COMMONWEALTH OF PENNSYLVANIA

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December 6, 2013

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

Re: Pa. Public Utility Commission
v.
The Columbia Water Company
Docket No. R-2013-2360798

Dear Secretary Chiavetta:

Attached for electronic filing are the Exceptions of the Office of Consumer Advocate in the above-referenced proceeding.

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

Respectfully submitted,

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Attachment
cc: Honorable Dennis J. Buckley
Office of Special Assistants at ra-OSA@pa.gov
Certificate of Service
175747.DOC

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
v.	:	Docket No. R-2013-2360798
	:	
COLUMBIA WATER COMPANY	:	

EXCEPTIONS
OF THE OFFICE OF CONSUMER ADVOCATE

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DATED: December 6, 2013

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I. INTRODUCTION

On April 25, 2013, Columbia Water Company (Columbia, CWC, or Company) filed Supplement No. 60 to Tariff Water - Pa. P.U.C. No. 7, to become effective June 24, 2013. In this filing, the Company sought Commission approval of rates designed to increase the Company's annual base rate revenues by $773,210 or 19.2%. For the typical residential customer using 3,000 gallons of water per month, the proposed rates would increase bills from $25.03 to $30.31 per month, or by 21.09%. A full history of the case is included in the OCA's Main Brief. OCA M.B. at 1-2.

The OCA's final position, as set forth in its Main and Reply Briefs, recommended a decrease in Columbia's revenues by $319,728, as opposed to the $773,210 increase the Company has requested. See OCA Table I (updated).

The OCA proposed adjustments pertain to the Company's proposed capital structure, the cost of equity, rate base, and net operating income claims, including PennVest plant, materials and supplies, cash working capital, miscellaneous revenues, the amortization of an acquisition adjustment, engineering expense, bad debts, membership dues, registration fees, charitable contributions, allocations to the Marietta Division, general liability insurance, officers' salaries and directors' fees and regulatory assessments. If accepted, these adjustments would result in the OCA's recommended revenue decrease of $319,728.

On November 22, 2013, the Office of Administrative Law Judge issued the Recommended Decision (R.D.) of ALJ Buckley. The R.D. recommended rejecting the City's proposed Supplement No. 60 because the rates contained therein are not just and reasonable or otherwise in accordance with the Public Utility Code and applicable regulations. The R.D. further recommended, inter alia, that the Commission issue an Opinion and Order directing the Company to file a tariff allowing for recovery of no more than $87,699 in additional base rate revenue. ALJ Buckley's recommendation adopted the OCA's adjustments for the acquisition adjustment, engineering, employee recognition, accounting, office expenses and utilities, ongoing requirements for time records, and adjustments to return on equity for performance.

While the OCA supports a number of the specific determinations made in the R.D., ALJ Buckley failed to adopt a number of OCA adjustments. The ALJ's recommendation to permit CWC to collect a return on and of PennVest-funded plant despite having collected principle and interest payments over the life of the loan should be reversed. In addition, the ALJ failed to adopt OCA's adjustments to CWC's claims for materials and supplies, bad debt expense, salaries and wages and pensions, insurance, and salaries and fees for officers and directors. As discussed below, the ALJ's recommendations regarding these adjustments should be reversed.

The OCA respectfully submits the following Exceptions to the Recommended Decision of ALJ Buckley.

II. OCA EXCEPTIONS

OCA Exception No. 1: <u>CWC Should Not Be Permitted to Collect PennVest-Funded Plant Twice from Ratepayers.</u> R.D. at 20-22, 39-40; OCA M.B. at 9-21; OCA R.B. at 4-9.

ALJ Buckley determined that CWC's claim for book depreciation reserve for PennVest-funded plant should be permitted because he could not ignore the Company's 1993 rate order. R.D. at 22. The OCA's position does not ask the Commission to ignore the 1993 rate order. In fact, it is Columbia that ignored the 1993 rate order in its claims in the rate cases that followed. Now, after full repayment of its PennVest loan, and after twenty years, Columbia wants to pretend that it has followed the 1993 rate order, albeit with a long gap where it did not depreciate the PennVest-funded plant, and pick up where it would have been with its rate base and depreciation reserve. As explained in the OCA's Main and Reply Briefs, Columbia's claim flies in the face of more than 25 years of Commission orders addressing recovery of PennVest-funded plant. Notably, ALJ Buckley did not disagree with the OCA's review of the relevant cases.

a. <u>Two Methods: Rate Base or Principle and Interest Surcharge</u>

Historically, the Commission has recognized two methods of recovery of the costs of plant funded by PennVest loans. The utility may choose to put the plant in rate base and recover the associated costs through depreciation expense and the opportunity to earn a return on the undepreciated plant over the useful life of the plant. Alternatively, the utility may choose to recover the principle and interest through a surcharge during the term of the loan. OCA St. 1 at 1S at 38. The Commission's "either or" position was established in several cases in the late 80's to mid 90's and, ultimately memorialized in its 1994 Policy Statement regarding the treatment of PennVest obligations at 52 Pa. Code § 69.363. <u>Pa. P.U.C. v. National Util., Inc.</u>, 1994 PaPUC LEXIS 55 at *17 (noting that the Commission permitted plant financed by WFLB loans to be included in the rate base of York Water Company in Docket No. R-850268, Order entered Nov.

25, 1986); Pa. P.U.C. v. Shickshinny Water Co., 67 PaPUC 3, 6, 12-13 (1988) (denying utilities' requests for rate base treatment and approving a principle/interest surcharge) (Shickshinny); Pa. P.U.C. v. Lemont Water Co., R-000912114, Order (June 19, 1992) (allowing the Company to include the PennVest-financed plant in rate base instead of recovering a principle and interest surcharge) (Lemont Order). Consistent with those cases, Section 69.363 provides that only principle/interest may be recovered through a surcharge mechanism:

> Water and wastewater companies with outstanding PennVest obligations that have not been reflected in rates or future PennVest obligations, may establish . . . an automatic adjustment by means of a sliding scale of rates or other method limited solely to recovery of the company's PennVest principal and interest obligations.

52 Pa. Code § 69.363 (emphasis added).

Under rate base/rate of return treatment, in keeping with the basic principles of depreciation accounting and ratemaking, the utility has an opportunity to earn a return on the investment, but the amounts recovered are never reconciled to either actual loan payments or a specified depreciation expense and rate of return allowed from the prior base rate case. OCA St. 1S at 38. The debt service costs are recouped through the rate of return over the entire useful life of the plant and may be more or less than the amount necessary to repay principle and interest, depending *inter alia* on capital structure, depreciation rate and the frequency of rate increase requests. OCA St. 1S at 42; Shickshinny at 6; Pa. P.U.C. v. National Util., Inc., 1994 PaPUC LEXIS 55 at *23, 29-30 (NUI Order). With a principle/interest surcharge, the Company recovers a higher amount in rates over the shorter term of the PennVest loan and nothing after the repayment period ends because the plant is not reflected in rate base. OCA St. 1S at 38, 40, 43; I&E St. 3-SR at 5-6 (citing NUI Order at *25-26); see also, Lemont Order at 31-34, 42-43, Shickshinny at 6-7 (discussing whether the utility's size and cash flow was sufficient for it to repay its PennVest debt through rate base treatment rather than a principle/interest surcharge).

In each of these cases, there was a factual determination whether the utility would be able to repay its PennVest loan under traditional rate base/rate of return ratemaking or whether principle/interest surcharge recovery over the term of the loan was required to ensure timely payments to PennVest.[1] For example, in Shickshinny, due to its small size and limited cash flow, and because the separate surcharge facilitates tracking the utility's loan repayment, the Commission determined that a principle/interest surcharge was appropriate.

> Rate base inclusion, with regard to these companies, could result in over or under recovery of these loans depending on the hypothetical capital structure, the cost of money employed, the depreciation rate recognized and the frequency of the rate increase requests. We therefore believe that the public interest would be better served by separate rate recognition of the principal and interest, rather than rate base inclusion.

Shickshinny at 6. In contrast, in Lemont, where the Commission allowed rate base recovery, the utility served more than 2,000 customers and had substantial non-PennVest rate base, adequate cash flow and a solid record in repaying its PennVest debt. Pa. P.U.C. v. Lemont Water Co., R-00912114, RD at 32-34, 42-43 (May 15, 1992) (Lemont RD).

Further, the determination of rate base/rate of return treatment versus principal and interest surcharge is made during the case in which the plant first becomes used and useful. Other than one unique instance described below, once that determination is made by the Commission, there is no opportunity to change the methodology.

[1] As summarized by the Presiding Officer in Lemont:

> The crux of the surcharge vs. rate-base repayment methodology was, in our opinion . . . that the operative factual conditions extant in this case should determine which theory should be applied.

Lemont RD at 33.

b. 1993 Settlement

In 1993, Columbia filed a request for approval of a principle and interest surcharge to recover the costs associated with a PennVest loan. Tr. 156; Pa. P.U.C. v. Columbia Water Co., R-00932594, Corrected Order (Apr. 30, 1993) (1993 Order). The OCA opposed this method of recovery on the basis that the facts did not support principle/interest methodology for this utility.

> [g]iven the size (nearly 6,000 customers) and financial condition of the Company, the Company should not be permitted to impose a debt-service based surcharge.

GDS Rebuttal Exh. 1, App. B at 1 (Joint Petition for Settlement) and App. C at 2 (OCA Statement in Support). Consistent with the OCA's position and Lemont, the Commission approved a Settlement between the Company and OCA that provided for rate base recovery of the PennVest costs. 1993 Order at 3. The Commission stated:

> The primary feature of the proposed settlement was Columbia's agreement to Rate Base treatment for plant additions of $4,547,617, constituting amounts attributable to PennVest funding, rather than to apply a surcharge equal to the debt service on the PennVest Loan.

1993 Order at 1-2. Specifically, paragraph 7 of the Settlement provided:

> Regarding the ratemaking treatment of Plant in Service, the Company agrees to Rate Base treatment for plant additions of $4,547,617, constituting amounts attributable to PennVest funding, rather than apply a surcharge equal to the debt service on the PennVest Loan. The following items are also reflected in the total revenue increase proposed in this stipulation: (a) the inclusion of these plant additions in the rate base, along with a return on the increased plant at an overall rate of return of 7.27%; (b) depreciation expense computed at the Company's current composite depreciation rate; (c) reflection of increased deferred income taxes.

GDS Rebuttal Exh. 1 (1993 Settlement); OCA St. 1S at 39. The settlement language is clear: the parties agreed to rate base treatment "rather than apply a surcharge equal to the debt service on the PennVest loan." Id. (emphasis added); Tr. 153. Because the 1993 case was an abbreviated, single-issue proceeding ("the proposed increase results solely from the proposed implementation of a surcharge to recover the debt service on a loan [from PennVest]"), rate base treatment was effectuated through a volumetric charge. 1993 Order, App. C at 1-2. The OCA agrees with Columbia that the 1993 case established rate base/rate of return treatment for its PennVest-funded plant. The disagreement in this proceeding is what happened *after* the 1993 case. If rate base/rate of return treatment had continued, certain things should have happened in Columbia's next rate case. OCA St. 1S at 41-42.

c. Columbia's Treatment of PennVest Costs Since 1993

The settlement rates took effect on May 1, 1993. 1993 Order at 4. In its subsequent filings (after 1997), the evidence shows that Columbia changed its method of recovery from rate base/rate of return treatment with depreciation to a reconcilable surcharge. OCA St. 1S at 39. Specifically, in its 1997 general rate increase, Columbia's first filing after 1993, the Company excluded the PennVest-funded plant from rate base, excluded the surcharge revenues and excluded the PennVest loan from capital structure in calculating its base rate revenue requirement. Pa. P.U.C. v. Columbia Water Co., R-00974007, RD at 10 (Nov. 20, 1997), Joint Petition at 4 (Oct. 27, 1997) (1997 RD); OCA St. 1S at 40.

In this case, Columbia advances the theory that it excluded the PennVest plant from the rate base in which it reflected all other utility plant but maintained a separate, additional PennVest rate base, to which it applied the rates of return and depreciation established in the 1993 Settlement.[2] Tr. 139, 145, 157-58. This treatment was neither required nor authorized by the Commission's Order in 1997 and is inconsistent with how other utilities reflect PennVest plant in rate base. OCA St. 1S at 41. OCA witness Everette walked through the steps a utility takes to reflect recovery of PennVest-financed plant in rate base:

[2] The parties agreed on a PennVest-specific rate in the 1993 case because the revenue increase related solely to the Company's proposed principle/interest surcharge. 1993 Order at 3. The initial rates of return and depreciation were intended to become irrelevant because the Company would have reflected the PennVest-funded plant in rate base thereafter and it would have been addressed just like any other plant in service in subsequent general rate cases. See OCA St. 1S at 38, 41-42.

> [T]he companies include that plant in rate base so that they may depreciate the PennVest-funded plant as any other plant and have the opportunity to earn a return on the investment, just as they would any other plant investment. When calculating the companies' rate of return in the rate case, the PennVest debt is included in the capital structure. This same procedure is followed in every rate case throughout the life of the PennVest-funded plant. That is, the PennVest-funded plant is included in rate base along with all other plant. The accumulated depreciation on the PennVest-funded plant is subtracted from rate base along with the accumulated depreciation on all other plant. The depreciation expense is calculated on the PennVest-funded plant in the same manner as all other plant. Finally, the outstanding balance of the PennVest loan and the interest rate on the loan is fully reflected in the capital structure.

OCA St. 1S at 41. Although PAWC and Aqua were used as specific examples, this process is the same for any water or wastewater utility that has used or will use rate base/rate of return recovery for its PennVest-funded plant. See, e.g., Pa. P.U.C. v. Emporium Water Co., 208 PUR4th 502, 509 (2001); Lemont Order at 1.

In contrast, in 1997, Columbia began reconciling the separate PennVest rate "to ensure it hit its rate base/rate of return income target." Id. The Company argues that this reconciliation was still based on rate of return rather than principle/interest. Tr. 139. The 1997 Settlement of that case tied the surcharge increase to PennVest payments, however, stating that the Company was "significantly under-recovering adequate revenues to repay the PennVest loan." 1997 RD, Joint Petition at 5. The 1997 settlement also provided that the Company would annually revisit the PennVest surcharge, "in order to 'true-up' recovery under such surcharge." Id. As discussed by OCA Witness Everette, rate base treatment does not provide for true-up or reconciliation:

> Under rate base/rate of return regulation, these companies have the opportunity to earn a return on the investment, but amounts recovered are never reconciled to either actual loan payments or a specified depreciation expense and rate of return allowed from the prior base rate case. The debt service costs are recouped through the rate of return.

OCA St. 1S at 42.

Columbia reconciled the amount of the surcharge at least four more times during the loan period, in 2001, 2003, 2005 and 2007. OCA St. 1S at 40, 44 and App. A. The subsequent cases are explicit that surcharge recovery was being reconciled to the annual repayment amount and, therefore, not to a rate base/rate of return income target. The Settlement of the Company's next base rate case in 2001 states specifically that the surcharge was calculated to recover the Company's PennVest loan payments through a surcharge reconciled to the annual repayment amount.

> Revenue for repayment of the Company's PennVest loan is recovered in rates charged to customers through a surcharge of $0.79 per 1,000 gallons that is imposed on all usage on a volume basis. For rate purposes, the revenue from the PennVest surcharge is excluded from base revenue, and associated capital costs are excluded from the rate base. Because the annual revenues required to repay the PennVest loan remain static and the Company's volumes of water sold have increased, the surcharge amount is being lowered to $0.72 per thousand gallons on all usage on a volume basis.

<u>Pa. P.U.C. v. Columbia Water Co.</u>, R-00016423, RD, CWC Statement in Support of Settlement at 3, ¶5 (Oct. 17, 2001) (<u>2001 RD</u>). The Commission's Orders in 2003 and 2005 also show the Commission understood Columbia's surcharge to be recovering principle and interest. The Orders stated:

> This decrease in the surcharge is necessary to bring the Respondent's surcharge collections into alignment with its PennVest obligation. The surcharge rates, most recently applied, have caused a surplus to accumulate and while the proposed rate of $0.66/1,000 gallons will generate fewer funds than necessary to meet the PennVest payments, it will allow the surplus to be drawn-down within approximately 3 years.

<u>Pa. P.U.C. v. Columbia Water Co.</u>, R-00038428, Order at 1-2 (July 17, 2003) (<u>2003 Order</u>).

> This increase in the surcharge is necessary to bring the Respondent's surcharge collections into alignment with its PennVest obligation. The current surcharge rates have resulted in an under collection of Columbia's PennVest liability and the proposed rate of $0.68 per 1,000 gallons will generate sufficient funds to meet the PennVest payments.

Pa. P.U.C. v. Columbia Water Co., R-00050611, Order at 1 (July 14, 2005) (2005 Order).

Significantly, Columbia's counsel filed a tariff supplement ending the surcharge when it ended its principle and interest payments to PennVest. The surcharge had been in effect for fourteen years, since the Company changed its recovery method to a reconcilable surcharge in 1997. The April 25, 2011 letter states:

> The occasion for the reduction of the stated surcharge is the retirement of the Company's indebtedness to PennVest. Accordingly no further surcharge recovery is required at this time.

OCA St. 1S at 39, App. A (letter from CWC counsel). The Commission approved the filing by Secretarial Letter dated June 2, 2011. I&E Exh. No. 3, Sched. 3.

Further, whatever the Company's belief or intent, the evidence shows the *Commission* was reconciling a principle/interest surcharge rather than approving rate base treatment. As discussed on pages 14 to 16 of the OCA's Main Brief, the Commission-approved settlement of the 1997 case tied the surcharge increase to PennVest payments, stating that the Company was "significantly under-recovering adequate revenues to repay the PennVest loan."[3] 1997 RD, Joint Petition at 5. In subsequent cases in 2001, 2003, 2005 and 2007, the Commission stated explicitly that surcharge recovery was being reconciled to the annual repayment amount and, therefore, not to a rate base/rate of return income target. 2001 RD, CWC Statement in Support of Settlement at 3, ¶5; 2003 Order at 1-2; 2005 Order at 1.

Notwithstanding this, Columbia argues that "[t]he Company simply wants to continue to claim the undepreciated amount of the PennVest plant in service" or, stated otherwise, it wants to continue "capital recovery and return on investment for the remaining useful and depreciable life of the assets." CWC M.B. at 14. Otherwise, it contends, it will be denied a return on the plant.

[3] That settlement also provided that revenue from the PennVest surcharge would be "excluded from base revenue" and raised the surcharge amount "separate from but concurrently with" the determination of base rates. Id.

The Company fails to recognize that, first, it was given the opportunity to earn a return on its PennVest-financed investment in 1993. When the Company recovered the plant through a reconcilable surcharge, it made a choice to recover its investment over the life of the loan (a much faster recovery) rather than depreciation and return over the life of the plant.[4] OCA St. 1S at 43. Second, the Public Utility Code does not prescribe rate base/rate of return regulation as the only permissible means of cost recovery for PennVest loans. See OCA M.B. at 18-19 (citing Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944) (Hope)). Third, there is no rate base on which to earn a return. Where a utility recovers its PennVest obligation by surcharge, the utility recovers the return of investments (depreciation) at a faster rate during the period of the loan than if the plant had been included in rate base and depreciated over its useful life. I&E St. 3-SR at 5-6. Columbia retired its PennVest debt in 2011. Columbia has no remaining "loan balance," so there is no value to include in rate base. OCA St. 1S at 39; NUI Order at *29-30; Pa. P.U.C. v. National Util., Inc., R-00932828, RD at 24-28 (July 1, 1994) (NUI RD).

In summary, Columbia's actions since the 1993 settlement are not consistent with rate base treatment. The Company never included the PennVest plant in rate base after its 1993 PennVest-only rate case, so the amount recovered was never adjusted to account for changes in depreciation methods, adjustments to accumulated deferred income taxes, the annual increases to the depreciation reserve on the PennVest-funded plant, or changes in the allowed rate of return. OCA St. 1S at 42-43. Over multiple cases and years, when the Company under-recovered and

[4] The OCA notes that the Company's "choice" of a recovery method is not consistent with how every other utility has recovered its PennVest-financed investment. OCA St. 1S at 40; OCA M.B. at 10-12. There is only rate base treatment or surcharge recovery, and no provision for a self-serving blend of the two.

> Water and wastewater companies with outstanding PennVest obligations that have not been reflected in rates or future PennVest obligations, may establish . . . an automatic adjustment by means of a sliding scale of rates or other method limited solely to recovery of the company's PennVest principal and interest obligations.

52 Pa. Code § 69.363 (emphasis added).

over-recovered, it reconciled.[5] The Company committed to "true-up" its revenues and costs annually. 1997 RD, Joint Petition at 5. Most telling, when the Company stopped paying PennVest, it ended the surcharge, which is consistent with a principle/interest surcharge. Although the PennVest-funded plant remains used and useful, the Company cannot now add it to rate base and earn a return, as if the surcharge never existed. As such, Columbia's PennVest-funded plant should not now be reflected in rate base, nor should any associated depreciation expense be included in expenses, in any amount in this case. OCA St. 1S at 42-43; see also I&E St 3-SR at 8.

d. The NUI Case Limits Post-Surcharge Recovery to PennVest Loan Balance.

The OCA and I&E recommendation is consistent with the Commission's Order in NUI Order, *supra*. There, as here, the utility asked for approval to take PennVest-financed plant that the Company had been recovering from ratepayers through a reconcilable surcharge and place it into rate base at its depreciated original cost amount.[6] NUI Order at *3. The Commission allowed the plant to be included in rate base but only at the amount of the PennVest account loan balances. The Commission stated:

> In considering this matter, we find, as the ALJ did, that the value of the Pennvest financed plant should be based upon the principal balance of the Pennvest/WFLB loans. We, therefore, conclude that the sum representing the difference between the loan balances and the original cost of the plant has in fact been provided by the customers. Therefore, NUI's proposal to include Pennvest financed plant in its rate base at original cost less book depreciation would result in double recovery from the ratepayers.

[5] The Company states that it only reconciled the surcharge because the Commission requested it, as though that lack of intent would somehow negate the fact that the surcharge was reconciled and convert its recovery to base rate treatment. CWC M.B. at 12. Even this dubious argument fails, however, because in settlement of the 1997 case, the Company committed to "true-up" its revenues and costs annually. 1997 RD at 5.

[6] The circumstances in the NUI case were unique. Specifically, NUI was consolidating rates for 19 previously stand-alone companies, most of which had PennVest loans that were being recovered through principle/interest surcharges. NUI Order at *3.

NUI Order at *29-30. In NUI's case the utility was still assessing a surcharge and repaying PennVest. Columbia has no remaining "loan balance," however, so there is no value to include in rate base. OCA St. 1S at 39.

Comparison of Columbia's surcharge revenues to its PennVest payments shows that the Company recovered $7.28 million from customers and paid $7.47 million to PennVest. Tr. 158-60. If Columbia believed that it had not fully recovered principle and interest on the loan, it had the opportunity to reconcile the surcharge rather than ending it in 2011.[7] The Company cannot, however, recalculate its rate base as though surcharge recovery never occurred.

Consistent with the Commission's decision in NUI, Columbia's proposal to include PennVest-financed plant in its rate base at original cost less book depreciation would result in double recovery from the ratepayers. NUI Order at *29-30. Accordingly, the OCA's Table II (updated) reduces the Company's rate base claim $3,048,292, to remove the net plant in service as of 12/31/13 that was funded by PennVest loans.[8] OCA Table II (updated), line 14. The OCA has also removed Columbia's claim for associated annual depreciation expense of $115,913. OCA Table II (updated), line 17.

Columbia witness Shambaugh argues, however, because the rate is no longer in Columbia's tariff and the remaining undepreciated plant and facilities are used and useful, the Company must be given the opportunity to earn a return on its debt-financed investment. CWC St. 2R at 2-3. Mr. Shambaugh took the same position on behalf of the utility in the NUI case. NUI RD at 24-28. His arguments fail here, for the same reasons they were rejected by the

[7] If Columbia made such a claim now, it would violate the Commission's prohibition against retroactive ratemaking because it would compensate it for an alleged past loss that the Company chose not to correct.

[8] It should be noted that the Company proposed rate base shown in OCA Table II (updated) reflects the amount of PennVest-funded plant prior to the Company's proposed change to depreciation reserve. Accordingly, the OCA's recommended adjustment to remove the PennVest-funded plant from rate base also does not include the Company's proposed change to depreciation reserve.

Presiding Officer and Commission in that proceeding. First, the Public Utility Code sets forth certain standards which the Commission must follow, but does not prescribe rate base/rate of return regulation as the only permissible means of cost recovery for PennVest loans. The Code sets as an overriding standard that "[e]very rate . . . shall be just and reasonable." 66 Pa. C.S. § 1301. The Company tries to argue that not allowing rate base/rate of return recovery would be confiscatory. There is no "confiscation" as it is the end result and not the method employed that is controlling. See Hope. Where a Company recovers its PennVest obligation by surcharge, the utility recovers the return of investments (depreciation) at a faster rate during the period of the loan that if the plant had been included in rate base and depreciated over its useful life.[9] I&E St. 3-SR at 5-6 (quoting NUI Order at *26).

> The dollar-for-dollar recovery of PennVEST debt service through the surcharge allowed the NUI companies to collect for and pay off their Penn VEST loans on a direct basis. This treatment provided a return of capital in the form of the repayment of the principal amount of the loan.

Id. In this way, surcharge recovery is more beneficial to the utility during the early years of the loan than rate base treatment would be. Contrary to Mr. Shambaugh's claim, there is no way to construe this result as being "confiscatory" or otherwise unconstitutional. CWC St. 3R at 11, 14; NUI RD at 55; NUI Order at *28-29.

Second, it cannot be overlooked that the Company *did* have the opportunity to earn a return on and of its debt-financed investment – rate base/rate of return recovery was approved by the Commission in 1993. Despite Commission approval of rate base/rate of return recovery, Columbia changed its recovery method and chose to fund the plant through a reconcilable surcharge over the period of the PennVest loan instead. OCA St. 1S at 43.

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[9] In 1993, the average remaining life of the PennVest plant was 46.5 years. CWC St. 2R at 12, 13. The term of the PennVest loan was 18 years. DTL Rebuttal Exh. 1 (Promissory Note, ¶3) ("Principal and interest shall be payable in 221 consecutive monthly installments commencing on the first day of each calendar month beginning with January 1, 1993 and continuing the first day of each calendar month thereafter to and including May 1, 2011.")

Company witness Shambaugh raises several other related arguments against the OCA's recommended removal of the PennVest plant from rate base, *inter alia* that the OCA treats the surcharge as a form of contribution in aid of construction (CWC St. 2R at 3-5) and does not recognize that the Company is at risk for the loan and plant (Id. at 5-6). The Presiding Officer in the NUI case considered and was not persuaded by the same arguments.

> We accept the OCA and OTS position that the loan payments were provided by the ratepayers and that NUI did earn a return of investment and a return of capital. NUI or its shareholders did not provide the funds, it was the ratepayers and it is inconceivable that the ratepayers should have to pay twice for the same plant.

NUI RD at 24-26, 52-55; OCA St. 1S at 40-41, 43 ("when a PennVest loan is recovered through a surcharge, it is treated differently than a traditional loan or bond for ratemaking purposes"). The bottom line is that when the Company recovered the plant through a reconcilable surcharge, it made a choice to recover principle and interest over the life of the loan rather than depreciation and return over the life of the plant. OCA St. 1S at 43.

In support of its argument that it has always recovered its PennVest investment through rate base/rate of return, Columbia argues that the Company earned more and less than its target rate of return. As such, its rate of return was not "guaranteed," as suggested by OCA Witness Everette. Tr. 145. The Company points out that in some years there were shortfalls. Id. The record also shows that the Company earned more than its PennVest payments over some 12-month periods. Tr. 159-61. This does not indicate, however, that the Company was applying rate base/rate of return treatment. Rather, it indicates that the Company could have done a better job of reconciling during the term of the loan. Recall that in the 1997 Settlement Columbia committed to annual review of its Section 1307 surcharge in order to true-up recovery. 1997 RD, Joint Petition at 5.

	Rate Base/Rate of Return Treatment	Typical Principle/Interest Surcharge	Columbia's Surcharge
Plant	Included in rate base	Recovered through a surcharge, excluded from rate base	According to Company filings: plant was excluded from rate base. According to CWC: plant kept in a separate, "second" rate base[10] Tr. 152-53, 163.
Recovery	Through rate base; treated the same as other plant-in-service and the recovery target takes the form of a granted rate of return	Through a surcharge on either the customer charge or volumetric rate	Through a surcharge on the volumetric rate
Basis for Annual Recovery Target	Depreciation expense and allowed return on the investment; calculated in each case as part of overall base rates	Annual principle and interest payments to PennVest	According to Commission Orders: annual principle and interest payments to PennVest. According to CWC: revenue requirement established in 1993 for PennVest plant.
Adjustments to Annual Recovery Target	Made in every base rate case to account for updates to depreciation reserve, depreciation methods, ADIT and granted rate of return	Made only if the annual principle and interest payments to PennVest are altered	Not adjusted in any case after 1993 to account for updates to depreciation reserve, depreciation methods, ADIT or granted rate of return
Reconciliations	Never reconciled, the Company is given the opportunity to earn the granted rate of return and may file for base rate increases if warranted	Reconciled when necessary to match revenues collected to PennVest obligation (principle and interest)	According to Commission orders: reconciled periodically to match revenues collected to the Company's PennVest obligation (principle and interest). According to CWC: reconciled periodically to match the 1993 revenue requirement for PennVest plant
Discontinuance of Recovery Method	When plant is fully depreciated, rates no longer reflect depreciation expense and return on that portion of rate base, just like any other plant in service	Surcharge is discontinued when PennVest loan is retired	Surcharge was discontinued when PennVest loan was retired

[10] In its rebuttal testimony, the Company stated that "the rate charge here is a rate of return, rate base, and depreciation rate as part of Columbia's overall cost of service." CWC St. 2R at 8. After the OCA and I&E pointed out that the PennVest-financed plant was not included in the Company's rate base claim in filings after 1997 (OCA St. 1S at 40; I&E St. 3-SR at 3), the Company – for the first time – contended that the plant was in a separate rate base earning a different rate of return than the rest of the Company's rate base. Tr. 152-53, 163.

OCA M.B. at 10-17; Shickshinny at 3, 6, 12-13; Lemont RD at 32-34, 42-43; 52 Pa. Code § 69.363.

Columbia collected its PennVest debt through a reconcilable surcharge between 1997 and 2011, when the loan was retired. GDS Exh. 1 at 1-17; OCA St. 1 at 5; OCA St. 1S at 39-40, 44. In this case, Columbia has included the *undepreciated* value of the same plant in rate base.[11] OCA St. 1 at 6; OCA St. 1S at 39, 42-43; I&E St. 3SR at 4. The OCA and I&E position is that utilities may choose to finance plant additions through inclusion in rate base *or* a principle and interest surcharge. OCA St. 1S at 38; I&E St. 3SR at 4. Columbia's claim is not consistent with basic ratemaking, Commission precedent or the Commission's policy statement on PennVest recovery. As noted, the same arguments by the same witness on behalf of a different utility were rejected twenty years ago. NUI RD at 24-28. For all of these reasons, the Company's PennVest-funded plant should not be reflected in rate base, nor should any associated depreciation expense be allowed. OCA St. 1S at 43; I&E St. 3 at 1-2.

OCA Exception No. 2: CWC's Materials and Supplies Claim Is Inconsistent with Prior Commission Cases and Should Be Denied. R.D. at 22; OCA M.B. at 21-23; OCA R.B. at 10-13.

The ALJ rejected the OCA's adjustment to Columbia's claim for materials and supplies because he found that the Company's three year average of materials and supplies inventory works and is reasonable and thus should not be "disturbed by what another party thinks is optimal and requests based on general policy." R.D. at 22. The OCA submits that its adjustment to reflect a 13 month average of materials and supplies works and is reasonable, and – in contrast to Columbia's claim – is based on Commission precedent that reflects a reasonable ratemaking policy.

[11] The average remaining life of the PennVest-funded plant is 26.5 years. CWC St. 2R at 12, 13.

Columbia claimed Materials & Supplies (M&S) in rate base of $62,314, which is based on a three-year average of the Company's Materials & Supplies inventory. GDS Exh. 1 at 1-17. The OCA explained that a 13-month average is a better measure of the expense because the balance of this account will fluctuate from month to month within a test year. For example,

> M&S in rate base are purchases that the Company makes in a given month but may not use for several months. . . . if the Company made large purchases in December, a year-ending balance from December would be greater than the average of the amount that Company had actually kept on-hand throughout the year, and would overstate the Company's investment in M&S throughout the year.

OCA St. 1S at 8-9; OCA St. 1 at 7. The Commission has consistently adopted a 13-month average for this reason. See, e.g., Pa. P.U.C. v. Total Envtl. Solutions, Inc. – Treasure Lake Water Div., 2008 PaPUC LEXIS 1227, *22, 24-25, 29; Pa. P.U.C. v. Mechanicsburg Water Co., 1993 PaPUC LEXIS 112, *34-35 (Mechanicsburg 1993); Pa. P.U.C. v. Borough of Media Water Works, 72 PaPUC 144, 150-51 (1990) (Media 1990).

Columbia argues that a three-year average would provide a larger sample of operating results to address volatility. CWC M.B. at 7-8. Ms. Everette showed how an average of three year-end account balances would exaggerate fluctuations:

> [S]uppose that the Company makes a large purchase in April and then uses these items throughout the summer. The Company might have a large balance in April, but a very low balance by October. Averaging three years of M&S would not smooth out this volatility; rather, it would highlight it. If the Company's year ended in May, the balance would be much larger than it might have been the rest of the year; if the Company's year ended in December, the balance would be much smaller than it might have been the rest of the year.

OCA St. 1S at 8-9; OCA M. B. at 21-22.

Next Columbia argues that small companies, like Columbia, do not have the ability to produce accurate inventory numbers on a monthly basis. CWC M.B. at 8. In support, Columbia points to the Commission's approval of a three-year average in Columbia's 2008 rate case.[12] Id. (citing Pa. P.U.C. v. Columbia Water Co., 2009 PaPUC LEXIS 2326 at *40-44) (2008 RD). The referenced pages of the Commission's Order address use of three-year average for M&S expense; the Commission (and ALJ) made no specific finding regarding the Company's claim for M&S in rate base in that case.

> The ALJ concluded that the three-year average is sufficient to normalize the materials and supplies expenses.

Pa. P.U.C. v. Columbia Water Co., 2009 PaPUC LEXIS 2326, *39-40 (2008 Order). M&S in rate base is different from M&S expense. M&S in rate base allows the Company the opportunity to earn a return on its investment in Materials & Supplies until they are used and expensed. Thus, it is appropriate to reflect an average throughout the year; *i.e.*, a 13-month average, in order to accurately account for the level of M&S that was kept in inventory throughout the year. OCA St. 1S at 9; Pa. P.U.C. v. Borough of Schuylkill Haven, 1995 PaPUC LEXIS 181, *32-34 (Commission adopted ALJ denial of M&S rate base claim, in part, because year-end inventory valuation is not sufficient evidence to show the claim is reasonable – without monthly figures, there is no way for ALJ and parties to ascertain if abnormal inventory levels have been claimed in the year-end valuation). On the other hand, M&S expense is the sum of the total annual expenditures, much like other expenses such as purchased power or mailing costs. GDS Exh. 1 at 1-15, 2-17. Thus, for M&S expense, it is appropriate to use the sum of the expenditures throughout the year. In Columbia's 2008 case, the Commission allowed the Company to use a 3-year average of its M&S expense in order to reflect the normal level of total annual expenses. 2008 RD at *40-44; 2008 Order at *35-40.

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[12] Columbia could not identify any cases where the Commission addressed a three-year average to calculate a claim for M&S rate base recovery. Tr. 164-65; CWC M.B. at 7-9.

Regarding Columbia's argument that small companies are unable to produce accurate inventory numbers on a monthly basis, if a utility is unable to maintain monthly inventory accounts on its books and records then it may capitalize M&S costs to specific projects or expense the items when purchased. See, e.g., TESI 2008 at *21-30. That is not the situation, here, however. In OCA Set I-7, the OCA requested monthly balances for Columbia's materials and supplies account from December 31, 2011 to present. OCA St. 1 at 7, App. B. The Company provided balances from December 2011 to March 2013. Id. The Company later updated its response to provide balances through July 31, 2013. CWC Rejoinder Exh. 3. Columbia is thus able to track its monthly inventory for purposes of supporting rate base recognition of its M&S purchases.

Further, the Commission's adoption of a 13-month average is not limited to larger companies. See, e.g., TESI 2008 at *29; Mechanicsburg 1993 at *34-35 (adopting a 13-month average corresponding with the test year); Media 1990 at 150-51.

The Company proposes that, if the Commission adopts the OCA's recommended 13-month average that the most recent 13-months should be used. CWC M.B. at 8. The OCA recommended use of a 13-month average based on the calendar year, which allows the expenditures to be matched with the maintenance and other expenses that are reflected in the test year claims, creating a better match between the test year level of inventory and the test year maintenance expenses incurred. OCA St. 1S at 9.

Columbia's thirteen-month average of M&S inventory from January 2012 to January 2013 was $57,722. OCA St. 1 at 7 (citing Company response to OCA-I-7). Accordingly, as discussed here and in the OCA's Main Brief, the OCA recommends adjusting the Company's rate base claim by $4,592 ($62,314 – $57,722) to the Company's claim for rate base. OCA Table II (updated), line 15; OCA M.B. at 21-22; OCA Exh. AEE-1S, Sch. 1S, line 3 (updated).

OCA Exception No. 3: CWC's Revenues for Merchandising Sales and Jobbing Work Should Be Reflected for Ratemaking Purposes. R.D. at 22-23; OCA M.B. at 23-26; OCA R.B. at 14-15.

CWC claimed $15,762 of revenue for Merchandising Sales and Jobbing Work as non-operating income. During the course of the proceeding, the Company accepted a portion of the adjustment for the revenues related to billing data. At issue is the remaining $5,838 of the revenue that the Company included in the Merchandising Sales and Jobbing account as non-operating income. That amount also should be included as above-the-line operating revenue because the expenses associated with these revenues were charged to operating expenses and paid for by Columbia ratepayers. OCA M.B. at 25. Thus, customers should get the benefit of the additional revenues. Id.

In rejecting the OCA's adjustment, the ALJ cites with approval to Columbia's statement that funds received from the sale of meters and insurance must be recorded to the accumulated depreciation reserve and not recognized as revenue for book and ratemaking purposes. R.D. at 23. However, Columbia does not actually follow this procedure, thus the ALJ's reliance on this testimony is misplaced. First, only $640 of the total Merchandising Sales and Jobbing Work of $15,762, was related to salvage value and insurance payments. OCA St. 1S at 2. Second, as noted by Ms. Everette, "Even if these repairs to capital items were considered fixed capital plant under the Uniform System of Accounts . . . this is not how the Company treated them." Id. If these revenues had been correctly accounted for under the Uniform System of Accounts, the Company would have credited the revenues to the depreciation reserve. The Company did not do that. Rather, the Company charged the repairs to Materials and Supplies expense and reflected the revenues as a credit to the expense. OCA St. 1S at 3; CWC response to I&E RE-21 (attached to OCA St. 1). Thus, contrary to the ALJ's determination that Mr. Shambaugh's statement is correct, the Company charged the expenses related to these revenues to expense accounts that are claimed in this case and the revenues received by the Company to offset these expenses should be considered as above the line and reflected in this case.

In the Company's last rate case in 2008, the Commission approved the inclusion of nearly identical revenues as above-the-line operating expenses. 2008 Order. Specifically, in 2008, the Company initially claimed that $12,662 of revenue received from the sale of water meter readings, bulk water sales, dual check valves, and damage or frozen meters was non-operating revenue. 2008 RD at *27. The then Office of Trial Staff argued "that Columbia claimed costs expended to generate these sums as operating expenses, and thus "all revenues generated from these expenditures should be included above the line as miscellaneous operating revenue." 2008 Order at *27-28. Columbia subsequently agreed to the adjustment and the ALJ recommended that the Commission add $12,662 to Columbia's operating revenue. Notably, the Commission adopted the ALJ's recommendation, finding the "recommendation to be reasonable, appropriate and otherwise in accord with the record evidence." Id. at *28.

The Company did not address the remaining revenues in rebuttal in this proceeding. The remaining $5,198[13] in revenues were received for assisting the Borough with turn offs and turn ons, and bulk water sales. As discussed above, because the Company claimed costs expended to generate the revenues as operating expenses, the revenues themselves should be included above-the-line. OCA St. 1S at 2. In rejoinder, Company witness Shambaugh opines that the revenues related to these tasks are not under the direct control of the Company. Tr. 133-34. This testimony is not relevant to the determination of whether the revenue should be above the line.

[13] $5,838-$640=$5,198.

The point is that there is revenue that was received for these tasks and since the expenses are claimed as expenses in this case, the revenues should be reflected in rates as well. The Company argues in its Main Brief that the revenues related to non-meter and non-insurance ($5,198) should not be included as operating income because there is a lack of stability in those items. Yet, the Company has not offered any evidence to support or demonstrate this claim. CWC M.B. at 17. The Company charged the expenses associated with these revenues to the customers of Columbia Water Company and, therefore, the customers should receive the revenues. OCA M.B. at 25; OCA St. 1S at 2.

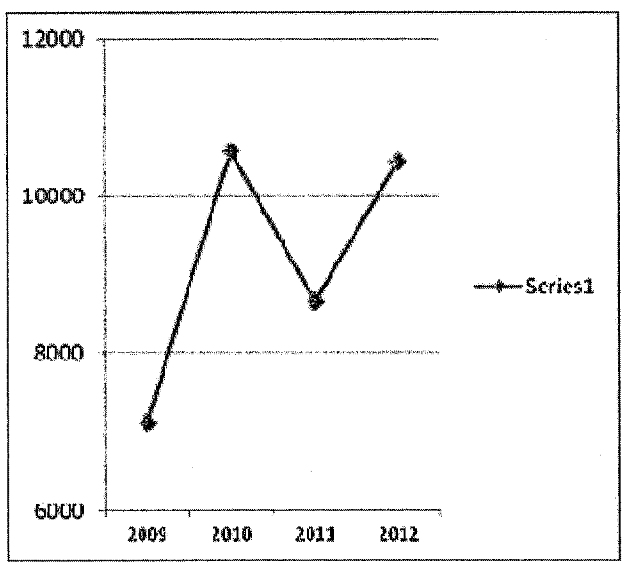
In summary, the OCA recommends that total $15,762 categorized as non-operating revenue for Merchandising Sales and Jobbing Work should be moved above-the-line. The Company has already admitted that the $9,932 associated with sewer billing data should be categorized as operating revenue. The remaining $5,838 includes the revenues for bulk water sales, assisting Columbia Borough with turn-offs and turn-ons, revenues for used meter sales, insurance payments for damage to a fence, and repairs to an air compressor. The OCA's recommendation is consistent with the Company's 2008 rate case in which the Commission adopted the adjustment to operating revenue. In addition, the Company has charged the expenses associated with these revenues to the customers of Columbia Water Company. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated).

OCA Exception No. 4: <u>Columbia's Bad Debt Expense Claim Should Reflect a Four Year Average to Account for Year to Year Variations.</u> R.D. at 27--28; OCA M.B. at 33-36; OCA R.B. at 19-20.

The Company claimed pro forma bad debt expense of $11,000. OCA St. 1 at 24; GDS Exh. No. 1 at 1-15. The claim should be adjusted to reflect a four year historical average of $9,192. OCA St. 1 at 24-25; OCA St. 1S at 9-12. A four year historical average of actual bad debt expense accounts for variations from year to year and is a more accurate method to estimate future bad debt expense. OCA St.1S at 10.

Although the ALJ determined that both the Company's approach and the OCA's approach were reasonable, the ALJ found that OCA had not "offered a convincing argument with respect to why its methodology should be preferred" and rejected the OCA's adjustment. R.D. at 28. As discussed below, the OCA has provided more than a sufficient basis as to why its adjustment is appropriate for ratemaking and why the Company's claim is unsupported and should be rejected. Moreover, the utility has the affirmative burden to establish the justness and reasonableness of every component of its rate request. See Burleson v. Pa. P.U.C., 461 A.2d 1234 (Pa. 1983). Conversely, there is no similar burden for a party proposing an adjustment to a utility base rate filing. Berner v. Pa. P.U.C., 382 Pa. 622, 116 A.2d 738 (1955).

The actual bad debt expenses for years 2009 through 2012 were as follows: $7,115 for 2009; $10,567 for 2010; $8,650 for 2011; and $10,436 for 2012. OCA St. 1 at 24. As illustrated by the following graph, the actual bad debt expense is not a linear progression but fluctuates from year to year.



OCA St. 1S at 10. Further, the fluctuations within the actual bad debt expense provided by the Company are significant; there is a 48.5% difference between the year with the highest bad debt expense (2010) and the year with the lowest bad debt expense (2009). OCA St. 1 at 24. The Company's increase of $564 from the test year 2012 expense of $10,436 to $11,000 does not accurately reflect the variation of bad debt expense. The OCA's adjustment is consistent with the Commission's traditional approach to this issue. Specifically, the Commission has held, "We note that bad debt expense has been traditionally computed based upon historical experience. Further, we note, in order to normalize bad debt expense to the extent possible, we consider projections over multi-year periods." Pa. P.U.C. v. LP Water & Sewer, 1993 PaPUC LEXIS 149, *63.

The Company posits that an increase in the bad debt expense of $564 over the test year 2012 expense is appropriate because "the real world of utility management recognizes that with customer rate increases, bad debt expense will likely increase because additional customers become delinquent on their water bills." CWC St. 2R at 15. Yet, the argument that an increase in rates will necessarily cause an increase bad debt expense is not the truism that the Company suggests. For example, the Company's actual bad debt expense for 2008 was $7,971. In 2009, after the rate increase of the 2008 rate case, the Company's bad debt expense was $7,115, a decrease of $856. OCA St. 1 at 24. Thus, the Company's argument that the bad debt expense must increase from the test year 2012 bad debt expense because the increase in rates will necessarily cause an increase bad debt expense is unfounded.

Similarly, citing the testimony of the Borough Manager that the Borough is an economically challenged community with a disproportionately high percentage of low-income households, senior citizens and rental housing, Columbia witness Shambaugh argued that, in his experience, bad debt will increase going-forward. Tr. 134-35. None of the public input testimony suggested that these conditions did not exist four years ago. Stated otherwise, during the past four years, under the same conditions, bad debt expense fluctuated significantly and as much as 48.5%.

Next, the Company argues that the claimed bad debt expense of $11,000 is reasonable because it only amounts to 0.23% of the Company's proposed billed revenues. CWC St. 2R at 16.[14] The OCA's proposed bad debt expense amounts to 0.25% of the OCA's proposed billed revenues ($3,725,556) at December 31, 2013. Id. OCA Witness Everette testified that "[j]ust as with the total amount of bad debt expense, the reasonableness of the percentage can only be assessed in terms of what that percentage has been historically. For this reason, the OCA has recommended an average of bad debt expense over the previous four years." OCA St. 1S at 11.

For the foregoing reasons, the Company's claimed bad debt expense of $11,000 should be adjusted to reflect a four year historical average of $9,192 in order to more accurately reflect the wide fluctuations of actual bad debt expense from year to year. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated).

OCA Exception No. 5: Columbia's Allocations to the Marietta Division Must Be Adjusted to Reflect Actual Experience. R.D. at 28-35; OCA M.B. at 36-53; OCA R.B. at 20-31.

The OCA made adjustments to a number of the Company's allocations to the Marietta Division to reflect a more accurate allocation of costs to that division.[15] The ALJ rejected nearly

[14] In direct and rebuttal testimony, the Company reflected an incorrect percentage of bad debt expense, stating that it was 0.023%. OCA St. 1S at 11. Company witness Shambaugh corrected it to 0.23%. Tr. 131.

[15] The OCA adjusted employee salaries and wages, and associated payroll taxes, pensions and benefits, including, health insurance, pension, disability and life insurance, vehicle insurance, worker's compensation insurance, accounting, and office expenses and utilities. OCA M.B. at 36-53.

all[16] of the OCA's adjustments by dismissing the OCA's adjustments as "what adjustments its witness wants." R.D. at 29. This criticism is unfounded. The OCA's witness has recommended adjustments that comport with acceptable ratemaking procedures and policies. Her detailed analysis of the actual costs incurred by Columbia provide more than a sufficient basis for the recommended allocations. The ALJ agrees with Columbia in part because the allocation factors may need to be adjusted in the future. See R.D. at 30. The OCA notes that it is the nature of allocation factors is that they may need to be adjusted in each case because the amount of time an employee may spend on one division versus another may vary for a number of reasons. In the context of the current case, the point is to determine the most accurate allocation factors based on the current information, which is what OCA's adjustments reflect. All of the OCA's adjustments are based on the data provided by Columbia.

a. Employee Salaries and Wages and Payroll Taxes

The ALJ rejected the OCA's adjustment (for the Foreman's and Service Person's salary) because he agreed with Columbia that, as noted by OCA's witness, the allocation may need to be adjusted in future cases. R.D. at 30. The OCA submits that this is the nature of allocation issues and should not be the basis to reject the OCA's adjustment. The ALJ also appears to criticize the OCA for accepting several corrections and updates that resolved adjustments that the OCA made to the Company's allocations for customer service personnel, meter reader, fire hydrant painter and operator. See R.D. at 29. As he notes, the OCA's objections were resolved by additional information, provided in Columbia's rebuttal testimony, which provided actual data regarding these positions.

[16] He accepted the OCA's adjustment to the accounting claim because he found the OCA's methodology reasonable and recognized that allowing the full costs to be included in the Columbia rates would result in a double recovery. R.D. at 34-35. He also adopted the OCA's adjustment for office expenses and utilities. R.D. at 35.

The Company allocates only 4.22% of the Foreman's salary and 2.31% of the Service Person's salary to the Marietta Division because it argues that these allocations are based on time spent on Marietta tasks during a three month period in 2012. CWC M.B. at 24. Ms. Everette has explained that the data from a few months of time sheets is not a reasonable basis to allocate wages over the course of a year. "Having a complete year-round picture is necessary in order to observe the fluctuations in the work load that may occur throughout the year." OCA St. 1 at 28; OCA St. 1S at 14. The Company provided no specific information to show that these two employees spend substantially less time on Marietta Division tasks than the 15% average estimated by Mr. Lewis even though their job descriptions include tasks in both divisions. Thus, until at least a year's worth of data is available, Ms. Everette's recommended allocations are fair and reasonable. OCA M.B. at 37-39; OCA St. 1 at 28-30; OCA St. 1S at 15-16.

The OCA allocated both Service Person positions at 15%, which decreased the revenue requirement for one and increased the revenue requirement for the other, for a net effect of increasing the revenue requirement by $735. For this reason, if the OCA's adjustment to the Service Person expense on line 10 of Schedule 2S (updated) is not accepted, Ms. Everette's adjustment on line 17 of Schedule 2S (updated) must also be adjusted so that her recommended revenue requirement decreases by $735. Id. The OCA notes that the ALJ did not make this concomitant adjustment.

The OCA's total recommended Salaries & Wages adjustment is $3,637. See OCA Table II (updated); OCA Exh. AEE-1S, Schs. 1S (updated), line 21, 2S (updated), line 26. It is also necessary to adjust Payroll Taxes to correspond to the OCA's Salaries & Wages adjustments. OCA M.B. at 39-40; OCA St. 1 at 30; OCA St. 1S at 18. The Company did not challenge the OCA's method of calculating its payroll adjustment. CWC M.B. at 25-26. These calculations are detailed on updated OCA Exh. AEE-1S, Schedule 3S (updated), and the $108 increase is shown on line 22 of Schedule 1S (updated). OCA Table II (updated).

b. Pension and Benefits

Columbia claimed a total pension expense of $59,682 and was able to support only $57,944 by providing the check that showed that was the amount it deposited for current pension expense. The OCA recommended an adjustment of $1,738 because Columbia supported $57,944. The ALJ rejected this adjustment because he did not "accept that just because the most current pension deposit does not reflect the total claimed expense that the total number is invalid." R.D. at 30-31.

By reflecting what was actually paid by Columbia, the OCA's adjustment is accurate and reasonable. The ALJ speculates that, "If there *is* a shortfall, then it seems to me that this is an amount that Columbia must nevertheless make good." R.D. at 31. There is no evidence that the $1,738 is a shortfall. Rather, the evidence shows that the actual payment was less than the estimate provided in the Company's original filing. The OCA's adjustment should be adopted.

c. Disability and Life Insurance

The OCA recommends that the Company's $10,176 claim for Disability/Life Insurance expense be reduced by $1,029 because the invoice provided in support of the claim supports only $9,147. OCA M.B. at 43; OCA St. 1 at 34 (citing CWC response to OCA-III-26). In rebuttal, the Company claimed that it had received a renewal notice for the Disability/Life Insurance premium, which would increase the expense by $1,659 but did not provide any documentation or specify a time period for the alleged increase. OCA R.B. at 24. Accordingly, OCA witness Everette adjusted the claim to the $9,147 amount supported by the invoice. OCA Exh. AEE-1S, Schs. 5S (updated), lines 37, 43, 6S (updated), line 4. In the Recommended Decision, the ALJ rejected the OCA's adjustment based on the unsupported statement that the insurance premium would increase. R.D. at 31.

The OCA also adjusted this expense to allocate it in the same way as the other Pension and Benefits expenses. The OCA recommends that $765 related to Disability and Life Insurance expenses be moved to the Marietta Division. OCA Table II (updated); OCA Exh. AEE-1S, Schs. 5S (updated), line 44, 6S (updated), line 4. The ALJ rejected the OCA's adjustment because it was too speculative. R.D. at 32. The OCA submits that its adjustment is not speculative as discussed above and for the reasons set forth in the OCA's Main and Reply Briefs.

d. Vehicle Insurance

The Company claimed a vehicle insurance expense of $6,900. OCA St. 1 at 37-38; OCA St. 1S at 23-25; OCA M.B. at 46. The OCA addressed the issue of the Company's claimed vehicle insurance expense on pages 46 to 48 of its Main Brief.[17] The OCA recommended that a portion of the claimed expense be allocated to the Marietta Division because Columbia vehicles were used to perform work for the Marietta Division. OCA M.B. at 46.

The ALJ rejected the OCA's adjustment because he accepted the statements made by Mr. Lewis at the hearing. R.D. at 33. However, the ALJ did not address the fact that these statements are inconsistent with the statements made by the Company in its response to discovery. As discussed below, the OCA's adjustment should be adopted.

In its Main Brief, the Company argues that none of the vehicle insurance expense should be allocated to the Marietta Division because employees that do work for the Marietta Division do not use Columbia vehicles.

[17] The OCA notes that its recommended allocation percentage has decreased from the 8.54% referenced in its Main Brief to 8.49% in its updated schedules. OCA Exh. AEE-1S (updated), Sch. 2S (updated), line 31. Accordingly, the updated adjustment to the Company's claimed vehicle insurance expense is $586. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 24.

Despite the Company's argument in its Main Brief to the contrary, this position is inconsistent with earlier statements made by the Company. See OCA M.B. at 46-47. In response to OCA-III-48, the Company indicated that "other vehicles on the policy are used by workers when doing work for the Marietta Division," and when it had more data, "[a] portion of the shared vehicle's commercial auto premium will be expensed to the Marietta Division using hours worked by staff in that division as the basis for sharing." OCA St. 1 at 37; OCA M.B. at 47. It is inherently inconsistent to indicate that Columbia vehicles were used to perform work for Marietta and that part of the vehicle insurance expense would be allocated to the Marietta Division when more data became available and then not allocate any vehicle insurance expense to Marietta by claiming that the work done for the Marietta Division is performed by workers that do not use a vehicle. Thus, based on the Company's own statements in response to OCA-III-48, it is appropriate to allocate vehicle insurance expense to the Marietta Division. OCA M.B. at 47.

The Company also claims the vehicle insurance expense is increasing and requests to adjust the vehicle insurance expense upward by $837. CWC M.B. at 30. The OCA argued that such an increase should not be permitted because it does not fall within the Future Test Year, or in the alternative, a portion of the increase should also be allocated to the Marietta Division. OCA M.B. at 48. In its Main Brief, the Company stated that the increase should be allowed because it is known and measurable and "it doubts OCA would ask the Commission to ignore the notice if it was a decrease in insurance rates." CWC M.B. at 30. The purpose of the test year concept, however, is to capture all revenues and all expenses and match them at a point in time. While some expenses may go up and others may go down, increases or decreases are not added at the last minute. Based on the foregoing, 8.49%, or $586, of the Company's vehicle insurance expense should be allocated to the Marietta Division, and the Company's request to increase the vehicle insurance expense should be denied. OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 24; OCA M.B. 46-48.

e. Worker's Compensation

The Company claimed a worker's compensation insurance expense of $24,500. OCA St.1 at 38; OCA St. 1S at 25-26; OCA M.B. at 48. The OCA recommends that 11.95%[18] (or $2,927) of the worker's compensation insurance expense should be allocated to the Marietta Division. OCA M.B. at 48-49; OCA Exh. AEE-1S, Sch. 7S (updated), line 3; OCA St. 1 at 38-41; OCA St. 1S at 25-26. The ALJ rejected the OCA's adjustment despite concluding that the Marietta Division does not carry its own worker's compensation insurance for its employees. R.D. at 34. If Marietta does not carry worker's compensation insurance, then the insurance is borne by Columbia and some portion must be allocated to the Marietta division as the OCA did with its adjustment.

The OCA argued that the Marietta Division has three employees that work solely for Marietta, but the Marietta Division does not carry its own worker's compensation insurance. OCA M.B. at 48-49. Consequently, assuming that the Company has complied with the requirement that it provide worker's compensation insurance, the expense claimed by the Company must include the expense for insuring the employees that work solely for the Marietta Division. Id. The Company does not address this issue or provide any explanation in its Main Brief.

Further, after the Company initially proposed allocating none of the worker's compensation expense to the Marietta Division, including the amount for Marietta-only

[18] This number has been updated to be consistent with updates to the OCA's recommended adjustment to Salaries & Wages expense. OCA Exh. AEE-1S, Schs. 1S (updated), line 25, Sch. 7S (updated).

employees, the Company created a new argument that only 3.8% of the expense should be allocated to the Marietta Division "based upon the actual hours worked on Marietta Division tasks. CWC M.B. at 31. The Company has the burden of proof to establish that 3.8% is the proper allocation but has provided no evidence or data to support this allocation, only a conclusory statement by Company Witness Lewis that worker's compensation should be allocated accordingly. See CWC St. 1R at 9.

Similar to the vehicle insurance expense, the Company has also requested the worker's compensation expense be increased by $2,752 after receiving a letter from its insurance provider indicating that the Company's premiums are expected to increase. OCA St. 1S at 26; OCA M.B. at 50. Just as with the vehicle insurance, the increase does not fall within the Test Year and last minute estimated increases should not be permitted because the purpose of the test year concept is to capture all revenues and all expenses and match them at a point in time. For the foregoing reasons, 11.95% of the Company's worker's compensation insurance expense should be allocated to the Marietta Division, and the Company's request to increase the expense should be denied. OCA Table II (updated); OCA Exh. AEE-1S, Schs. 1S (updated), line 25, 7S; OCA M.B. at 48-50.

OCA Exception No. 6: Columbia's Claims for Officers Salaries and Directors Fees Should Be Reduced to Reflect a Reasonable Level of Costs. R.D. at 35-39; OCA M.B. at 53-65; OCA R.B. at 31-40.

Columbia claimed $68,900 of Salaries for Officers, Directors and Majority Shareholders and $62,500 for Directors' Fees & Expenses in this proceeding. The OCA recommends an adjustment based on the reasonableness of these costs (a reduction of $33,451 to the combined claim of $130,835) and also an adjustment of $14,608 to allocate a portion of these expenses to the Marietta Division because Columbia did not allocate any of these expenses to the Marietta

Division. OCA M.B. at 53, 63-64. The ALJ rejected both adjustments. Regarding the adjustment to the overall claim, the ALJ states that the OCA's adjustment is based on hours and dollar amounts that are "entirely hypothetical" and that it equates to micromanaging. R.D. at 36-37. As discussed below, the OCA based its adjustment on the actual data provided by Columbia and the equivalent hourly rate of the President, Mr. Nikolaus. The ALJ also rejected OCA's recommended allocation of 15% of the costs to the Marietta Division stating that it is an "arbitrary allocation" and that there is no magic in 15%. As discussed below, the OCA's proposed allocation of 15% is not arbitrary, rather it is based on the record in this proceeding and it is grounded in the data provided by Columbia, thus, no magic is necessary. Finally, the ALJ's determination that Columbia's original claim, *i.e.*, no costs allocated to the Marietta Division, ignores Columbia's subsequent testimony that a 4% allocation was reasonable. CWC M.B. at 40; CWC St. 1R at 21; GDS Rebuttal Exh. 3 (Revised) at 2.

The evidence in this proceeding establishes that the overall cost of the officers and directors is excessive given the amount of time spent on Columbia business. Ratepayers should pay rates that reflect a reasonable level of officers and directors fees. The OCA's adjustment is based on the information that Columbia provided regarding Mr. Nikolaus' active contribution to the Company as an Officer and Director. OCA M.B. at 55-56; OCA St. 1 at 56-57. The OCA disagrees with the ALJ's conclusion that consideration of the time spent on Company business means that the OCA is ignoring "quality in exchange for quantity." R.D. at 37; CWC M.B. at 39. The OCA has not challenged the quality of work provided by the officers and directors. Rather, the OCA is evaluating the active contribution of these individuals to the Company's provision of water service. OCA M.B. at 54-55; OCA St. 1 at 51-53, 55-56. As discussed above, the shareholders may pay any amount, but the hours spent on Company business are a reasonable check on the amount recoverable in rates. Thus, contrary to the ALJ's conclusion, the OCA is not micromanaging rather, the OCA is recommending an adjustment that would result in ratepayers paying a reasonable level of expense for the value provided by the officers and directors. To accept the ALJ's approach, would be to allow any amount to be claimed, because it is so difficult to measure the quality of the work provided by the officers and directors. That position is not reasonable for ratemaking purposes.

The evidence shows that the compensation of the officers and directors is excessive in relation to the time spent on Columbia business. The amount of Officers' Salaries and Directors' Fees that is charged to ratepayers should reflect the contribution provided to Columbia by its officers/directors. The OCA recommends that the Officers' Salaries expense of $68,900 be reduced by $12,456 and Directors' Fees of $61,935 by $20,995, or a total reduction of $33,451. See OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 31.

Regarding the ALJ's characterization of the OCA's 15% allocation factor as "arbitrary", it should be noted that the 15% is the number provided by Columbia. The Company's Vice President stated that the Company expensed 15 percent of the salaries and benefits of Columbia's salaried employees to the Marietta Division. OCA St. 1 at 58 (citing Company response to I&E-RE-6). This allocation is based on his "prior experience as Superintendent for the Marietta Gravity Water Company." Mr. Lewis also pointed out that his 15% allocation is supported by the fact that the Marietta Division accounts for about 12 percent of the overall customer base. Id. (citing Company response to OCA-III-17). The OCA used that specific factor because it is logical that the time spent by Columbia's officers and directors will be the same as or similar to the ratio of time spent by Columbia employees on the Marietta Division. Id. Thus, the ALJ's characterization of the OCA's adjustment should be rejected. Moreover, the OCA's adjustment is reasonable and should be adopted.

The Marietta Division customers have an amount for Officers' Salaries and Directors' Fees built into base rates. OCA R.B. at 41 ($34,650 in 2011). They should contribute a fair amount toward the expenses of their new Board and Officers. Id. Further, if these amounts are not allocated to the Marietta Division, Columbia will be overcollecting. The Company seeks to recover approximately $126,180 of Officers' Salaries and Directors' Fees from the Columbia Division. Id. If approved, the Company would collect this amount plus the amount in Marietta Division rates ($34,650) for a total of $160,830. But the Company is only paying the Officers and Directors $131,400, which means it would overcollect annually by $29,430. Id.

For these reasons, the OCA's recommended 15% allocation of the total Officers' Salaries and Directors' Fees allowed by the Commission to the Marietta Division should be adopted. Ms. Everette recommended a total expense of $97,384 for Officers' Salaries and Directors' Fees ($56,444 for Officers' Salaries and $40,940 for Directors' Fees); 15% of this results in an allocation of $14,608 to the Marietta Division.[19] OCA Table II (updated); OCA Exh. AEE-1S, Sch. 1S (updated), line 32.

[19] If the Commission does not accept the OCA's adjustment to the amount of Officers' Salaries and Directors' Fees expenses, *i.e.* allows the entire claim of $130,835 ($68,900 Officers' Salaries + $61,935 Directors' Fees), 15%, or $19,625 should be allocated to the Marietta Division. OCA St. 1S at 59, n.22.

III. CONCLUSION

For all of the reasons discussed above and in its Main and Reply Briefs, the Office of Consumer Advocate respectfully excepts to the Recommended Decision of Administrative Law Judge Buckley on the issues discussed above. The Office of Consumer Advocate respectfully requests that the Commission grant these exceptions.

Respectfully Submitted,

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December 6, 2013
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CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission	:		
v.	:	Docket No.	R-2013-2360798
Columbia Water Company	:		

I hereby certify that I have this day served a true copy of the foregoing Exceptions of the Office of Consumer Advocate upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant) and as modified by the Presiding Officer, in the manner and upon the persons listed below:

Dated this 6th day of December 2013.

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