CAPM analysis performed by Mr. Keller resulted in an 11.09% indicated return on equity. I&E M.B. at 22. As discussed in the Company's Main Brief, I&E's CAPM analysis is flawed because I&E witness Keller relies on the projected 10-Year Treasury Bond yield to determine his risk-free rate of return. Company M.B. at 77-78. As Mr. D'Ascendis noted, this is the incorrect measure because medium-term Treasury bonds do not match the life of the assets being valued.[89] Conversely, both Mr. D'Ascendis and Mr. Garrett rely on the 30-Year Treasury Bond yield. Company M.B. at 78; *see also* OCA M.B. at 48. Additionally, Mr. Keller's CAPM analysis fails to reflect the longest projection available for determining the risk-free rate by not incorporating *Blue Chip* forecasts for the period 2030-2034 when determining his risk-free rate, which is inconsistent with the Efficient Market Hypothesis ("EMH").[90] Company M.B. at 78-79.[91] Lastly, Mr. Keller fails to use the ECAPM, which appropriately corrects for the CAPM's tendency to underestimate the performance of low-stock betas.[92] Company M.B. at 64.

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[88] *See* CWC St. 4 at 4:7-8.
[89] CWC St. 4-R at 28:7-26.
[90] CWC St. 4-R at 29:13-19.
[91] Citing CWC St. 4-R at 30:2-19 (footnote omitted).
[92] CWC St. 4 at 39:22-23.

d. *Mr. D'Ascendis' Use of the PRPM is Reasonable*

I&E next makes several arguments criticizing the Company's use of the Predictive Risk Premium Model ("PRPM"). I&E argues that Company witness D'Ascendis (1) inappropriately relied upon statistical software to perform his PRPM, (2) the PRPM does not solve the problem of the RPM because it is still an indirect measure of the cost of equity and it uses historic data that may not represent the current or future economic conditions, (3) that the PRPM is not commonly used, and (4) that the PRPM uses proprietary software. I&E M.B. at 28.

I&E's arguments are without merit. As Mr. D'Ascendis reasonably explained, the traditional RPM utilizes a predicted equity risk premium, which is generated by the prediction of volatility or risk.[93] However, the PRPM, which was published in the *Journal of Regulatory Economics* and *The Electricity Journal*, was developed from the work of Robert F. Engle who found that volatility in prices and returns cluster over time and, therefore, can be highly predictable such that historic prices and returns can be used to predict future levels of risk and risk premiums.[94] Using historic returns from the Utility Proxy Group to determine the appropriate risk premium is appropriate for those reasons. Moreover, Mr. D'Ascendis' indicated ROE from his RPM analysis is based on average of his PRPM and his Total Market Approach Risk Premium Model to ensure a balanced result.[95] Thus, Mr. D'Ascendis reasonably weights multiple models to determine the appropriate indicated ROE from his RPM analysis.

e. *Mr. D'Ascendis' CAPM Analysis is Reasonable and Appropriate*

I&E criticizes Mr. D'Ascendis' CAPM analysis for several reasons. I&E argues that the use of the 30-Year Treasury Bond yield is not the correct basis for determining the risk-free rate

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93 CWC St. 4 at 24:11-12.
94 CWC St. 4 at 24:3-14.
95 CWC St. 4 at 36:4-6.

because the 10-year Treasury Note is appropriate given that it will cover the time period in which Columbia's rates are expected to be in effect and appropriately balances the short-term volatility risk and the long-term inflation risk. I&E M.B. at 29-30.

The Company credibly addressed these concerns in its Main Brief. Company M.B. at 77-78. Simply put, the 30-Year Treasury Bond yield better matches the perpetual claim on cash flows provided by equity securities:

> [b]ecause common stock is a long-term investment and because the cash flows to investors in the form of dividends last indefinitely, the yield on very long-term government bonds, namely, the yield on 30-year Treasury bonds, is the best measure of the risk-free rate for use in the CAPM… The expected common stock return is based on long-term cash flows, regardless of an individual's holding time period.[96]

The OCA likewise relies on the 30-Year Treasury Bond yield to develop its risk-free rate in this proceeding. OCA M.B. at 48. Thus, this is the proper measure of the risk-free rate for the CAPM analysis.

I&E next argues that the Company's ECAPM analysis is not reasonable as it merely adds a measure of subjectivity to the CAPM as an attempt to refine its predicted Security Market Line ("SML") through an additional factor that corrects none of the underlying problems of the model. I&E M.B. at 30.

I&E's mere speculation that the ECAPM adds a measure of subjectivity to the CAPM, should be rejected. The Company reviewed financial literature explaining that the traditional CAPM assumes an overly steep predicted SML that is corrected by the empirical SML in the ECAPM. *See* Company M.B. at 63-65. Nevertheless, Mr. D'Ascendis applies both the traditional

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[96] CWC St. 4-R at 28:7-26 (citing Morningstar, Inc., 2013 Ibbotson Stocks, Bonds, Bills and Inflation Valuation Yearbook, at 44; Morin, at 169) (footnote omitted).

CAPM and ECAPM to the companies in the Utility Proxy Group and averages his results to achieve a conservative estimate.[97] Thus, the arguments of I&E should be denied.

f. *Size Adjustment*

I&E's Main Brief opposes the Company's proposed size adjustment. *See* I&E M.B. at 33-35. Per the Company's Main Brief, I&E's efforts to discredit the existence of a size risk, the relevance of the size risk analysis from Dr. Zepp, and Mr. D'Ascendis' independent size risk analysis are not credible and should be disregarded. Company M.B. at 70-74. I&E first references an Ibbotson Stocks, Bonds, Bills, and Inflation: 2015 Yearbook ("SBBI Yearbook") showing year-to-year variance in returns for large and small-capitalization stocks listed on the New York Stock Exchange ("NYSE"), American Stock Exchange ("AMEX"), and National Association of Securities Dealers Automated Quotations ("NASDAQ") and argues that the fact that large capitalization stocks outperform small capitalization stocks at times refutes the existence of size risk. I&E M.B. at 48. However, the very analysis cited by I&E also invalidates I&E's characterization of the study as a conclusive rebuttal to the existence of size risk, noting that the findings merely "led some market observers to speculate that there is no size premium." I&E M.B. at 33, note 93 (emphasis added). The Company's reliance on published industry data affirming continued acceptance of size risk far outweighs I&E's reference to speculation among some unquantifiable observers in the industry.

I&E's suggestion that Dr. Zepp's study is irrelevant must also fail. The Company's Main Brief presented arguments affirming Dr. Zepp's study as an authoritative and utility-specific rebuttal to the flawed study conducted by Dr. Wong. See Company's M.B. at 72-73. With that argument addressed, I&E pivots to arguing that the Zepp article does not contain enough credible

[97] CWC St. 4 at 42:5-9.

evidence because it is based on two studies, one of which is a study completed by the California Public Utilities Commission staff in 1991 and is not included in the article, and the other being a study which examines the effects of size on four water utility companies. See I&E M.B. at 34. However, rate of return fundamentals are uniform among water utilities, as even the seminal *Bluefield* case addressed rate of return for a water utility generally. Accordingly, the Zepp article is a relevant and credible rebuttal to Dr. Wong's study.

Lastly, I&E's criticism of Mr. D'Ascendis' size study as having limited explanatory power ignores Mr. D'Ascendis' comments explaining his findings. Mr. D'Ascendis' utility size study produced a statistically significant link between size and risk for utilities. Company's M.B. at 73-74.[98] I&E improperly emphasizes only Mr. D'Ascendis' general observation without reference to the context explaining that his study confirms the inverse relationship between utility size and risk.

2. Response to OCA's Position on Cost of Common Equity

The Company will address specific responses to each of the claims made by the OCA in its Main Brief regarding the cost of common equity. For the reasons set forth below, the OCA's position should be denied.

a. *The OCA's CAPM Analysis is Flawed, whereas the Company's CAPM Analysis is Appropriate*

In its Main Brief, the OCA set forth its CAPM analysis, wherein OCA witness Garrett obtained an indicated ROE of 8.2%. OCA M.B. at 47. While the OCA and the Company agree on the use of the 30-Year Treasury Bond yield as the appropriate risk-free rate, the Company and the OCA disagree regarding the Equity Risk Premium ("ERP"). The OCA's ERP is developed based upon surveys and the implied ERP methods for analyzing the CAPM for Columbia Water. OCA M.B. at 49. In turn, the OCA criticized Company witness D'Ascendis' analysis because he

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[98] Citing CWC St. 4-R at 36:4-13.

uses the ECAPM, which in the OCA's words, double-counts upward adjusted betas. OCA M.B. At 50-51.

The Company, however, discussed at length in its Main Brief, why the OCA's method for determining the ERP is flawed. Company M.B. at 80-83. The Company demonstrated that surveys of expected returns are of little value,[99] OCA witness Garrett's own sources contradict his use of a survey of expected returns,[100] and that Mr. Garrett's implied ERP relies on a set of questionable assumptions that, when changed, produce markedly different outcomes.[101] Company M.B. at 80-84. For these reasons, Mr. Garrett's ERP is flawed.

Additionally, as the Company has discussed both in its Main Brief and above, in response to I&E, the ECAPM appropriately corrects the CAPM's tendency to underestimate the future earnings potential of low-beta stocks. Company M.B. at 63-64.[102] Furthermore, the notion that betas already account for this tendency is incorrect. As Mr. D'Ascendis testified:

> A 1980 study by Litzenberger, et al. found the CAPM underestimates the ROE for companies, such as public utilities, with betas less than 1.00. In that study, the authors applied adjusted betas and still found the CAPM to underestimate the ROE for low-beta companies. Similarly, Brattle Group's Risk and Return for Regulated Industries supports the use of adjusted betas in the ECAPM:
>
> > Note that the ECAPM and the Blume adjustment are attempting to correct for different empirical phenomena and therefore both may be applicable. It is not inconsistent to use both, as illustrated by the fact that the Litzenberger et.al (1980) study relied on Blume adjusted betas and estimated an alpha of 2% points in a short-term version of the ECAPM. This issue sometimes arises in regulatory proceedings.[103]

99 CWC St. 4-R at 48:22 – 49:9.
100 CWC St. 4-R at 50:1-38 (footnotes omitted).
101 CWC St. 4-R at 51:9-21; *see also* CWC St. 4-R at 52:1-2.
102 Citing CWC St. 4 at 37:9-16; CWC St. 4 at 38:1.
103 CWC St. 4-RJ at 13:6-18.

Moreover, betas are adjusted because of their general regression tendency to converge toward 1.0 over time, i.e., over successive calculations of beta.[104] This is not to be confused with the slope of the SML, which empirically has understated the ROE for low-beta companies. For these reasons, the OCA's criticisms of the ECAPM are without merit.

b. *The OCA's Position on Mr. D'Ascendis' Size Adjustment Should be Denied*

In its Main Brief, the OCA asserts that Mr. D'Ascendis' size adjustment should be denied because it is arbitrary, OCA M.B. at 52, that the size phenomenon no longer exists noting that in the 1980's small-cap fund underperformed relative to large-cap stocks, OCA M.B. at 52, that small utilities do not face the same risks that competitive enterprises face, OCA M.B. at 53, and that the PENNVEST surcharge and recovery of its related tax impacts reduces the risk the Company faces such that a size adjustment is not warranted, OCA M.B. at 53-54. These arguments are without merit.

As the Company explained at length in its Main Brief, Company witness D'Ascendis cited numerous studies and reports confirming the existence of the size phenomenon. Company M.B. at 71-73. The financial literature confirms "that the capital market demands higher returns on stocks of small firms than on otherwise similar stocks of the large firms."[105] Mr. D'Ascendis also responded to OCA witness Garrett's concern that in the 1980's small-cap stocks underperformed large-cap stocks:

> The issue with Mr. Garrett's position is that the size premium measures the increased risk associated with a company's smaller size; Mr. Garrett is only focused on returns. As I discussed in my Direct Testimony, smaller companies face increased business risk as they are less equipped to cope with significant events that affect sales, revenues, and earnings, as the loss of a few larger customers

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[104] CWC St. 4-RJ at 11:19-20.
[105] CWC St. 4 at 48:16-24.

> will have a greater effect on a smaller company than a larger company.
>
> This is further evident when we consider that increasing capital costs (i.e., risk) for one set of securities will put downward pressure on those securities as investors transition to securities with lower risk. Under this premise, the underperformance is directly tied to the increase in risk. As such, Mr. Garrett's premise that smaller companies' underperformance indicates a reduction of risk is in fact the opposite – underperformance indicates an increasing level of risk.[106]

Mr. D'Ascendis even conducted his own study demonstrating that there was a statistically significant link between size and risk. Company M.B. at 73-74. Neither I&E nor OCA rebutted Mr. D'Ascendis' study in their surrebuttal testimonies nor did they cross examine him on the results of those studies. Thus, the Company has provided evidence demonstrating the existence of the small size effect and the adjustment is not arbitrary for those reasons.

Moreover, a fair return on rate base is one that is "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 . . ."[107] In this regard, Company witness D'Ascendis has demonstrated that the small size of Columbia Water relative to the proxy group is a "significant element of business risk for which investors expect to be compensated through greater returns."[108] It would be unreasonable to deny the Company a size adjustment due to the nature of the regulatory environment in which it exists or merely because it implements a surcharge mechanism to pay its PENNVEST loans as the OCA suggests. This has not previously prevented the Commission from recognizing that size as an indicator of greater risk for smaller utilities, as occurred in *Pa. Pub. Util. Comm'n v. Citizens' Electric Company of*

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106 CWC St. 4-R at 56:9-21.

107 *Bluefield*, 262 U.S. at 692-93

108 CWC St. 4-R at 34:4-6.

Lewisburg, PA, Docket No. R-2019-3008212, 2020 WL 2487407 (Opinion and Order entered Apr. 27, 2020).

The Commission also previously recognized the Company's small size in setting the Company's ROE in past cases, stating:

> Based on our review of the testimony, data, and cost models presented, we believe that the evidence in this case supports an ROE finding in the reasonable range of 9.25% to 10.25% using the DCF method as the foundation. The equity-heavy capital structure of Columba indicates that a slightly lower ROE is appropriate. *However, the small size of the Company, its management effectiveness, and the results of other ROE models other than the DCF are all reasons to set a higher ROE*. Therefore, within our indicated range of reasonableness, we conclude that an ROE of 9.75% is appropriate for our ratemaking determinations herein.[109]

Thus, the Commission should find that the Company's smaller size relative to the Utility Proxy Group requires recognition of a size adjustment corresponding to that risk.

c. *The OCA's Alternative Recommendation Should be Denied*

The OCA argues that if the Commission does not adopt the OCA's recommended capital structure, the Commission should approve a much lower ROE than 9.4%, to recognize that the results of the CAPM and other models indicate the DCF result is high. OCA M.B. at 55. Specifically, the OCA recommends an ROE of no higher than 8.8%, which is the median result of Mr. Garrett's recommended ROE range. OCA M.B. at 55. The OCA argues that this is necessary to offset the increased capital costs that would occur under the Company's capital structure. OCA M.B. at 55.

The OCA's alternative recommendation should be denied. As set forth above, the OCA's range of ROEs, which is based on the OCA's CAPM result (low-end) and DCF result (high-end), is not an appropriate range because, for the reasons stated above and in its Main Brief, (1) the

[109] *CWC 2013*, 2014 WL 316891, at *29.

OCA's CAPM analysis contains numerous errors (Company M.B. at 80-84), (2) the OCA's analysis also fails to consider the other financial models that Company witness D'Ascendis relies upon in formulating his decision, such as applying the RPM and comparing his results to the Non-Utility Proxy Group, and (3) the OCA does not make an appropriate size adjustment in recognition of the small size of the Company relative to the Utility Proxy Group (Company M.B. at 69-74).

Rather, the Company's ROE analysis indicates the appropriate financial risk adjustment to make based upon the Company's actual capital structure. *See* Company M.B. at 74-75. Thus, the OCA's alternative recommendation to substantially reduce the Company's ROE if the Company's actual capital structure is used should be denied.

D. CONCLUSION

The weight of evidence on the appropriate rate of return in this proceeding supports a capital structure of 36.66% long-term debt and 63.34% common equity at cost rates of 3.15% and 11.25%, respectively, as recommended by Company witness D'Ascendis. This results in an overall rate of return of 8.28% for the Company.[110] The failure to grant the Company an adequate overall return will make it more difficult to meet its capital requirements and access capital markets at a reasonable cost and provide reliable and high-quality service for its customers.

VIII. MISCELLANEOUS ISSUES

A. QUALITY OF SERVICE

1. Isolation Valves

In its Main Brief, the OCA recommends that the Commission require the Company to:

> Exercise valves to isolate fire hydrants from the distribution system annually.
>
> Exercise critical isolation valves on a one-to three-year cycle.

[110] CWC St. 4 at 55:4-8.

> Within the next five years, exercise all non-critical isolation valves that CWC has no record of exercising within the past ten years (some number smaller than 1,425 valves). Subsequently, exercise all non-critical isolation valves on a seven-to ten-year cycle. The requirements for exercising non-critical isolation valves should not apply to in-line isolation valves that cannot be exercised on a regular schedule, non-isolating valves such as at the end of a main extension or cul-de-sac, pressure reducing valves, or check valves.
>
> Continue to file reports on its valve exercising activities consistent with the settlement of the 2017 base rate proceeding (see, supra, footnote 31).
>
> ***
>
> In its next base rate case filing, include a report on the number of critical valves and non-critical valves that were not exercised during the five-year period ending the most recent calendar year prior to the rate case filing.

OCA M.B. at 75-76. The OCA's recommendation is based on the testimony of OCA Witness Terry L. Fought who stated that "[i]t is important to exercise isolation valves to prevent the valves from seizing up and getting stuck from corrosion or other deposits adjacent to the valve." OCA M.B. at 72. The OCA also bases its recommendation on the testimony of Company witness Lewis who stated that the Company is "on par to substantially comply with a recommendation to exercise solely the 1,425 non-critical valves." OCA M.B. at 73. The Company submits that the OCA's recommendations should not be accepted.

As a general matter, the Commission may not interfere with the lawful management decisions of a utility, including decisions related to the necessity and propriety of operating expenses, unless the Commission finds an abuse of the utility's managerial discretion based on record evidence.[111] Moreover, "it is well established that a public utility has the right to manage its own affairs to the fullest extent consistent with the public interest. It is not within the province

[111] *Nat'l Fuel Gas Dist. Corp. v. Pa. Pub. Util. Comm'n,* 464 A.2d 546 (Pa. Cmwlth. 1983); *see also Emporium Water Co. v. Pa. Pub. Util. Comm'n,* 955 A.2d 456 (Pa. Cmwlth. 2008), *app. den.* 961 A.2d 860 (Pa. 2008).

of the Commission to interfere with the management of a utility unless an abuse of discretion or arbitrary action is established."[112]

In this case, the Company has provided evidence that it has exercised all its critical isolation valves within the past five years.[113] The Company has also provided evidence of its significant efforts over the past few years to exercise its isolation valves in accordance with the 2017 rate case settlement:

> Columbia took prompt steps to comply and has routinely exercised system isolation valves, including critical valves, exercising 136 valves (135 critical valves) in 2018, 342 valves (126 critical valves) in 2019, 456 valves (131 critical valves) in 2020, 356 valves (135 critical valves) in 2021, and 497 valves (150 critical valves) in 2022. See Annual Reports filed at Docket No. R-2017-2598203. (https://www.puc.pa.gov/pcdocs/1769777.pdf)[114]

Please note that data for 2023 was not entered into the record as efforts are still ongoing and such data is not yet available. Nonetheless, the Company also provided testimony indicating that it is on par to exercise the remaining 1,425 non-critical isolation valves over the next four years to complete its requirement from the last rate case.[115] Thus, the Company has provided sufficient evidence that it is complying with the last rate case settlement, has implemented the recommendations originally requested by the Bureau of Audits in 2014, and is providing service that is reasonable and consistent with the public interest. *See also* Company M.B. at 87-92.

Conversely, the OCA and OCA witness Fought do not have the same familiarity with Company operations and are not positioned to make recommendations about how the Company should operate its system. For example, in its Main Brief, the Company explained why OCA

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[112] *Pa. R.R. Co. v. Pa. Pub. Util. Comm'n*, 146 A.2d 352, 355 (Pa. Super. 1958), *rev'd on other grounds* (Pa. 1959).

[113] CWC St.1-R at 9:1-3.

[114] CWC St. 1 at 9:3-8.

[115] CWC St. 1-RJ at 6:12-15.

witness Fought was wrong when he stated it is required practice to fully close valves during main breaks, *i.e.*, the valves often times remain open to maintain positive pressure.[116] Company M.B. at 89. The Company explained that its isolation valves are designed to remain open and that manufacturers know this, such that gate valves are designed with resilient seats.[117] Company M.B. at 90. The Company also confirmed that it has had less than five valves with trouble closing in the past 10 years of exercising thousands of valves.[118] Company M.B. at 90. Furthermore, Mr. Fought has demonstrated his inexperience with the latest technology in record-keeping, suggesting that the Company's ArcGIS data, which is the industry standard, is not appropriate for maintaining the Company's valve exercising records.[119] Company M.B. at 91.

All these facts demonstrate that: (1) the Company is best positioned to make determinations about system operations and the frequency of valve exercising and (2) the OCA has failed to show any harm to the public interest or abuse of discretion by the Company and the frequency of its valve exercising. The Commission should not interfere here, but rather let the Company continue its existing efforts and reporting consistent with the requirement from the 2017 rate case.

The OCA's recommendation is likewise deficient for failing to provide an expense allowance for the proposed tasks. If the OCA's recommendation is adopted, which it should not, the Company would have to implement a parallel schedule for critical isolation valves (every 1 to 3 years), non-critical isolation valves (every 5 to 10 years), and fire hydrant valves (annually). Moreover, the requirement to exercise *every* fire hydrant isolation valve annually is a new effort that the Company is not currently undertaking for rational and sound reasons.[120]

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[116] CWC St. 1-R at 4:10-19

[117] CWC St. 1-R at 6:11-19.

[118] *Id*.

[119] CWC St. 1-RJ at 6:4-15.

[120] *See* CWC St. 1 at 9:3-8.

In its Main Brief the Company explained the types of costs these activities will generate due to the large number of valves in its system:

> Regarding the cost of exercising valves, exercising one valve requires employees, traffic control devices, road closing permits, etc. Columbia Water's system has 3,481 valves. Two to four employees or contractors are needed just to flag and control the traffic, depending on road configurations. Another two employees or contractors are required to open the valve box and exercise the valve. A twelve-inch valve requires 38 turns to open and 38 to close. A large tee-handled wrench is used to operate the valve requiring two people to turn the wrench. Once the valve is operated it must be inspected to assure the valve packing is not leaking. To repair any packing found to be leaking, the valve needs to be excavated. To exercise every valve in a five-year period would mean dedicating three full time employees, at a minimum (two to flag traffic and one at minimum to turn the valve), to turn 3,481 valves. (More employees are needed for traffic control in four way intersections.) That equates to 696 valves a year or 58 valves a month. Thus, to exercise all of the isolation valves in a 5 year period, the Company would need to, at a minimum, hire three full time employees. In addition, the Company would need to purchase two vehicles and traffic control equipment for each vehicle. The Company estimates that the annual cost to exercise all its valves on the five-year schedule Mr. Fought proposes, would be $500,000 per year and plus $100,000 in capital for vehicles, tools and traffic control devices.[121]

Simply put, the Company will incur significant additional costs if this becomes a prospective Commission-required mandate. The OCA, however, has made no such allowance.

The Commission has previously held that the OCA's failure to provide an allowance for the estimated costs was reason enough to deny the OCA's proposal:

> Upon review of the record, we conclude that the OCA did not meet its burden of proving that requiring a five-year inspection cycle for non-critical isolation valves is necessary or will be cost-beneficial to Aqua's system. The OCA did not provide any cost estimates for the implementation of its recommended five-year program. Without any cost estimates, it is not possible to determine whether any benefits from the accelerated program will be commensurate with its costs. The costs associated with any additional time and workforce needed for the program could exceed its operational

[121] CWC St. 1-R at 5:3-20.

> benefit and render it inefficient and redundant. For these reasons, we will not require Aqua to implement a five-year inspection cycle for non-critical isolation valves.[122]

The OCA's recommendation suffers the same faults here and should likewise be rejected. Both because the OCA has not made any allowance for these activities and because the OCA has not demonstrated that the benefits outweigh the potential costs.

For these reasons, the OCA's recommendation should be denied. If the Commission accepts the OCA's recommendation, the Commission will be impermissibly acting as a superboard of directors, essentially telling the Company how to manage its business and what to focus on. It will require the Company to either reduce its efforts in other areas or hire more people to accomplish those tasks. The Company will be required to make the OCA's recommendation a priority over other tasks, without the ability to use its discretion as to what requires the most attention. This is why the Commission must refrain from interfering with a public utility's operations, absent a showing of an abuse of discretion that is inconsistent with the public interest. The OCA, however, has failed to demonstrate any abuse of discretion such that the Commission should interfere here.

2. Complaint Log

In its Main Brief, the OCA recommends that, based on the testimony of Mr. Fought, that the Company should be required to record additional detail in its complaint log regarding (1) the character of the complaint, including but not limited to whether a water quality complaint is due to sediment, cloudiness, discoloration, which would indicate what may be the possible cause and (2) whether or not the action taken by the Company resolved the customer's complaint. OCA M.B

[122] *Aqua 2021*, 2022 WL 1732770, at *214.

at 78. The OCA also requests that the log be provided in Excel format. OCA M.B. at 78. The OCA then attached the complaint log to their Main Brief. OCA M.B. at 77.

The Company's position opposing the OCA's recommendation is set forth in its Main Brief. Company M.B. at 92-93. The OCA is unnecessarily concerned about a one-page complaint log, rather than recognizing the Company's miniscule number of customer complaints since 2020. Moreover, the Company's complaint log provided both the nature of the customer complaint and the Company's response. This is fully consistent and compliant with Section 65.3(b) of the Commission's regulations.[123] Conversely, the OCA's recommendation that the Commission require the Company to state whether the complainant was 'satisfied' or 'resolved' is problematic because that term is not defined. It is also a subjective term that is inconsistent with the Commission's regulations. Rather, the information provided by the Company is appropriate. To the extent the OCA wants additional information after receiving the complaint log in the next base rate case, it can do so during the discovery process.

IX. RATE STRUCTURE

A. COST OF SERVICE

As stated in the Company's Main Brief, the Company's Cost of Service Study ("COSS") uses the Base-Extra Capacity Method, as described in the water rates manual published by the American Water Works Association ("AWWA") entitled "M1 Principles of Water Rates, Fees, and Charges," to allocate pro forma costs. Company witness Fox explained the steps associated with the Base-Extra Capacity Method in his direct testimony.[124]

The OCA accepted the Company's use of the Base-Extra Capacity Method. *See* OCA M.B. at 59. I&E did not challenge the Company's use of the Base-Extra Capacity Method, but did

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[123] 52 Pa. Code § 65.3(b)
[124] CWC St. 3 at 8:14 – 9:4.

disagree with the Company's customer cost analysis. I&E M.B. at 36-39. OSBA likewise did not challenge the use of the Base-Extra Capacity Method, but disagrees to the extent the Company did not prepare a customer class demand study and had to estimate max-day and peak-hour peaking factors by rate tier. OSBA M.B. at 6-7. The OSBA also raises concerns regarding the Company's decision to functionalize 30% of Transmission and Distribution (T&D") O&M Expense as customer-related. OSBA M.B. at 7.

With respect to I&E's concerns regarding the customer cost analysis, the Company disagrees with I&E for the reasons set forth in its Main Brief. Company M.B. at 102-103. As Mr. Fox stated, indirect costs, such as those functionalized as customer-related in this proceeding, are essential to providing service to customers:

> The indirect costs, as described by Mr. Mierzwa, are essential for providing service to customers, especially with regard to maintaining facilities, services, and meters, and should not be limited to only "direct" costs associated with connecting and maintaining a customer's account. Mr. Mierzwa took exception with the allocation of several operation and maintenance expenses, such as indirect general and administrative expenses, building rental expenses, bad debt expense, and office furniture and equipment costs. These functions are critical to providing safe and reliable service. Meters and services would not be maintained and repaired without them. Customer service functions would not exist. Bad debt expenses are a function of customer service and billing. These expenses have a direct correlation with providing customer, billing, meter, and service to customers, and it is more than reasonable to include these functions within the customer charges.[125]

For those same reasons, the Company's decision to functionalize 30% of T&D O&M expense as customer-related is appropriate. As Mr. Fox stated, T&D O&M Expenses "are not just for maintaining the transmission and distribution pipes. These costs are also included, in part, for the maintenance and repair of meters and services."[126] The Company would not have the ability to

125 CWC St. 3-R at 8:17 – 9:1.
126 CWC St. 3-R at 7:1-5.

service customers without these expenses. The Commission has likewise recognized this principle. In *Aqua 2021*, the ALJ stated that:

> While the Commission generally disfavors the inclusion of indirect costs into the calculation of customer charges, the Commission has nevertheless permitted the allocated portions of certain indirect costs such as employee benefits, local taxes and other general and administrative costs. I find that Aqua's witness adequately demonstrated that the indirect costs included in her study fall within the ambit of permissible general and administrative costs.[127]

In affirming the ALJ's analysis the Commission sated:

> Upon our consideration of the evidence and record herein, we conclude that the ALJ correctly recommended that, consistent with the *Aqua 2004 Order*, and subsequently affirmed in the *2012 PPL Order*, other customer-related costs are properly includable in a customer cost analysis. We find that the OCA proposed limitation of costs excludes customer costs that should be included in a customer charge and is unreasonably narrow.[128]

The Company's inclusion of these customer-related costs in its customer cost analysis likewise falls within the ambit of permissible general and administrative costs that are considered customer-related.

Regarding the OSBA's concern related to the customer class demand study, Company witness Fox stated that the Company did not possess daily or hourly consumption data, by customer class, necessary to perform a customer class demand study.[129] The OSBA likewise recognized that Pennsylvania water utilities do not typically have this data. OSBA M.B. at 6. While the OSBA argues that Company witness Fox could have used 24/7/365 usage data from a sample of each of the Company's customer classes, Mr. Fox stated his estimates for max-day and peak-hour peaking factors by rate tier, in the absence of granular and more detailed data, are

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127 *Aqua 2021*, 2022 WL 1732770, at *147.
128 *Aqua 2021*, 2022 WL 1732770, at *157.
129 CWC St. 4-R at 11:2-13.

reasonable in his professional opinion.[130] The Company will further discuss how Company witness Fox used these estimates to determine his proposed volumetric allocation and rate design below.

For these reasons, the Company submits that it has fully supported the use of the Base-Extra Capacity Method used in its COSS, the functionalization of certain costs as customer-related, and its decision to estimate max-day and peak-hour peaking factors by rate tier.

B. REVENUE ALLOCATION

OSBA first raises its concern that the Company did not have revenue targets to guide its revenue allocation proposal and, thus, made assumptions when assigning increases to the various rate block tiers. OSBA M.B. at 8. OSBA argues that the Company witness Fox failed to provide a cost basis for his proposed method of designing general metered service volumetric charges and that there is no way to verify that the proposed allocation represents the true cost of providing service to its customers. OSBA M.B. at 9. Consequently, the OSBA recommends that the Commission adopt a GMS rate design that provides for uniform increases to the Company's customer classes, to the extent feasible, on a consolidated basis. OSBA M.B. at 11.

The Company continues to disagree with OSBA's proposal. As set forth in the Company's Main Brief, the Company's respective allocations to each rate block are reasonable and more accurately reflect the true cost of providing volumetric service to each rate tier. Company M.B. at 105-106. Moreover, by increasing the higher volume tiers at a larger percentage increase, the Company is sending a stronger pricing signal to customers for conservation purposes.[131]

The OCA likewise presented evidence demonstrating the reasonableness of the Company's allocation to the various rate blocks. That is, Mr. Fox and Mr. Mierzwa agreed that the existing

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130 CWC St. 3-R at 11:6-13.
131 CWC St. 3-R at 11:6-13.

Tier 2 and 3 rates for the Columbia rate district were deeply discounted relative to Tier 1. OCA M.B. at 61.[132] Mr. Mierzwa also showed that CWC's proposed ratios are more in line with the ratios in effect for the other two water utilities that do have class cost of service studies to support their rate design. OCA M.B. at 61-62.[133]

Thus, for these reasons, and as further stated in the Company and the OCA's Main Briefs, it is reasonable to rely upon Mr. Fox's cost of service analyses to determine the volumetric usage charges at the Company's filed rate increase. Company M.B. at 105-106; OCA M.B. at 62.

C. TARIFF STRUCTURE

In its Main Brief, the Company proposes to consolidate rates of the Columbia and Marietta Rate Districts based on a tariff structure that is informed by its COSS. Company M.B. at 104-105. This includes cost-based customer charges, including a proposed customer charge of $14.79 for customers in the Columbia and Marietta Rate Districts with a 5/8" inch meter, and corresponding consolidated increases to the Company's rate blocks. Company M.B. at 105. None of the parties opposed consolidation of the rates of the Columbia and Marietta Rate Districts. I&E M.B. at 39; *See* OSBA M.B., App. A; OCA M.B. at 62.

The Company's proposed tariff structure is based on a reasonable COSS supported by substantial evidence and should be adopted by the Commission. The rate design of the other parties should not be adopted for the reasons set forth below.

1. OSBA's Rate Design Should Be Denied

In its Main Brief, the OSBA presents a tariff structure that is informed by OSBA's recommended modifications to the Company's COSS, including the reassignment of T&D O&M Expense and the proposed uniform increase to the consolidated customer classes, as discussed

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[132] Citing OCA St. 3SR at 6-7.

[133] Citing OCA St. 3SR at 8-9; OCA Sch. JDM-3 at 1-3; *see also* Tr. 81, ln. 19-22.

above. OSBA M.B. at 12. The OSBA's proposed rate design is, thus, improper given its modifications to the Company's COSS are equally unreasonable.[134] Moreover, the Company has supported its increases to the consumption blocks, with the first tier receiving the smallest increase, and the second and third declining blocks receiving larger increases.[135] As Company witness Fox stated, "[i]f the Company's proposed volumetric rate design is arbitrary, per Mr. Kalcic's claim, then maintaining the Company's existing volumetric rate differentials is equally arbitrary."[136] Rather, the Company's witness utilized estimates for max-day and peak-hour peaking factors by rate tier that are reasonable and reasonably match the rate designs of other water utilities with declining block rates.[137] Thus, the Commission should not adopt the OSBA's proposed rate design.

2. I&E's Proposed Customer Charges Are Unreasonable

I&E's proposed rate design proposes to reduce the Company's requested increase to the customer charges. I&E M.B. at 39-40. This proposal is informed based on I&E's modification to the Company's customer cost analysis. I&E M.B. at 41. I&E does not recommend a specific proposal regarding the Company's proposed volumetric charges. *See* I&E M.B. at 39-41. For the reasons stated in its Main Brief and above, the Company disagrees with I&E's modifications to the Company's customer cost analysis. OCA M.B. at 102-103. Accordingly, I&E's proposed rate design should not be adopted.

3. The OCA's Proposed Customer Charges Are Unreasonable

The OCA presents two recommendations in its Main Brief, a primary and alternative recommendation. The primary recommendation is to reduce customer charges based on their

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134 *See* Section IX.A, *supra*.

135 *See* Section IX.B, *supra*.

136 CWC St. 3-R at 11:4-6.

137 CWC St. 3-R at 11:6-10; *see also* OCA St. 3SR at 8:14 -

modifications to the Company's customer cost analysis. OCA M.B. at 63-64. Like I&E, the OCA recommends removal of certain indirect costs from the calculation of the cost-based customer charge.[138] OCA M.B. at 65-68. Under their primary recommendation, the 5/8" customer charge would be approximately $12.45. OCA M.B. at 64. The OCA's alternative recommendation continues to exclude the indirect costs but allows recovery of 15.7% of T&D O&M Expense in the customer charge should the Commission agree with OSBA. OCA M.B. at 69. Under their alternative recommendation, the 5/8" customer charge would be approximately $13.56. OCA M.B. at 64. The OCA, however, agreed with the Company's proposed rate design for its volumetric rates. OCA M.B. at 62-63.

As the Company discussed at length above, inclusion of the indirect expenses in the customer charge as proposed by the Company is appropriate because indirect costs are essential for providing service to customers, especially with regard to maintaining facilities, services, and meters, and should not be limited to only "direct" costs associated with connecting and maintaining a customer's account.[139] These functions are critical to providing safe and reliable service. Meters and services would not be maintained and repaired without them. The Company continues to assert that its customer cost analysis and its proposed customer charge rates and volumetric rates are appropriate and reasonable.

4. Scale Back

Each party contains a different scale back proposal in their Main Brief. I&E states that if the Commission grants less than the Company's requested increase and adopts the I&E customer charges, the Commission should scale-back only the usage portion of customer rates. I&E M.B. at 41. I&E, however, states that there would be no need to scale back public fire rates because the

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138 OCA St. 3 at 7:13 – 8:4.

139 CWC St. 3-R at 8:17 – 9:1.

revenue being collected for public fire is already well below what the COSS demonstrates is required. I&E M.B. at 42.

The OSBA recommends that the Commission scale back proportionately the dollar increases applied to each element of the Columbia Division's rates under the OSBA recommended rate design to retain the relative magnitude of the OSBA's recommended class increases, while facilitating the consolidation of the Columbia and Marietta Rate Districts. OSBA M.B. at 12-13.

The OCA recommends that to the extent that CWC is awarded a lesser revenue increase than filed-for, the customer charges and volumetric rates determined in the first step should be proportionately scaled back to account for the reduction in the overall revenue increase. OCA M.B. at 71.

The Company submits that if the Commission grants less than the Company's requested increase and adopts the Company's customer charges, I&E's recommendation that the Commission scale-back only the usage portion of customer rates is appropriate.

D. SUMMARY AND ALTERNATIVES

The Company's proposed COSS, revenue allocation, and rate design are guided by the current cost to serve each customer class and incorporates principles of gradualism and equity. Thus, for the reasons stated above, the result of the Company's proposed rate design is just and reasonable and appropriately recovers the requested rate increase.

X. CONCLUSION

Columbia Water Company has justified an annual increase in revenues of $999,900 in this proceeding. Accordingly, the Commission should grant the Company's request for the reasons set forth above.

Respectfully submitted,

/s/Phillip D. Demanchick Jr.

Whitney E. Snyder, Attorney I.D. 316625
Thomas J. Sniscak, Attorney I.D. 33891
Phillip D. Demanchick Jr., Attorney I.D. 324761
Hawke McKeon & Sniscak LLP
100 North Tenth Street
P. O. Box 1778
Harrisburg, PA 17105-1778
(717) 236-1300
wesnyder@hmslegal.com
tjsniscak@hmslegal.com
pddemanchick@hmslegal.com

Counsel for
Columbia Water Company

DATED: September 21, 2023

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the parties, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party).

BY ELECTRONIC MAIL ONLY:

Barrett C. Sheridan, Esquire
Erin L. Gannon, Esquire
Office of Consumer Advocate
555 Walnut Street
5th Floor Forum Place
Harrisburg, PA 17101
OCAColumbiaWater2023@paoca.org

Carrie B. Wright, Esquire
Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120
carwright@pa.gov

Steven C. Gray, Esquire
Small Business Advocate
Pennsylvania Office of Small Business Advocate
555 Walnut Street
1st Floor Forum Place
Harrisburg, PA 17101
sgray@pa.gov

Sandra E. Shaub
3282 Horizon Drive
Lancaster, PA 17601
sandishaub@comcast.net

Vincent E. Collier III
3287 Horizon Drive
Lancaster, PA 17601
vecollierIII@gmail.com

/s/ Phillip D. Demanchick Jr.
Whitney E. Snyder
Thomas J. Sniscak
Phillip D. Demanchick Jr.

Dated this 21st day of September, 2023