



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
COMMONWEALTH KEYSTONE BUILDING
400 NORTH STREET, HARRISBURG, PA 17120

BUREAU OF
INVESTIGATION
&
ENFORCEMENT

November 9, 2023

Via Electronic Filing

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

Re: Pennsylvania Public Utility Commission v.
Columbia Water Company
Docket No. R-2023-3040258
I&E Replies to Exceptions

Dear Secretary Chiavetta,

Enclosed for electronic filing please find the Replies to Exceptions of the Bureau of Investigation and Enforcement (I&E) in the above-captioned proceeding.

Copies are being served on parties of record per the attached Certificate of Service. Should you have any questions, please do not hesitate to contact me.

Respectfully,

A handwritten signature in black ink that reads 'Carrie B. Wright'.

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CBW/ac
Enclosures

cc: Honorable Mary D. Long, Administrative Law Judge (*via email & First-Class Mail*)
Honorable Charece Z. Collins, Administrative Law Judge (*via email only*)
Office of Special Assistants (*via email – ra-OSA@pa.gov*)
Per Certificate of Service

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

**REPLY EXCEPTIONS
OF THE
BUREAU OF INVESTIGATION AND ENFORCEMENT**

Carrie B. Wright
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Dated: November 9, 2023

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I. INTRODUCTION

On October 23, 2023, Administrative Law Judges Mary D. Long and Charece Z. Collins (the ALJs) issued a Recommended Decision (RD) in the above-captioned proceeding. On November 2, 2023, the Bureau of Investigation and Enforcement (I&E), The Columbia Water Company (Columbia or Company), the Office of Small Business Advocate (OSBA), and the Office of Consumer Advocate (OCA), filed Exceptions to the ALJs' Recommended Decision. In response to Columbia's Exceptions, I&E files these Reply Exceptions, addressing Exceptions Nos. 1.a., 1.c., 1.d., 1.e. and 2. For the reasons fully explained below, I&E respectfully requests the Commission deny these Exceptions.

II. I&E REPLY EXCEPTIONS

A. **I&E Reply to Wellsboro Exception No. 1.a: The ALJs correctly rejected Columbia's arguments that the ECAPM is an appropriate model to analyze rate of return.**

Columbia's Exceptions erroneously state "[t]he ED does 'not find the ECAPM results to be appropriate' but fails to explain why."¹ In fact, the RD states "[w]hile some studies indicate that the ECAPM inaccurately defines the SML, the degree to which the CAPM requires adjustment is variable. As stated above, the ECAPM merely adds a measure of subjectivity to the CAPM. Moreover, the additional layer of subjectivity introduced by ECAPM only provides a stronger basis to rely on the DCF..."²

I&E explained in Main Brief that the ECAPM is a modified version of the CAPM which attempts to address the belief that actual risk versus return correlation is flatter

¹ Columbia Exceptions, p. 9.

² RD, p. 62.

than what is predicted by the CAPM. The implication is that the CAPM under-estimates returns with lower levels of risk and over-estimates the returns associated with higher levels of risk. It is assumed that the resulting flattened Security Market Link (SML) addresses the claimed inaccuracy of the CAPM.³

As the CAPM method is already itself somewhat flawed, introducing another, even more flawed method, the ECAMP, makes little sense. As such, the ALJs did not err in determining the results of the ECAMP were not appropriate.

B. I&E Reply to Columbia Exception No. 1.c: The ALJ properly concluded that the Risk Premium model is not an appropriate model upon which to base ROE.

In the RD, the ALJs note that they believe the equity risk is overstated by Columbia.⁴ In Exceptions, Columbia states that “Company witness D’Ascendis relies on the Predictive Risk Premium Model (“PRPM”). The PRPM is not based on an estimate of investor behavior, but rather on the evaluation of the results of that behavior (i.e., the variance of historical equity risk premiums).”⁵

I&E explained in Main Brief why the use of the PRPM is inappropriate. First, the PRPM does not solve the problem of the RP method 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. Second, the PRPM is not a commonly used method and cannot be evaluated or recreated without purchasing the Eviews[®] software. Relatedly, the required use of specialized software is, to I&E knowledge, proprietary. It is inappropriate to

³ I&E Main Brief, pp. 30-31.

⁴ RD, p. 63.

⁵ Columbia Exceptions, p. 13.

require non-company witnesses to purchase this software simply to recreate Columbia witness D'Ascendis' flawed analysis.

Therefore, while I&E does not agree that the ALJs' return on equity (ROE) analysis was appropriate as described in the I&E Exceptions, I&E does concur that it was appropriate to not include the results of the RP or, in this case, the PRPM in the ROE analysis.

C. I&E Reply to Columbia Exception No. 1.d: The ALJs properly determined that no upward adjustment to Columbia's return on equity was necessary as a result of Columbia's size.

The RD noted that the Company's size adjustment to its return on equity would be rejected.⁶ In Exceptions, Columbia states that the ALJs erred because the RD "...makes an apples to oranges comparison when discussing risk. In short, the amount of leverage in a given capital structure is a financial risk while size is a business risk."

In Main and Reply Briefs, I&E explained why a size adjustment is not appropriate. I&E explained that Columbia's proposed size adjustment is unnecessary because none of the cited technical literature supports investment adjustments related to the size of a company is specific to the utility industry; therefore, such an adjustment is not appropriate.⁷ In *UGI Utilities, Inc. – Electric Division*, the Commission rejected use of technical literature not specific to the regulated utility industry to support a size adjustment.⁸

⁶ RD, p. 64.

⁷ I&E Statement No. 1-SR, p. 26.

⁸ *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058, p. 100 (Order entered October 25, 2018).

Specific to the utility industry, I&E notes that in the article “Utility Stocks and the Size Effect: An Empirical Analysis,” Dr. Annie Wong concludes:

The objective of this study is to examine if the size effect exists in the utility industry. After controlling for equity values, there is some weak evidence that firm size is a missing factor from the CAPM for the industrial but not for utility stocks. This implies that although the size phenomenon has been strongly documented for the industrials, the findings suggest that there is no need to adjust for the firm size in utility rate regulation.⁹

I&E presented technical literature demonstrating a size effect for utilities does not exist,¹⁰ and Columbia did not provide sufficient evidence to the contrary. The Company’s proposed size adjustment is unnecessary and unsupported because none of the technical literature the Company cited in support of investment adjustments related to the size of a company is specific to the utility industry nor is it relevant in this proceeding.¹¹ In addition, as explained above, Commission precedent demonstrates that a size adjustment is unnecessary. Absent any credible article to refute the relevant literature cited by I&E, the Company’s proposed size adjustment to its CAPM results should be rejected.

Therefore, I&E maintains the ALJs did not err in denying Columbia an upward ROE adjustment related to its size.

⁹ Wong, Annie, “Utility Stocks and the Size Effect: An Empirical Analysis” *Journal of the Midwest Finance Association* (1993), pp. 95-101.

¹⁰ I&E Main Brief, p. 34.

¹¹ I&E Main Brief, pp. 33-34.

D. I&E Reply to Columbia Exception 1.e: The ALJs properly did not include an upward “performance adjustment” to Columbia’s ROE based on its quality of service.

Columbia’s Exceptions seem to indicate that the Commission must make an upward adjustment to ROE for quality of service. While it would certainly be within the Commission’s authority to grant an upward adjustment to ROE for management performance, this is not an absolute.

Columbia provides no evidence that it has exceeded its statutory and regulatory requirements under the Public Utility Code to provide safe and reliable service at just and reasonable rates. Fulfilling this basic requirement, which all regulated utilities are required to satisfy, does not warrant an upward adjustment to Columbia’s ROE. Columbia has the burden of proof in this proceeding and has failed to demonstrate that additional basis points due to the Company’s quality of service are reasonable. Therefore, Columbia’s Exception must be rejected.

E. I&E Reply to Columbia Exception No. 2: The ALJs properly disallowed Columbia’s request to normalize rate case expense over a 3-year period and properly recommended that the expense be normalized over a 5-year period.

Columbia claimed rate case expense of approximately \$390,330 and proposed to normalize it over three years. The Company proposed this normalization period based on its intentions of filing its next base rate case within three years. In the RD, the ALJs stated “...Columbia Water has not persuaded us that departure from the Commission’s strong preference for normalizing rate case expense based upon a utility’s historic filing

pattern is justified. Therefore, we recommend that the Company's claimed rate case expense of \$390,330 be normalized for a five-year period."¹²

In support of this determination, the ALJs pointed to a 2012 PPL base rate case¹³ and a 2019 Wellsboro Electric base rate case.¹⁴ The ALJs noted that:

...the Commission granted PPL Electric Utilities Corporation (PPL) permission to normalize its rate case expense over a 24-month period based on the expected timing of future base rate case filings.⁷⁸ That particular base rate case was filed on March 30, 2012; however, PPL did not file its next base rate case until March 31, 2015, which was 36 months after the 2012 rate case filing. Similarly, in 2019, Wellsboro Electric Company filed a base rate case requesting a normalization of its rate case expense over a period of three years due to its intent to file a base rate case within that time frame.⁷⁹ The Commission found that there was substantial evidence that warranted a deviation from the traditional practice of relying on historical filing frequency. In that case, Wellsboro had not filed a base rate case; thereby demonstrating there was no actual need to deviate from historic practices and that projections related to when a base rate case will be filed are largely inaccurate.¹⁵

In reviewing those case, the ALJs explained that the results of these cases demonstrate the value of the Commission's preference of relying on historical filing frequency.¹⁶

Columbia attempts to disprove the ALJs analysis by stating that the decision in *Wellsboro* means that the Commission must take into account future projections when setting the rate case expense normalization period.¹⁷ However, Columbia's interpretation

¹² RD, p. 26.

¹³ *Pa. Pub. Util. Comm'n v. PPL Elec. Util. Corp.*, Docket No. R-2012-2290597, pp. 47-48 (Opinion and Order entered Dec. 28, 2012).

¹⁴ *Pa. Pub. Util. Comm'n v. Wellsboro Elec. Co.*, Docket No. R-2019-3008208, pp. 70-73 (Opinion and Order entered April 29, 2020).

¹⁵ RD, p. 25.

¹⁶ RD, p. 25.

¹⁷ Columbia Exceptions, p. 20.

of the Commission's Order is incorrect. In *Wellsboro*, the Commission found that there was substantial evidence to deviate from its normal practice of relying on historical filing frequency.¹⁸ It was not, in fact, the Commission's position that future intentions to file a base rate case must always be considered, but merely that in some instances it would be taken into account where substantial evidence exists.

Here, the ALJs stated that the drivers of Columbia's intent to file a base rate case in three years were not persuasive enough to warrant deviation from the Commission's preference of relying on the utility's historical filing frequency.¹⁹ As noted in the RD, the main driver of the Company's intention to file a base rate case in three years is to address the rates of the EDTMA rate division after Columbia's agreement to freeze rates ends in 2025. However, the ALJs observed that:

...the evidence in the EDTMA acquisition proceeding suggests there may be no need for a base rate filing in the near term. Columbia Water projected that current EDTMA rates would generate net operating income of \$150,080 annually. As for capital improvements, the Company told the Commission that those would be funded through EDTMA net operating income and borrowed funds, which might include PENNVEST loans. The Company already has a PENNVEST surcharge mechanism in place, to which it can incorporate new PENNVEST loans without filing a base rate case. Infrastructure investment, including lead service line replacement, will be recovered either in this base rate proceeding or in the Company's distribution system improvement charge (DSIC).²⁰

¹⁸ *Wellsboro* at 70.

¹⁹ RD, pp. 25-26.

²⁰ RD, p. 26.

Thus, if the basis for the filing of a base rate case in three years is the EDTMA rates, it appears that at best, the need to file a base rate case is tentative.

Additionally, it is important to note that Columbia's reliance on the *Wellsboro* decision is misplaced given that it further demonstrates that a utility's stated intention to file a future base rate case is speculative and unreliable. In that case, even though the Commission determined that Wellsboro provided substantial evidence that it would file a base rate case within a three-year period, it failed to make a filing in the anticipated three years given that its most recent rate case was filed on July 1, 2019 and it has not filed a subsequent rate case. Wellsboro's three-year projection that it represented to the Commission anticipated a future rate case filing by July 2022; however, it is currently 16 months past that anticipated filing deadline and Wellsboro has not filed a rate case to date. While I&E recognizes that predicting future expenses and filings is not an exact science, Columbia's reliance on *Wellsboro* in support of its shorter normalization period is in error given that Wellsboro failed to file within the claimed timeframe. If anything, *Wellsboro* demonstrates the importance of using a utility's historical filing frequency to determine the appropriate normalization period given the unreliable nature of a utility's ability to accurately predict its next rate case filing.

I&E avers the ALJs correctly found the Company's stated intentions to file a base rate case in three years are not a sufficient basis to deviate from the historic Commission practice of relying on historic filing frequency to determine the normalization period for rate case expense. Because Columbia has not demonstrated the ALJs erred, its Exception should be rejected.

III. CONCLUSION

For the reasons discussed above, the Bureau of Investigation and Enforcement respectfully requests the Commission reject the Exceptions of the Columbia Water Company.

Respectfully submitted,

Handwritten signature of Carrie B. Wright in cursive.

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Dated: November 9, 2023

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Replies to Exceptions** dated November 9, 2023, in the manner and upon the persons listed below:

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