**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17105**

Public Meeting held January 9, 2014

Commissioners Present:

Robert F. Powelson, Chairman, Statement

John F. Coleman, Jr., Vice Chairman

James H. Cawley, Dissenting on Rate of Return Issue

Pamela A. Witmer

Gladys M. Brown

Pennsylvania Public Utility Commission, R-2013-2360798

The Office of Consumer Advocate, C-2013-2363612

The Office of Small Business Advocate, C-2013-2363728

and Vincent E. Collier C-2013-2364726

v.

The Columbia Water Company

**OPINION AND ORDER**

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**BY THE COMMISSION:**

Before the Pennsylvania Public Utility Commission (Commission) for consideration and disposition are: (1) the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Dennis J. Buckley issued on November 22, 2013; (2) the Exceptions to the Recommended Decision filed on December 6, 2013, by the Columbia Water Company (Columbia, CWC, or Company), the Office of Consumer Advocate (OCA), and the Commission’s Bureau of Investigation and Enforcement (I&E); and (3) the Reply Exceptions filed on December 16, 2013, by the Company, the OCA and I&E. For the reasons explained more fully below, we shall modify the ALJ’s Recommended Decision and authorize the Company to file a revised tariff supplement designed to provide the Company with the opportunity to collect additional base rate revenues of $534,970.

# I. History of the Proceeding

On April 25, 2013, Columbia filed Supplement No. 60 to Tariff—Water Pa. P.U.C. No. 7, which contained proposed changes in rates, rules, and regulations calculated to recover an estimated annual increase in base rate revenues of $773,210 from customers of its Columbia Division. Complaints against the proposed rate increase were filed by the OCA, the Office of Small Business Advocate (OSBA), and Mr. Vincent E. Collier.[[1]](#footnote-1) I&E entered an appearance. By Order entered June 13, 2013, the Commission suspended the filing by operation of law until January 24, 2014.

On September 3, 2013, a public input hearing was held in Columbia, Pennsylvania, at which twelve witnesses gave sworn testimony. Vincent Collier, who filed a Formal Complaint (Complaint) against the proposed rate increase, testified and asked that the rate increase request be denied in its entirety. The public input hearing produced a transcript of eighty-four pages and four exhibits.

On September 5, 2013, an evidentiary hearing was held in Harrisburg, Pennsylvania. Columbia presented two witnesses, David Lewis and Gary Shambaugh. Ethan Cline testified for I&E, and Ashley Everette testified for the OCA. The hearing produced a transcript of 118 pages and fourteen exhibits. The Parties filed Main Briefs on September 26, 2013, and Reply Briefs on October 7, 2013. The record closed on October 31, 2013.

On November 22, 2013, ALJ Buckley issued his Recommended Decision, recommending that the Company’s proposed rate increase of $773,210 be rejected, and that the Company instead be authorized to file a tariff supplement designed to produce additional revenues of $87,699.

# II. Background

The Columbia Water Company has two divisions. The Columbia Division serves Columbia and Mountville Boroughs and West Hempfield and Manor Townships in Lancaster County. The Marietta Division serves Marietta Borough and East Donegal Township in Lancaster County, and Hellam Township in York County. This rate case pertains only to the Company’s Columbia Division. The Columbia Division serves approximately 8,870 customers. CWC St. 1 at 2-3.

In this rate case, Columbia has requested an increase to annual operating revenues of $773,210. I&E recommended a decrease of $243,609 to the Company’s current annual revenues of $4,227,272. Similarly, the OCA recommended a revenue decrease of $320,267.

The ALJ observed that Columbia is a relatively small, local water company, and opined that the proposed adjustments should not be about what Columbia *might* do in an ideal world, but whether the evidence presented by Columbia supports its rate increase request. The ALJ concluded that Columbia’s overall management of its affairs has been reasonable. In this regard, the ALJ noted that “with limited exceptions, I am reluctant to accept proposed adjustments, that while in and of themselves may be supportable, are not reasonable for this utility.” R.D. at 17. The ALJ noted that the Commission is not a super-board of directors, but that accepting a number of the proposed adjustments would have the effect of the Commission acting as such. *Metropolitan Edison Company v. Pa. PUC*, 437 A.2d 76 (Pa. Cmwlth. 1981); *Northern Pa. Power Company v. Pa. PUC,* 333 Pa. 265, 5 A.2d 133 (1939).

The ALJ identified three primary issues in this case: (1) whether certain Pennsylvania Infrastructure Investment Authority (PennVest) financed plant should be included in the Company’s rate base; (2) the allocation of certain expenses to the Marietta Division; and (3) the Company’s capital structure and rate of return. R.D. at 49. The ALJ concluded that Columbia’s inclusion of its remaining used and useful undepreciated PennVest plant and facilities in rate base is appropriate. The ALJ also concluded that I&E’s recommended 7.07% overall rate of return, derived from its recommended 50/50 capital structure and its recommended 9.15% cost of common equity, is reasonable. The ALJ rejected Columbia’s request for a combined upward adjustment of 50 basis points to its return on equity to reflect the Company’s management efficiency and the acquisition of two water systems. In lieu of Columbia’s requested rate increase of $773,210, the ALJ recommended a revenue increase of $87,699 to be allocated on an “across-the-board” basis to all customers. R.D. at 49.

# III. Discussion

## **A. Legal Principles**

In this proceeding, the Company has the burden of proof to establish that it is entitled to the relief it is seeking. 66 Pa. C.S. § 332(a). The Company must establish its case by a preponderance of the evidence. *Samuel J. Lansberry, Inc. v. Pa. PUC*, 578 A.2d 600 (Pa. Cmwlth. 1990), *alloc. den*., 529 Pa. 654, 602 A.2d 863 (1992). To meet its burden of proof, the Company must present evidence more convincing, by even the smallest amount, than that presented by any opposing party. *Se-Ling Hosiery, Inc. v. Margulies*, 364 Pa. 45, 70 A.2d 854 (1950).

In general rate increase proceedings under Section 1308(d) of the Public Utility Code (Code), 66 Pa. C.S. § 1308(d), a public utility has the burden of proving the justness and reasonableness of every element of its rate increase request. The standard to be met by the public utility is set forth at 66 Pa. C.S. § 315(a):

**Reasonableness of rates.** –In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceeding upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. § 315(a). The burden of proof does not shift to parties challenging a requested rate increase. Rather, the burden of proof remains with the public utility throughout the course of the rate proceeding. *Berner v. Pa. PUC,* 382 Pa. 622, 116 A.2d 738 (1955).

Although the utility bears the burden of proving that its proposed rate increase is just and reasonable, a party that advances a proposal that the utility did not include in its filing carries the burden of proof as to that contrary proposal. *Petition of Duquesne Light Company*, Docket No. P-2012-2301664 (Order entered January 25, 2013); *Joint Default Service Plan for Citizens’ Electric Company and Wellsboro Electric Company*, Docket Nos. P-2009-2110798, *et al*. (Order entered February 25, 2010); *Pa. PUC v. Metropolitan Edison Company*, Docket Nos. R-00061366, *et al.* (Order entered January 11, 2007).

A public utility is entitled to an opportunity to earn a fair rate of return on the value of the property dedicated to public service. In determining a fair rate of return the Commission has been guided by the criteria provided by the United States Supreme Court in the cases of *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) (*Bluefield*), and *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591 (1944) (*Hope*). In *Bluefield*, the Court stated:

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

262 U.S. at 692-693. In *Hope*, the Court stated:

From the investor or company point of view, it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

320 U.S. at 603 (citations omitted).

Before we address the merits of the Exceptions to the Recommended Decision, we note, as a preliminary matter, that any issue or Exception that we do not specifically address has been duly considered and will be denied without further discussion. It is well settled that the Commission is not required to consider, expressly or at length, each contention or argument raised by the parties. *Consolidated Rail Corporation v. Pa. PUC*, 625 A.2d 741 (Pa. Cmwlth. 1993); *see also*, *generally*, *University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984).

## **B. Rate Base**

### 1. **PennVest Book Depreciation Reserve**

**a. Positions of the Parties**

Columbia’s original claim for rate base in its filing, as of December 31, 2013, was $13,527,774. CWC St. 2 at 11:14-15; GDS Exh. 1 at 1-17. However, during the course of the proceeding, Columbia revised its rate base claim to $13,796,745. CWC M.B. Table I. Columbia explained that it had overstated the book depreciation reserve related to the PennVest plant in service. The Company’s book depreciation ($1,853,844) for this plant includes annual depreciation accruals based upon the straight-line average remaining life methodology. However, Columbia witness Shambaugh testified that the PennVest rate was based solely on the 4% Compound Interest method during the term of the rate. Therefore, there exists a difference between the book depreciation reserve and the capital recovery in customer rates of approximately $339,038 for this plant. CWC St. 2R at 20:12-21; Tr. at 142.

The most contentious issue in this proceeding was whether the PennVest book depreciation reserve should be included in the Company’s rate base, given the discontinuance of the Company’s PennVest surcharge in 2011. I&E and the OCA took the position that utilities may choose to finance plant additions through inclusion in rate base or through a principal and interest surcharge, but not both. I&E St. 3SR at 4; OCA St. 1S at 38. As I&E stated in its Main Brief:

That PennVest loan had been completely repaid by the Company in 2011 from proceeds received as a result of the Company’s decision to increase customer rates on a volumetric basis. Given the Company’s collection of the entire amount of the monies used to add the PennVest-financed plant to the system, it is fair and accurate to state that not one penny of the cost of this portion of plant has come out of the pockets of the Company and they have no right whatsoever to claim that they are entitled to a return of and a return on monies they’ve invested in the plant – because there are none.

I&E M.B. at 21.[[2]](#footnote-2)

Likewise, the OCA argued that the Commission’s 1994 *PennVest Policy Statement*[[3]](#footnote-3) provides that only principal and 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.

In reply, Columbia pointed to the Commission’s Opinion and Order at *Pa. PUC v. Columbia Water Company*, Docket No. R-00932594 (Order entered June 1, 1993) (*1993 PennVest Order*) as the basis for the rate base/rate of return treatment approved for this plant. According to Columbia, I&E and the OCA are challenging a Commission-approved rate. CWC R.B. at 7-8.

Columbia argued that, once the treatment of PennVest plant was approved by the Commission’s *1993 PennVest Order* as a volumetric rate base/rate of return rate, the *1993 PennVest Order* became “*prima facie* evidence of the facts found and shall remain conclusive upon all parties affected thereby, unless set aside, annulled or modified on judicial review” in accordance with Section 316 of the Code, 66 Pa. C.S. § 316. Columbia submitted that the volumetric rate base/rate of return rate for this plant was never appealed, and thus remains conclusive. CWC R.B. at 8-9. Columbia also argued that the I&E and OCA position is contrary to Generally Accepted Accounting Principles (GAAP) and well-established ratemaking principles, and would conflict with the United States Tax Code. *Id*. at 14-20.

**b. ALJ’s Recommendation**

The ALJ agreed with the Company’s position, stating that the Commission’s *1993 PennVest Order* cannot be ignored. The ALJ concluded that Columbia’s inclusion of its remaining used and useful undepreciated PennVest plant in rate base is appropriate. R.D. at 22.

**c. Exceptions**

**In its first Exception, I&E argues that the ALJ erred by not**adopting I&E’s recommendation that the Company’s rate base claim exclude the depreciated value of plant funded entirely from a PennVest loan. I&E argues that this plant was completely funded by ratepayers through an accelerated and adjusted charge that allowed the Company to timely repay the underlying principal and interest pursuant to the PennVest loan repayment schedule. I&E recommends that the Commission reduce the Company’s rate base claim by $3,048,292 to remove the depreciated value of the PennVest-financed plant from Columbia’s rate base. I&E notes that this adjustment would require a corresponding reduction to the Company’s claimed depreciation expense related to the plant. I&E Exc. at 5-6.

I&E further notes that the ALJ stated that ‘but for’ the unique regulatory history of Columbia’s PennVest plant, he would have been inclined to accept I&E’s proposed adjustment. *Id*. at 6, citing R.D. at 38. I&E states that the ALJ’s reasoning in rejecting the proposed adjustment presumably was based on his conclusion that he was bound to adhere to the terms and conditions agreed to by the OCA and the Company, and approved by the Commission in the *1993 PennVest Order*, which the ALJ stated “cannot be ignored.” *Id*. at 7, citing R.D. at 22.

Moreover, I&E argues that the Company itself ignored the results of the *1993 PennVest Order*, and instead transformed the subsequent collection of the PennVest loan repayment into a surcharge mechanism for all intents and purposes. According to I&E, the Company deviated from the terms of the Joint Stipulation approved in the *1993 PennVest Order*, and therefore those terms are no longer applicable. Specifically, I&E submits that, in the rate cases that followed the *1993 PennVest Order*, the Company removed the PennVest-funded plant from rate base; removed the surcharge revenues; and excluded the PennVest loan from its capital structure in calculating its base rate revenue requirement. I&E alleges that the Company changed and reconciled the volumetric charge several times over the term of the PennVest loan to ensure that adequate monies were collected from ratepayers, and then subsequently extinguished that charge when the loan was repaid. I&E argues that these actions by Columbia either were not taken into consideration or were not given sufficient weight by the ALJ. *Id*. at 7-8. I&E argues that the provisions of the *1993 PennVest Order* are no longer applicable, since the Company failed to adhere to the rate base treatment parameters provided for at that time. *Id*. at 8-9.

I&E submits that the Company’s PennVest loan was completely repaid by 2011 from proceeds received as a result of the Company’s decision to increase customer rates on a volumetric basis. “Given the Company’s collection of the entire amount of the monies used to add the PennVest-financed plant to the system, it is accurate to state that no Company monies were expended to finance any portion of the cost of the plant.” *Id*. at 9‑10. I&E argues that the Commission should not allow a utility to fully recover the monies used to finance plant through PennVest loan repayments, and then allow that utility to collect additional revenues from ratepayers by placing that very same plant (at its depreciated value) in rate base. I&E speculates that, if the Commission does not adjust Columbia’s rate base, it is likely that other utilities that have repaid PennVest loans with customer-provided funds would attempt to follow suit and include the undepreciated value of their PennVest-financed plant in rate base. *Id*. at 10.

I&E states that it appears that the ALJ was aware of the potential adverse precedential effect of his recommendation because he attempted to limit its applicability by stating that “but for” the “unique regulatory history of this PennVest plant,” he would have been “strongly inclined” to accept I&E’s proposed adjustment. *Id*. at 11, citing R.D. at 39. I&E submits that it is unlikely that the ALJ’s qualification would be recognized by other utilities that become aware that Columbia received full recovery through a surcharge methodology and then received rate base treatment for the same plant. *Id*.

As support for its argument that the Company cannot recover the principal amount of a PennVest loan, plus interest, that is used to finance plant, and then include the undepreciated value of the plant in rate base, I&E refers to the Commission’s *PennVest Policy Statement*, which states, in relevant part, that:

Companies with outstanding PENNVEST loans not currently reflected in rates and companies that will receive PENNVEST loans in the future are encouraged to establish under 66 Pa. C.S. § 1307(a) (relating to sliding scale of rates; adjustments) and subject to Commission approval, an automatic adjustment by means of a sliding scale of rates limited solely to the recovery of PENNVEST principal and interest obligations, **instead of seeking recovery of these amounts under 66 Pa. C.S. § 1308 (relating to voluntary changes in rates) base rate filing**.

52 Pa. Code § 69.361 (emphasis added). I&E submits that the *PennVest Policy Statement* demonstrates that a utility may finance plant additions *either* through rate base inclusion *or* through a PennVest surcharge on its customers, but not both. *Id*. at 12-13. In conclusion, I&E states that, since Columbia provided no monies of its own toward the original cost of the PennVest financed plant, it is not entitled to include the depreciated value of this plant in rate base. *Id*. at 13.

I&E notes in its second Exception that the removal of the PennVest-financed plant from the Company’s rate base claim would require a corresponding reduction to the Company’s claimed level of depreciation expense related to that plant. I&E proposed a reduction to Columbia’s annual depreciation expense claim in the amount of $115,913.[[4]](#footnote-4) Consistent with its recommendation that the PennVest plant be removed from the Company’s rate base, I&E submits that the Commission should approve a depreciation claim of $623,347, which reflects a reduction of $115,913 ($739,260- $115,913) to the Company’s annual depreciation expense claim. *Id*. at 13-15.

In its first Exception, the OCA similarly argues that Columbia should not be permitted to collect PennVest-funded plant twice from ratepayers, as memorialized in the Commission’s 1994 *PennVest Policy Statement*. OCA Exc. at 3-4. The OCA submits that, under a surcharge, a utility “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.” *Id*. at 4. The OCA further submits that the determination of rate base treatment versus a surcharge is made during the case in which the plant first becomes used and useful. According to the OCA, once that determination is made by the Commission, generally there is no opportunity to change the methodology. *Id*. at 5.

The OCA states that the *1993 PennVest Order* arose from a request filed by Columbia for approval of a surcharge to recover the costs associated with a PennVest loan. The OCA opposed Columbia’s proposed surcharge mechanism, and the Commission subsequently approved a Joint Stipulation of Settlement (1993 Settlement) between the Company and the OCA that provided for rate base recovery of the PennVest costs. The primary feature of the 1993 Settlement was Columbia’s agreement to rate base treatment for plant additions of $4,547,617, constituting amounts attributable to PennVest funding, rather than a surcharge equal to the debt service on the PennVest Loan. *1993 PennVest Order* at 1-2. The OCA states that, because the 1993 case was an abbreviated, single-issue proceeding, rate base treatment was effectuated through a volumetric charge. *1993 PennVest Order*, Appendix C, at 1-2. OCA Exc. at 6-7.

The OCA states that the disagreement in the instant proceeding pertains to what happened *after* the *1993 PennVest Order*. According to the OCA, Columbia changed its method of recovery from rate base treatment to a reconcilable surcharge. “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.” [[5]](#footnote-5) *Id*. at 7. The OCA states that, in the instant case, Columbia argues that it has maintained a separate PennVest rate base to which it has applied the rates of return and depreciation approved by the *1993 PennVest Order*.[[6]](#footnote-6) The OCA argues that this rate treatment was not authorized by the Commission’s 1997 Order at *Pa. PUC v. Columbia Water Co.*, Docket No. R-00974007 (Order entered December 18, 1997) (*1997 Order*), and is inconsistent with how other utilities reflect PennVest plant in rate base. *Id*.

According to the OCA, in 1997 Columbia began to reconcile its PennVest rate to ensure it hit its income target. In response to the Company’s argument that its income target was based on continued rate base/rate of return, the OCA argues that the Settlement approved by the Commission’s *1997 Order* (1997 Settlement) tied the surcharge to PennVest payments. The OCA refers to a statement in the 1997 Settlement that the Company was “significantly under-recovering adequate revenues to repay the PennVest loan,” and a provision in the 1997 Settlement that the Company would revisit the PennVest surcharge annually “in order to ‘true-up’ recovery under such surcharge.” 1997 Settlement at 5. OCA Exc. at 8. The OCA submits that Columbia reconciled the surcharge at least four more times during the loan period, in 2001, 2003, 2005 and 2007.[[7]](#footnote-7) The OCA submits that the subsequent cases explicitly state that the surcharge was being reconciled to the annual repayment amount, and that the surcharge was no longer based on a rate base/rate of return income target. *Id*. at 9.

The OCA notes that, in 2011, Columbia filed a tariff supplement ending the surcharge when it ended its principal and interest payments to PennVest. According to the OCA, the surcharge had been in effect for fourteen years, since the Company changed its recovery method to a reconcilable surcharge in 1997. OCA Exc. at 10. The OCA notes that the Company’s cover letter stated that “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.” *Id*. The OCA further argues that, whatever the Company’s belief or intent, the evidence shows that the *Commission* was reconciling a surcharge rather than approving rate base treatment, citing the Commission’s approval of the 1997 Settlement that “tied the surcharge increase to PennVest payments,”[[8]](#footnote-8) and subsequent cases in 2001, 2003, 2005 and 2007, where the Commission stated explicitly that surcharge recovery was being reconciled to the annual repayment amount and not to a rate base/rate of return income target. *Id*.

According to the OCA, the Company made a choice to recover its investment through a surcharge over the life of the PennVest loan (a much faster recovery), rather than depreciation and return over the life of the plant. The OCA argues that consequently 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.” *Id.* at 11. Because Columbia retired its PennVest debt in 2011, the OCA submits that there no longer is any value to include in rate base. *Id*. Although the OCA concedes that the PennVest-funded plant remains used and useful, the OCA argues that “the Company cannot now add it to rate base and earn a return, as if the surcharge never existed.” *Id*. at 12.

The OCA also submits that its position is consistent with *Pa. PUC v. National Utilities, Inc.*, 1994 WL 711488, 1994 PaPUC LEXIS 55 (1994) (*NUI Order*), where he utility asked for approval to take PennVest-financed plant that the company had been recovering through a reconcilable surcharge and place it into rate base at its depreciated original cost amount. The Commission allowed the plant to be included in rate base, but only at the amount of the PennVest account loan balances. The OCA observes that, 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. The OCA argues that:

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. If Columbia believed that it had not fully recovered principle (sic) and interest on the loan, it had the opportunity to reconcile the surcharge rather than ending it in 2011. The Company cannot, however, recalculate its rate base as though surcharge recovery never occurred.

OCA Exc. at 13 (record citation and footnote omitted). Accordingly, the OCA proposes that the Company’s rate base claim be reduced by $3,048,292, to remove the net plant in service as of December 31, 2013, that was funded by PennVest loans. The OCA also proposes that Columbia’s claim for associated annual depreciation expense of $115,913 be eliminated. *Id*.

**d. Reply Exceptions**

In reply to the Exceptions of I&E and the OCA regarding the inclusion of undepreciated PennVest plant in rate base, as well as the associated accrued and annual depreciation, Columbia argues that I&E and the OCA ignore the *1993 PennVest Order* and Section 316 of the Code, 66 Pa. C.S. § 316, which mandates that Commission Orders “shall be *prima facie* evidence of the facts found and shall remain conclusive upon all parties affected thereby, unless set aside, annulled or modified on judicial review.” Columbia submits that the *1993 PennVest Order* set the PennVest volumetric rate using a rate base/rate of return methodology, was never appealed, and thus became conclusive upon all Parties. Columbia emphasizes that both I&E’s and the OCA’s witnesses admitted on cross-examination that they were unaware of the *1993 PennVest Order* when they prepared their pre-filed testimony***.*** CWC R.Exc. at 5.

Columbia submits that the I&E and OCA argument is based primarily on the allegation that, although the PennVest volumetric rate was established in 1993 based on rate base/rate of return principles, this rate was somehow converted, without Commission Order, into a debt-service only surcharge that recovered only the principal and interest on the PennVest loan. In contrast, Columbia asserts that the PennVest volumetric charge was set using rate base/rate of return methodology in 1993, and was never transformed into a debt-service only surcharge. *Id*. at 5, n. 2. Columbia submits that the adoption of I&E and the OCA’s “revisionist argument” would deny the Company necessary cash flow to support $4.9 million of plant in service that both of these Parties admitted was used and useful in providing service. *Id*. at 5.

Columbia submits that, in the *1993 PennVest Order*, the Commission approved the 1993 Settlement between the Company and the OCA that established rate base treatment of the investment in the PennVest plant and facilities. Specifically, the 1993 Settlement established the ratemaking treatment of the PennVest plant as follows:

7. Regarding the ratemaking treatment of Plant in Service, the Company agrees to Rate Base treatment for plant additions of $4,547,617, constituting [the] amount 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 of increase proposed in this Stipulation: (a) the inclusion of these plant additions in the rate base, along with the return on the increase 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.

CWC R.Exc. at 6, citing CWC St. 2R at 13:1-15; GDS Rebuttal Exh. 1. Accordingly, Columbia submits that the PennVest surcharge was a rate base/rate of return volumetric charge applicable to all customer classes. Columbia notes that, in its Statement in Support of the 1993 Settlement, the OCA stated that:

The Proposed Settlement provides for an overall base rate increase of $342,508 on an ongoing basis. This lesser amount is the result of permitting the Company to recover the costs of its PennVest-financed plant additions through rate base (including the provision of a reasonable rate of return and an allowance for depreciation expense), rather than through the imposition of a debt-service based surcharge. The OCA submits that, given 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.

CWC R.Exc. at 6, n. 4. Columbia submits that, under Section 316 of the Code, approval of rate base treatment for the PennVest plant in the *1993 PennVest Order* via a volumetric rate is “prima facie evidence of the facts found and remains conclusive upon all parties affected thereby, unless set aside, annulled or modified on judicial review.” 66 Pa. C.S. § 316. Columbia further submits that the OCA admitted as much in arguing that “[t]he 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. … once that determination is made by the Commission, there is no opportunity to change the methodology.” *Id*., citing OCA Exc. at 5.

In addition, Columbia submits that the adjustment proposed by I&E and the OCA should be disregarded because I&E and the OCA failed to qualify the adjustment properly, citing *Popowsky v. Pa. PUC.* 550 Pa. 449, 706 A.2d 1197 (1997). Columbia submits that the proposed adjustment would violate the Internal Revenue Code, the U.S. Constitution, GAAP and generally accepted ratemaking principles. *Id*. at 7.

Columbia asserts that, since the *1993 PennVest Order*, it has kept its books and tax accounts in reliance upon rate base treatment of the PennVest plant. Now, twenty years later, I&E and the OCA “want to retroactively unwind that by essentially removing that plant – which they admit is used and useful – from the Company’s rate base and therefore books.” *Id*. Columbia submits that, to remove this plant from rate base and the Company’s books (*i.e.* reflect a zero value), only two accounting methods are available, and neither appears to be lawful or generally accepted. According to Columbia, both have adverse legal consequences that I&E and the OCA blithely failed to consider and

address. *Id*.

Columbia argues that the proposed adjustment would force Columbia to take one of two accounting actions.One option would be to reflect the PennVest adjustment as a retroactive contribution in aid of construction; however, “the repayment of a loan with proceeds from rates does not meet that test under any accounting or Uniform System of Accounts since a CIAC must be given up front by a customer or developer for a utility to fund and install facilities.” *Id*. Columbia asserts that the use of monies from rates to repay a loan has never been deemed to be a retroactive CIAC; rather it is debt financing by the Company that is built into the total cost of service. According to Columbia, if the “unorthodox theory [of I&E and the OCA] were correct, then when any utility paid off a loan using monies from rates then that plant’s useful and depreciable life would be irrelevant and the plant would come out of rate base as a retroactive CIAC.” *Id*. (emphasis omitted).Columbia argues that a retroactive CIAC would create financial chaos, since the Company would have been taxed improperly since 1993, and neither I&E nor the OCA has offered any solution as to how this might be accomplished under the Tax Code. *Id*., n. 6

Columbia asserts that the only other way to remove the PennVest plant from rate base and the Company’s books is to somehow show that it was depreciated over twenty years or the life of the loan. Columbia asserts that this would result in two illegalities. First, Columbia states that, under the Internal Revenue Code, the facilities cannot be depreciated – even using accelerated depreciation – over a period less than twenty-five years, because the “applicable recovery period” is twenty-five years.[[9]](#footnote-9) Second, Columbia states that, in the *1993 PennVest Order*, the Commission directed ordinary rate base/rate of return treatment, which does not provide for accelerated depreciation. *Id*. at 8.

In addition, Columbia argues that the adjustment proposed by I&E and the OCA would “completely overrule” *Hope* and *Bluefield*, which provide that a utility is entitled by law to an opportunity to earn a return on and return of its investment in assets. *Id*. Columbia submits that, taken to its logical conclusion, the arguments of I&E and the OCA could be applied to a utility’s equity-funded investments; for example, to plant financed with retained earnings (monies whose source was rates from ratepayers). *Id*.

Columbia also argues that the retroactive adjustment proposed by I&E and the OCA should be rejected based on the doctrine of laches or estoppel. Columbia submits that it was directed by the *1993 PennVest Order*, of which the OCA was the primary driver, to utilize rate base/rate of return treatment for its PennVest plant. Now, twenty years later, it is facing an untimely and retroactive adjustment that would unwind the Company’s reliance on and compliance with the *1993 PennVest Order*. The proposed adjustment would require Columbia to remove $4.9 million in used and useful plant from its rate base, and prospectively require the Company to support that plant without any revenue stream, in violation of *Hope* and *Bluefield*. *Id*.

Columbia submits that there are additional deficiencies with I&E’s and the OCA’s retroactive adjustment. According to the Company, the adjustment ignores the effect on the Company’s accumulated deferred income taxes for rate making purposes. As such, the adjustment is insufficiently developed and lacks ratemaking symmetry, and should be rejected on that basis alone.*Id*. at 8-9. As the Company explained in its Reply Brief:

Specifically, I&E and OCA’s witnesses admitted on cross as to the used and usefulness of the remaining undepreciated utility plant assets of $3,048,292 well beyond the 20 year term of the PennVest loan. (Tr. at 177, 187) However, in making their adjustments, they ignored the offsetting increase to the Company’s rate base created by the reduction to the Company’s accumulated deferred tax balance as of December 31, 2013 if the assets, as OCA and I&E propose, are stated at a zero (0) dollar value for ratemaking purposes. The Commission’s 1993 Order established the annual depreciation expense and overall return appropriate for the assets funded by the PennVest loan. Now both I&E and the OCA are challenging that order and ***changing*** the basis of the Company’s cost recovery mechanism as stated in that order from a rate base/rate of return basis to a concocted “principal and interest basis.”

*Id*. at 9, citing CWC R.B. at 17-18 (emphasis in original). The Company states that, since the life expectancies of the PennVest assets are far greater than the lives used for deferred tax purposes, I&E and the OCA should have made a significant downward and offsetting adjustment to the Company’s claimed accumulated deferred income taxes as of December 31, 2013. According to the Company, at the very minimum, the Company’s effective combined state and federal tax rate of approximately 42% applied to the $3,048,292 would result in a reduction of $1,280,283 to the Company’s accumulated deferred tax balance as of December 31, 2013, and would have increased the Company’s measures of value at December 31, 2013 by at least $1.3 million. *Id*. at 9.

Finally, the Company submits that the adjustment proposed by I&E and the OCA is not grounded in sound ratemaking or accounting principles, and neither I&E nor the OCA set forth the necessary accounting and/or rate making adjustments. According to Columbia, there are no accounting rules in the NARUC Uniform System of Accounts or GAAP that would allow the removal of the PennVest plant from rate base, or in fact any assets upon the retirement of associated debt, thereby stranding the undepreciated assets.[[10]](#footnote-10) Columbia states that the only accounting treatments contained in the NARUC Uniform System of Accounts that even remotely address the proposed adjustment would be the booking of the total $4,902,136 as a contribution in aid of construction, which is not possible for several reasons.[[11]](#footnote-11) For these reasons alone, Columbia submits that the PennVest adjustment proposed by I&E and the OCA should be denied. However, as described below, the Company states that there are numerous other reasons to reject the adjustment. *Id*. at 9‑10.

First, the Company asserts that its volumetric rate differs from a typical PennVest surcharge that is non-usage sensitive and applied equally to all customers.[[12]](#footnote-12) Columbia states that I&E and the OCA have not provided a citation to any case where the Commission converted Columbia’s PennVest rate base/rate of return volumetric surcharge into a debt-service only surcharge. Although its PennVest rate eventually became reconcilable, Columbia asserts that the rate remained one developed based on rate base/rate of return. According to Columbia, the reconciliation feature added in 1997 simply was a refinement to ensure that the Company hit its rate base/rate of return income target, consistent with the Commission’s obligation under the PennVest Act, 35 P.S. §§ 751.1 *et seq.*, to ensure that a utility is able to repay its PennVest loan, and did not change the nature of the charge. Columbia states that, although its volumetric rate was adjusted several times, it simply was adjusted upward or downward prospectively to try to meet the rate base/rate of return/depreciation “money stream goal” of the *1993 PennVest Order*. The reconciliations of its volumetric rate did not capture past under-collections, relative to debt service, as would have been done if its rate were a true reconciliation mechanism. Columbia submits that the suggestion that its rate was “transformed” in 1997, shortly after it had been established by the *1993 PennVest Order*, without any mention of the “transformation” by the Commission or any of the Parties is absurd. Noting the OCA’s vehement opposition in 1993 to a debt-service only surcharge, Columbia argues that the “transformation” was not mentioned in the 1997 Settlement because the *1993 PennVest Order* was still fresh in everyone’s mind and it was clear that no transformation was occurring. CWC R.Exc. at 10-11.

Columbia further argues that I&E’s and the OCA’s interpretation of the *PennVest Policy Statement* is wrong. Columbia argues that the *PennVest Policy Statement* does not limit surcharges to debt service surcharges to the exclusion of other types of surcharges. Rather, the *PennVest Policy Statement* states that amounts collected under a Section 1307(a) automatic adjustment clause ***or other method*** are subject to reconciliation and refund. According to Columbia, its unbundled rate base/rate of return rate is an “***other method***” under the *PennVest Policy Statement*. CWC R.Exc. at 11.

Columbia further contends that the argument of I&E and the OCA that the Company did not claim the PennVest plant in rate base in subsequent rate cases should be rejected “because the 1993 volumetric rate was an essentially unbundled rate base/rate of return rate with depreciation, which was periodically reviewed by the Commission and treated separately.” CWC R.Exc. at 12. Columbia asserts that claiming its PennVest plant as part of its rate base during the time that its PennVest rate base/rate of return rate was in effect would have resulted in double counting that plant. Columbia states that, since its PennVest rate has ended, its PennVest plant is no longer in rates, which is why the Company has sought to bundle the undepreciated remaining PennVest plant back into rate base in this case. *Id*.

Next, Columbia points out that its *1993 PennVest Order* predates the 1994 *PennVest Policy Statement,* which was intended to apply to companies that had not yet elected rate base or surcharge treatment. In addition, Columbia argues that the *PennVest Policy Statement* does not forbid capital recovery and return on investment for the remaining useful and depreciable life of the assets. Columbia asserts that the term of a loan does not establish the basis for the service lives of the assets or the future life expectancies. “The Commission should decline OCA and I&E’s invitation to replace sound engineering service life judgment with loan terms written by bankers or lenders.” CWC R.Exc. at 13. Columbia states that, now that the PennVest debt service has been retired, it simply wants to continue to claim the undepreciated amount of the PennVest plant in service. “That is the case with any loan used by utilities to fund plant - particularly plant with a long term life that exceeds loan terms. . . [A] PennVest loan is no different than any other loan.” *Id*.

Next, Columbia argues that the 1994 *NUI Order* cited by the OCA in support of its adjustment is distinguishable. Columbia argues that NUI was trying to eliminate its PennVest surcharge and convert it into a rate base/rate of return rate. According to Columbia, that is “the complete opposite of what we have here, which is a volumetric rate that is a rate base/rate of return rate, which included the plant in rate base, rate of return, depreciation expense, and income taxes.” CWC R.Exc. at 14. The Company states that it simply wants to continue including the plant in rate base in order to realize a return on its original cost minus depreciation investment. *Id*.

Moreover, Columbia argues that using revenues from rates to pay a loan does not transform a loan into a retroactive contribution in aid of construction. Columbia disputes the I&E and the OCA argument that, because a utility loan is paid off with revenues derived from rates, then somehow the ratepayers, not the utility, provided the plant. Columbia argues that this assertion does not comport with basic ratemaking principles. In addition, Columbia asserts that the record shows that revenue from rates was not the sole source of funds used to repay the loan. Specifically, Company witness Lewis testified that the Company used: “[s]everal sources including draws on a line of credit/loan, monies from sales of metering information, a dividend received annually from Workers Compensation insurance, and of course, monies we receive from all our rates under our tariff.” CWC R.Exc. at 15, citing CWC St. 1R at 23:13-15. Columbia states that there was no earmarking or separate account, as would have been required for a surcharge under the Commission’s *PennVest Policy Statement*, which is another distinguishing feature of its rate base/rate of return rate. *Id.* at 14-15.

Next, Columbia argues that its PennVest rate had the characteristics of a rate base and rate of return rate, as opposed to a debt service only surcharge that guarantees 100% collection of a loan. Columbia asserts that debt service surcharges typically are kept in a separate account for repayment, so that monies collected from ratepayers are available and used to pay the loan, and often are customer-based charges as opposed to volumetric. CWC R.Exc. at 15. In contrast, Columbia states that its volumetric rate provided for a return on rate base and depreciation. Columbia states that, in compliance with and reliance on the *1993 PennVest Order*, it depreciated its plant using normal depreciation principles and lives. Moreover, Columbia asserts that the record shows that it did not collect revenues sufficient to cover the entire loan’s debt service on a dollar-for-dollar basis, and in fact was at least $200,000 short, which is not unusual under a rate base/rate of return methodology. Columbia argues that this distinguishes the rate at issue from a debt service only surcharge that is 100% reconciled. CWC R.Exc. at 15-16.

Regarding I&E’s concern that adoption of the ALJ’s recommendation may embolden other utilities to claim rate base treatment of undepreciated PennVest plant after the termination of debt service surcharges, Columbia states that its PennVest volumetric rate was never a debt-service only surcharge. Therefore, Columbia submits that no precedent is created by the instant proceeding. CWC R.Exc. at 17.

For all of the reasons stated above, Columbia submits that the Exceptions of I&E and the OCA should be denied.

**e. Disposition**

We shall adopt the ALJ’s recommendation on this issue, and approve the inclusion of Columbia’s undepreciated PennVest plant in its rate base.

All Parties agree that Columbia’s surcharge was approved by the Commission in 1993 on the basis of rate base/rate of return treatment of its PennVest plant. The core of the arguments made by I&E and the OCA is their conclusion that Columbia’s surcharge was transformed from a surcharge based on rate base/rate of return treatment of PennVest plant, to a reconciliation mechanism under Section 1307(a) of the Code by the Commission’s *1997 Order*. We do not agree with the conclusion of I&E and the OCA that the Commission’s *1997 Order* had this transformative effect. Our reading of the *1997 Order* is that it simply added the forward-looking adjustment mechanism to Columbia’s existing surcharge to ensure that the Company remained on track to recover its rate base/rate of return income target. As Columbia points out, the new adjustment feature that was added to the existing surcharge was not designed to capture past under-collections, relative to debt service, as would have been done if it were a true Section 1307(a) reconciliation mechanism. Instead, it was a forward-looking adjustment feature that adjusted the surcharge rate up or down to keep the revenue stream on track to enable Columbia to repay its PennVest obligations.

The evidence presented by Columbia supports our conclusion that our *1997 Order* did not transform Columbia’s 1993 surcharge into a Section 1307(a) reconciliation mechanism. As noted above, the Company presented testimony that, in addition to surcharge revenues, the Company used several sources of income to repay its PennVest obligations, including “draws on a line of credit/loan, monies from sales of metering information, a dividend received annually from Workers Compensation insurance, and of course, monies received from all our rates under our tariff.” CWC R.Exc. at 15; CWC St. 1R at 23:13-15. If the surcharge had been transformed into a Section 1307(a) reconciliation mechanism by the Commission’s *1997 Order* as argued by I&E and the OCA, a separate account would have been established and funds would not have been comingled. CWC R.Exc. at 14-15. In addition, Columbia did not collect revenues sufficient to cover the entire loan’s debt service on a dollar-for-dollar basis, and in fact was at least $200,000 short. We agree with Columbia’s point that this fact further distinguishes its surcharge from a Section 1307(a) reconciliation mechanism.

Finally, we agree with Columbia’s argument that, if its surcharge had been transformed into a Section 1307(a) reconciliation mechanism by the Commission’s *1997 Order*, shortly after it had been established by the *1993 PennVest Order*, the transformation would have been worthy of mention. The fact that there was no mention of such “transformation” by the Commission or any of the Parties lends support to the conclusion that no transformation occurred, and that the *1997 Order* simply added a forward-looking adjustment mechanism to the existing rate base/rate or return surcharge. Noting the OCA’s vehement opposition in 1993 to a debt-service only surcharge, Columbia argued that the “transformation” was not mentioned in the 1997 Settlement because the *1993 PennVest Order* was still fresh in everyone’s mind and it was clear that no transformation was occurring. CWC R.Exc. at 10-11. We agree.

Having concluded that Columbia’s surcharge was not transformed into a Section 1307(a) reconciliation mechanism by our *1997 Order*, we briefly would like to address the arguments of I&E and the OCA regarding the Commission’s *PennVest Policy Statement*. Our first observation is that the 1994 *PennVest Policy Statement* did not apply to Columbia. By its own terms, it applied to “Companies with outstanding PENNVEST loans *not currently reflected in rates* and companies that will receive PENNVEST loans in the future.” 52 Pa. Code § 69.361 (emphasis added). Similarly, “[C]ompanies with outstanding [or future] PENNVEST obligations *that have not been reflected in rates* . . . , may establish under [Section 1307(a)] an automatic adjustment . . . or other method limited solely to recovery of the company’s principal and interest obligations.” § 69.363 (emphasis supplied). When the *PennVest Policy Statement* was issued in 1994, Columbia’s 1993 PennVest surcharge already was in place and its PennVest loans were already reflected in rates. Therefore, the *PennVest Policy Statement* by its own terms did not apply to Columbia.

Our second observation is that, even if the *PennVest Policy Statement* had applied to Columbia, it would not have had the overly prescriptive effect urged upon us by I&E and the OCA, for several reasons. First, it was a policy statement issued by the Commission, not a statute promulgated by the General Assembly, or even a regulation promulgated by the Commission. Policy statements by their very nature are not binding on the Commission or on a utility. Instead, they are intended merely to provide guidance to utilities. Consistent with the legal effect of policy statements generally, the *PennVest Policy Statement* specifically states several times that utilities are “encouraged” (not “required”) to take various actions. Second, in our view the Parties have attached too much significance to the precise wording of the *PennVest Policy Statement*. The *PennVest Policy Statement* was intended to address the requirement that the Commission facilitate the repayment of PennVest loan obligations. To accomplish that directive, the Commission encouraged utilities to establish Section 1307(a) reconciliation mechanisms. However, the *PennVest Policy Statement* did not limit utilities to a choice between a Section 1307(a) adjustment mechanism and a Section 1308 base rate filing as I&E and the OCA contend. Rather, the *PennVest Policy Statement* recognized that a utility could use some “other method” to recover its PennVest obligations. *See* § 69.363(a) (companies may establish a Section 1307(a) clause or *other method*); § 69.363(c) (companies are encouraged to provide notice of rate increases under a Section 1307(a) clause or *other method*); § 69.363(d) (filing requirements under a Section 1307(a) clause *or other method*); § 69.363(e) (amounts collected under a Section 1307(a) clause *or other method* subject to reconciliation and refund). Accordingly, even if the *PennVest Policy Statement* had applied to Columbia, it would not have limited Columbia to a choice between a Section 1307(a) reconciliation clause or rate base treatment under Section 1308 as the advocates contend. Therefore, it is unnecessary to determine whether Columbia’s surcharge falls into one category or the other; other types of recovery mechanisms were recognized as possibilities. The *PennVest Policy Statement* was not intended to be as prescriptive as I&E and the OCA contend.

Therefore, we conclude that, consistent with the Commission’s obligation under the PennVest Act, 35 P.S. §§ 751.1 *et seq.*, to ensure that a utility is able to repay its PennVest loan, the Commission’s *1997 Order* approved the addition of a forward-looking adjustment feature to Columbia’s 1993 rate base/rate of return surcharge mechanism, but did not change the nature of the charge. Accordingly, there is no bar to the inclusion of Columbia’s undepreciated PennVest plant in rate base, and the adjustment urged upon us by I&E and the OCA is rejected.

### 2. **Cash Working Capital**

The Parties agreed on the methodology to be used to calculate cash working capital. Specifically, the Company used the formula method, or one-eighth (12.5%) of operating and maintenance (O&M) expenses. GDS Exh. 1 at 1-17. Using this method, Columbia calculated a claim for cash working capital of $248,967. The claim for cash working capital ultimately will be established based upon the outcome of the Commission’s final ratemaking determinations. R.D. at 19, Table II.

No Exceptions on this issue were filed. Therefore, finding it otherwise reasonable, we will adopt the ALJ’s recommendation, subject to an adjustment to reflect the O&M expenses allowed by this Opinion and Order.

**3.** Materials & Supplies

**a. Positions of the Parties**

Columbia claimed Materials and Supplies (M&S) in rate base of $62,314 based on a three-year average of the Company’s M&S inventory. GDS Exh. 1 at 1-17. The OCA argued that the Company’s claim should be adjusted downward by $4,592 based on the Commission’s policy of using a thirteen-month average of M&S. In rebuttal, the Company argued that, if the expense is volatile, an average based on a longer period should be used. CWC St. 2R at 14-15. The Company also contended that it would have to close its books on a monthly basis in order to accurately reflect a thirteen-month average. CWC St. 2R at 14.

**b. ALJ’s Recommendation**

The ALJ agreed with the Company. “As stated above, this is an instance of where ‘what works and what is reasonable,’ for this utility specifically should not be disturbed by what another party thinks is optimal and requests based on general policy. The OCA’s recommendation to reduce Columbia’s rate base claim by $4,592 should not be adopted.” R.D. at 22.

**c. Exceptions**

In its Exception, the OCA argues that Columbia’s M&S claim is inconsistent with prior Commission cases in which the Commission consistently has adopted a thirteen-month average.[[13]](#footnote-13) The OCA disputes Columbia’s argument that a three-year average would provide a larger sample of operating results to address volatility, arguing that the average balance could be skewed if there were an unusually large balance in the last month of the Company’s accounting year. OCA Exc. at 17.

With regard to the Commission’s approval of a three-year average in Columbia’s last rate case, the OCA submits that the Commission’s Order approved a three-year average for M&S *expense*, as opposed to a claim for *rate base*. *Pa. PUC v. Columbia Water Co.,* Docket No. R-2008-2045157, *et al*. (Order entered June 10, 2009) (*2009 Rate Case Order*). The OCA argues that a claim for M&S in rate base is different than a claim for M&S expense because M&S in rate base allows the Company the opportunity to earn a return on its investment in M&S until they are used and expensed. OCA Exc. at 19.

Regarding Columbia’s argument that small companies are unable to produce accurate inventory numbers on a monthly basis, the OCA submits that this is not the case with Columbia. The OCA asserts that, in response to an interrogatory, the Company provided monthly balances for M&S from December 2011 to March 2013, and later updated its response to provide balances through July 31, 2013. “Columbia is thus able to track its monthly inventory for purposes of supporting rate base recognition of its M&S purchases.” OCA Exc. at 20. Further, the OCA submits that the Commission has adopted a thirteen-month M&S average for smaller companies, citing *Treasure Lake*, *Mechanicsburg*, and *Media*. *Id*.

Based on these arguments, the OCA recommends reducing Columbia’s rate base claim by $4,592 based on Columbia’s thirteen-month average of M&S inventory of $57,722 ($62,314 – $57,722). OCA Exc. at 20-21.

**d. Reply Exceptions**

In its Reply Exceptions, Columbia argues that, if a test year element is volatile, a larger sample is warranted, such as a three-year average of M&S. Columbia also states that adoption of a thirteen-month average would require it to close its books on a monthly basis, despite the fact that it closes its books annually, which is more economical for smaller companies. Columbia also submits that its annual numbers are audited numbers, based on actual inventory, and are more accurate than the monthly estimates that the OCA obtained from a discovery response. Furthermore, Columbia states that it is not economical for small companies like Columbia to have such a sophisticated accounting system that would allow the Company to produce accurate numbers on a monthly basis. CWC R.Exc. at 17-18.

In the event that the OCA’s thirteen-month position is accepted, Columbia submits that the most recent thirteen-months should be used, as opposed to the outdated thirteen months used by the OCA. If the most recent thirteen months were used, the M&S inventory would be $64,888, which is $2,574 *above* the Company’s three-year average. CWC R.Exc. at 18.

**e. Disposition**

We shall adopt the ALJ’s recommendation on this issue, and reject the OCA’s proposed adjustment to M&S inventory. We find that the Company’s use of a three-year average of the Company’s inventory is preferable to the OCA’s proposed thirteen-month average for the reasons advanced by Columbia. Although it may be possible for the Company to produce inventory levels in a monthly basis, we accept the Company’s explanation that its monthly numbers are not audited and are less accurate than the year-end numbers produced by its current accounting system. We are not persuaded by the OCA’s arguments, which would require Columbia to incur the costs of adopting a more sophisticated and expensive accounting system for little discernable benefit.

## C. Capital Structure

**1. Positions of the Parties**

Columbia proposed a *pro forma* capital structure consisting of 35.6% long-term debt and 64.4% common equity is based on its projected actual capital structure as of December 31, 2013. The Company argued that circumstances have not changed substantially since the Commission approved a capital structure of 35.8% long-term debt and 64.2% in the Company’s last rate case. CWC M.B. at 45, referencing the Company’s *2009 Rate Case Order* at 71.

I&E recommended a capital structure of 50% debt and 50% equity. I&E argued that Columbia’s actual capital structure has a disproportionately high percentage of equity, which results in an inflated overall rate of return. I&E argued that Columbia’s capital structure should be rejected because it is not in line with the industry average. The five year average capital structure for the water proxy group selected by I&E Witness Maurer was 50.99% long-term debt, 0.25% preferred stock and 48.77% common equity, which approximates the capital structure recommended by I&E. In addition, I&E argued that the Company’s capital structure as of December 31, 2103, is weighted more heavily toward equity than at any time in the last five years. According to I&E, Columbia’s five-year average capital structure from 2008-2012 was 42.45% long term debt and 57.55% equity. I&E M.B. at 41-43; I&E St. 1 at 13-15.

The OCA recommended an actual capital structure of 44.15% long-term debt and 55.85% common equity. The OCA argued that the Company calculated its actual capital structure incorrectly by using an incorrect Total Measure of Value of $11,738,152, which is substantially less than the Total Measure of Value of $13,527,774 used to set rates. The OCA pointed to a $2.2 million Wells Loan received by the Company on October 4, 2012, at an interest rate of 4.5%, and stated that it was “appropriate to allocate this [4.5%] cost rate to this unexplained gap between the Company’s claimed capitalization and the Total Measure of Value to set rates. OCA M.B. at 70. The OCA submitted that, with this correction, the Company’s actual capital structure was 44.15% long-term debt and 55.85% common equity. In the alternative, the OCA recommended a capital structure based on a comparative water group of 51.76% long-term debt and 48.24% common equity. *Id*. at 70‑71.

**2. ALJ’s Recommendation**

The ALJ concluded that I&E’s recommended capital structure of 50% debt and 50% equity is one that is fundamentally fair and better representative of Columbia. The ALJ recommended that I&E’s capital structure be adopted. R.D. at 46.

**3. Exceptions**

In its first Exception, Columbia argues that the ALJ erred in adopting I&E’s “punitive” hypothetical capital structure of 50% long-term debt and 50% common equity (50/50 capital structure). Columbia asserts that the hypothetical 50/50 capital structure is contrary to good public policy because it arbitrarily and significantly lowers its equity ratio and raises its ratio debt. According to Columbia, this forces the Company to accept an unnecessary risk that could diminish its superior performance record. The Company argues that “[i]nstead, the Commission should reward small companies like Columbia for their efforts to provide reasonable and safe service while minimizing financial risk to the extent possible.” CWC Exc. at 6-7.

According to Columbia, the circumstances in this proceeding are virtually identical to Columbia’s most recent rate case, where the Commission approved the use of the Company’s *pro forma* capital structure at December 31, 2008, of 35.80% long-term debt and 64.20% common equity for ratemaking purposes.[[14]](#footnote-14) Columbia states that the Commission, in approving Columbia’s actual capital structure, held:

In order to determine Columbia’s overall cost of capital an appropriate capital structure must be used. We agree with the ALJ that Columbia’s capital structure is not disproportionately weighted on the equity side. Columbia’s capital structure is not unreasonable or uneconomical under the rational of the *Carnegie* decisionas discussed earlier. The record evidence does not indicate that Columbia has abused its managerial discretion with regard to the development of its capital structure. Therefore, we will adopt the ALJ’s recommendation to use Columbia’s actual capital structure of 35.8% debt and 64.2% common equity for ratemaking purposes.[[15]](#footnote-15)

CWC Exc. at 7-8. Columbia argues that, as set forth in the *Carnegie*[[16]](#footnote-16) case, a utility’s capital structure is within the management discretion of the utility, and the touchstone for evaluating a utility’s actual capital structure is whether the utility abused its discretion. As the Commission stated in *Carnegie*:

The Commission has the duty to regulate utilities in a manner which provides customers with reliable service at reasonable cost. This is not to say that we may mandate to regulated utilities the proportion of debt and equity contained in their capital structures. Rather, the actual capital structure is a matter within the discretion of corporate management; however, this does not preclude the commission from determining that a particular utility’s capital structure is unreasonable and uneconomical when balancing the goals of safety, prudent management, and economy and utilize a hypothetical capital structure for rate-making purposes.[[17]](#footnote-17)

CWC Exc. at 8. Columbia submits that in the instant proceeding, as in Columbia’s prior rate case, there are no excessive capital costs. In Columbia’s *2009 Rate Case Order,* the Commission found that using a hypothetical capital structure was not appropriate. Columbia submits that no one alleged in the 2009 rate case that Columbia was abusing its management discretion by maintaining a capital structure with 62.4% common equity, and no one has alleged and proven in the present case that Columbia is abusing its management discretion by maintaining an almost identical capital structure with 64.2% common equity. *Id*. at 8-9.

Columbia argues that, likewise, there is no finding that Columbia’s capital structure is unreasonable and uneconomical when balancing the goals of safety, prudent management, and economy.[[18]](#footnote-18) To the contrary, Columbia asserts that its relatively strong capital structure benefits both the Company and its ratepayers by providing financing flexibility and access to capital when required. Columbia questions whether I&E and the OCA would prefer having the Company become less able to borrow money due to being more debt ridden. Columbia notes that neither of these Parties has recommended any additional return “for being more debt ridden and riskier as they say it should be for ratemaking purposes.” *Id*. at 9. According to Columbia, I&E and the OCA want the borrowing benefits of having the present actual capital structure, but wish to ignore the obvious increase in risk (which should warrant a higher equity return rate) of becoming more debt ridden. Columbia states that the effects on the Company are no different now than when the Commission rejected a hypothetical capital structure in the *2009 Rate Case Order*. CWC Exc. at 9.

Columbia states that, in recommending a hypothetical 50/50 capital structure, I&E improperly relied on a five-year historic average of Columbia’s capital structure. According to Columbia, this average improperly elevates stale historic information over its existing capital structure, and ignores the prospective nature of ratemaking. Even if the Commission were to adopt a capital structure based on the Company’s historic five-year average, Columbia submits that it should not be the 50/50 hypothetical capital structure that I&E recommended, but rather the actual average that I&E identified, which is a capital structure of 42.45% debt and 57.55% common equity. CWC Exc. at 10.

Because I&E and the OCA failed to demonstrate that ratepayers would be unnecessarily burdened by Columbia’s actual capital structure, or that Columbia has abused its discretion by manipulating its capital structure, Columbia submits that the Commission should approve the Company’s actual capital structure in this case. Columbia reiterates that its claimed capital structure is virtually identical to the capital structure approved by the Commission in the Company’s last rate case. However, if the Commission adopts a 50/50 capital structure for Columbia, the Company asserts that there must be an upward adjustment to Columbia’s rate of return on common equity to reflect the increased financial risk resulting from increased debt. CWC Exc. at 10.

**4. Reply Exceptions**

In its Reply Exceptions, I&E reiterates that the capital structure utilized by Columbia is not in line with its historical capital structure, but is in fact more heavily weighted toward equity than the Company has been in any of the past five years. I&E also contends that Columbia’s actual capital structure is not in line with the industry average, and places an unfair financial burden upon customers. I&E submits that its selected water proxy barometer group had a five year average capital structure of 50.99% long term debt, 0.25% preferred stock, and 48.77% equity, similar to the 50/50 capital structure that it recommended. I&E R.Exc. at 7-8.

I&E submits that the Company has not refuted I&E’s rationale for using a hypothetical 50/50 capital structure. I&E argues that the actual capital structures that existed in the interval between this and the previous rate case filing, which were less skewed toward equity, apparently did not arouse the same concerns now expressed by Columbia regarding alleged financial risks of a capital structure. I&E submits that Columbia’s Exceptions do not provide a convincing basis for the Commission to reject the 50/50 capital structure recommended by the ALJ. I&E R.Exc. at 10.

In its Reply Exceptions, the OCA does not respond directly to the Company’s Exceptions. Instead, the OCA submits that the ALJ’s adoption of the 50/50 capital structure recommended by I&E is reasonable. “However, if the Commission is inclined to use another capital structure, the OCA notes that the alternative capital structures presented by the OCA reflect the current debt financing obtained by [Columbia] and are more reasonable for ratemaking purposes than [Columbia’s] proposed capital structure.” OCA R.Exc. at 3.

**5. Disposition**

Upon review, we shall adopt the Company’s *pro forma* capital structure as of December 31, 2013, consisting of 35.6% long-term debt and 64.4% common equity. We agree with the Company that circumstances have not changed materially since the Commission approved a nearly identical capital structure of 35.8% long-term debt and 64.2% in the Company’s last rate case. *2009 Rate Case Order* at 71. We also agree with Columbia’s assertion that adopting a hypothetical 50/50 capital structure, rather than the Company’s actual capital structure, would be somewhat arbitrary, and would fail to recognize the benefits to ratepayers of the Company having ready access to capital markets due to its strong capital structure.

## D. Rate of Return

### 1. Return on Equity

**a. Positions of the Parties**

Columbia requested a return on common equity (ROE) of 10.85% in this proceeding, exclusive of two requested premiums of 25 basis points each, or 50 basis points in total (0.50%), that are discussed below. Columbia developed its recommended ROE based on three market-based cost of equity models using a proxy group of nine water companies. The three models used by Columbia Witness D’Ascendis to develop his recommended ROE were the Discounted Cash Flow (DCF) methodology, the Risk Premium Model (RPM) and the Capital Asset Pricing Model (CAPM). Inclusive of the two premiums, Columbia requested a ROE of 11.35% and a 9.18% overall cost of capital.[[19]](#footnote-19) CWC M.B. at 45-50. Columbia’s proposed overall rate of return of 9.18% was shown in Table 1 attached to the Columbia Main Brief.

I&E recommended a ROE of 9.15%, which would produce an overall rate of return of 7.07% with its recommended 50/50 capital structure. I&E asserts that a ROE of 9.15% and overall rate of return of 7.07% represent a fair and reasonable determination that properly balances the interests of the Company and its ratepayers. I&E M.B. at 37-41; I&E St. 1 at 3-4.

The OCA recommended a ROE of 8.25% based on a discounted cash flow analysis, which would produce an overall rate of return of 6.75% with its recommended capital structure of 44.15% long term debt and 55.85% common equity.[[20]](#footnote-20) OCA M.B. at 66-69, 72-84.

**b. ALJ’s Recommendation**

The ALJ concluded that I&E provided the most reasonable resolution of this issue. The ALJ stated that the OCA’s proposed rate of return is a bit too parsimonious, whereas Columbia’s requested rate of return is excessive and based on an overly generous methodology. Accordingly, the ALJ adopted I&E’s recommended ROE of 9.15%, which would produce an overall rate of return of 7.07% using the 50/50 capital structure recommended by I&E. R.D. at 43‑46.

**c. Exceptions**

Columbia strongly disagrees with the ALJ’s adoption of I&E’s return on equity of 9.15%. Columbia argues that this recommended ROE would be the lowest authorized ROE in the country for a water utility since at least 2011 (without provisions for double leverage), and would send the wrong message to any utility that is considering investing in the Commonwealth. CWC Exc. at 10.

Columbia argues that I&E’s ROE was based solely on the results of I&E’s DCF model, while the Commission repeatedly has acknowledged that the DCF model misstates investor-required returns when market value exceeds book value. Columbia refers to *The City of Lancaster – Sewer Fund*, Docket No. R‑00049862 (Order entered August 26, 2005), where the Commission adopted a market-to-book adjustment of 65 basis points (0.65%), and stated that the adjustment was necessary because the DCF method produces the investor required return based on the current market price, not the return on the book value capitalization. CWC Exc. at 11.[[21]](#footnote-21)

Columbia states that it is not requesting a specific adjustment to the DCF result, but does request that the Commission consider appropriate adjustments and multiple models when determining the ROE for Columbia in this case. Columbia argues that the use of multiple common equity cost rate models adds reliability when arriving at a recommended common equity cost rate, and that it is against basic financial precepts to rely exclusively upon one cost of common equity model. *Id*. at 12-14.

Columbia submits that its witness recommended a ROE of 10.85% (net of the requested 0.50% premium) based on an assessment of multiple market-based cost of common equity models using a proxy group of water companies.[[22]](#footnote-22) According to Columbia, its witness was the only one who relied on multiple methodologies to estimate the required return on equity, whereas both I&E’s and the OCA’s witnesses focused solely on the DCF methodology. *Id*. at 14.

**d. Reply Exceptions**

In its Reply Exceptions, I&E objects to Columbia’s “completely unsupported assertions that were not offered into the evidentiary record by Columbia at any point during this proceeding.” [[23]](#footnote-23) I&E R.Exc. at 10. I&E requests that the Commission give no weight to Columbia’s unsubstantiated assertions.

Contrary to Columbia’s argument that I&E’s recommended ROE was based solely on the DCF model, I&E submits that its rate of return witness used both a DCF and a CAPM analysis, with the DCF method being the primary method, and the CAPM used as a comparison to the DCF results. I&E R.Exc. at 12; I&E M.B. at 47-48. I&E asserts that the Commission traditionally has relied on the DCF method and informed judgment in determining the cost of common equity for utilities.[[24]](#footnote-24) According to I&E, the Company’s statements that I&E relied exclusively upon the DCF analysis are inaccurate. I&E R.Exc. at 12.

I&E also takes issue with Columbia’s statement that “[n]either opposing witness during the testimonial part of the case nor the ALJ in his recommended decision discredited Mr. D’Ascendis’ use and application of multiple common equity models to determine his recommendation or any of his adjustments to the indicated common equity cost rate by using financial literature.” *Id*. at 13. I&E submits that its witness provided extensive analysis and criticism of a number of the methodologies employed by the Company. I&E notes that its witness used a CAPM analysis to compare the results of the DCF analysis; however, I&E’s witness also referenced several disadvantages to CAPM, which is why she did not use it as a primary method of establishing ROE. *Id*. at 13-14.

I&E submits that the DCF method is superior to other methodologies, and that its use of DCF as the primary method to establish ROE was appropriate. According to I&E, the DCF model: (1) is based upon the concept that the receipt of dividends plus expected appreciation is the total return requirement determined by the market; (2) uses the utilities’ own stock prices and growth rates, which are directly employed in a formalistic calculation; (3) recognizes the time value of money and is forward-looking; and (4) has the most wide-spread regulatory acceptance. *Id*. For these reasons, I&E submitted that the Commission should adopt the ALJ’s recommended Return on Equity and reject the Company’s Exception in its entirety.

In its Reply Exceptions, the OCA states that the ALJ’s reliance on the DCF methodology was reasonable, and that reliance on other models that have multiple flaws is not a reasonable approach to determining the appropriate return on equity. OCA R.Exc. at 3. The OCA asserts that the Commission favors the use of a DCF analysis, and that the Commission relied primarily on the DCF methodology, along with informed judgment and consulting other models, in Columbia’s *2009 Rate Case Order*. *Id*. at 4. The OCA submits that the ALJ’s recommendation was reasonable, and consistent with the Commission’s approach to determining a rate of return that balances the interests of the utility and its ratepayers. *Id*. at 5.

**e. Disposition**

Upon consideration of the evidence in this proceeding, we will modify the ALJ’s recommendation and adopt a rate of return on common equity of 9.75%.

Rate of return on common equity frequently is the most material and most contested issue in a base rate proceeding. This case is no different, and the setting of an appropriate ROE is even more critical as our Pennsylvania utilities implement plans to accelerate the much-needed replacement of aging infrastructure. Attracting capital to Pennsylvania at reasonable rates has never been more important to Columbia, its customers, and our Commonwealth.

In this case, the range of ROE recommendations presented by the Parties based on the DCF methodology is 8.25% to 11.35%. Based on our review of the testimony, data, and cost models presented, we believe that the evidence in this case supports an ROE finding in the reasonable range of 9.25% to 10.25% using the DCF method as the foundation. The equity-heavy capital structure of Columbia indicates that a slightly lower ROE is appropriate. However, the small size of the Company, its management effectiveness, and the results of ROE models other than DCF are all reasons to set a higher ROE. Therefore, within our indicated range of reasonableness, we conclude that a ROE of 9.75% is appropriate for our ratemaking determinations herein.

### 2. Rate of Return Premiums

**a. Positions of the Parties**

The Company claimed two rate of return premiums of 0.25% each on two separate bases: (1) exemplary performance over the last several years in providing water service to the public under Section 523 of the Code, 66 Pa. C.S. § 523; and (2) an acquisition incentive premium for acquiring the Mountville Municipal System in 1998 and the Marietta Gravity Water Company (MGWC) in 2012 under 52 Pa. Code § 69.721(g). CWC M.B. at 51.

Specific reasons cited by Columbia as justification for a rate of return premium for exemplary performance included: (1) meeting or exceeding all federal and state water quality standards and requirements; (2) only two minor operational issues occurring since 2010; (3) no informal complaints and only one Commission Formal Complaint filed since 2010; (4) minimizing expenses and using existing staff efficiently, including better treatment chemical combinations that reduced costs, and the capability to construct water main extensions and make water main repairs in-house, allowing the Company to install nearly twice the amount of pipe annually compared to the cost of using outside contractors; (5) at the request of Manor Township, extending service to two communities with failing septic systems and contaminated wells; (6) reducing power consumption through the use of solar-powered mixers for its Prospect and Manor/Mountville tanks; and (7) taking steps toward establishing an e-billing system for its customers. CWC M.B. at 52-55.

With regard to a rate of return premium to recognize its acquisition of the Mountville Municipal System in 1998 and the MGWC in 2012, Columbia stated that it has made improvements to both systems, including installing a new one-million gallon storage tank and pumping system to serve the Mountville pressure zone; modifications to improve water pressure; the replacement of all meters, since they previously had never been tested or replaced; and replacement of old water mains on numerous streets in the borough. CWC M.B. at 57-58.

I&E opposed the requested acquisition premium, noting that Columbia’s acquisition of the Mountville Municipal System occurred fifteen years ago, and arguing that Columbia had not demonstrated that the MGWC would not have been viable had it not been purchased by Columbia. I&E R.B. at 46.

The OCA opposed both premiums requested by Columbia, and noted that the combined premiums of 0.50% would add approximately $68,988 to the Company’s annual revenue requirement.[[25]](#footnote-25) The OCA argued that a utility must do more than provide adequate, safe, reasonable and efficient service, which is required of all utilities under 66 Pa. C.S. § 1501, to earn a performance premium. The OCA noted that the Commission rejected Columbia’s similar request for a 0.25% premium for management efficiency in the Company’s last rate case, and stated that the Company has provided much of the same information in this case. For the reasons stated in the *2009 Rate Case Order*, the OCA argued that the performance premium should be rejected here. OCA M.B. at 87-89. The OCA also argued that Columbia should not be awarded an acquisition premium because Columbia did not demonstrate that MGWC was not a viable system or that it had improved service to MGWC’s customers as envisioned by § 69.721, and the acquisition of the Mountville Municipal System occurred fifteen years ago. *Id*. at 90-93.

**b. ALJ’s Recommendation**

The ALJ recommended that Columbia’s requests for an acquisition premium of 0.25% and a performance premium 0.25% should be denied.

With regard to the requested performance premium, the ALJ agreed with the OCA’s point that all regulated utilities in Pennsylvania are required to provide safe, adequate, reasonable and efficient service as a matter of law under Section 1501 of the Code, 66 Pa. C.S. § 1501. The ALJ observed that an appropriate rate of return on common equity assumes efficient and reasonable management of a utility. According to the ALJ, a utility must be doing more than providing efficient and reasonable service in order to receive a performance premium. The ALJ also observed that, under Section 523 of the Code, 66 Pa. C.S. § 523(a), a utility cannot be rewarded a rate of return premium without specific evidence to support the adjustment, and noted that the Commission denied Columbia’s request for a performance premium in its last rate case. *2009 Rate Case Order* at 93. The ALJ concluded that, in this case, the evidence provided by Columbia shows compliance with Commission requirements and policies, *i.e.* the provision of reasonable and adequate service, but does not support the award of a performance premium of 0.25%. R.D. at 46-47.

With regard to the requested acquisition premium, the ALJ stated that the Commission’s policy statement at 52 Pa. Code § 69.721, *Acquisition of Viable Water and Wastewater Systems – Statement of Policy* (*Acquisition Policy Statement*), specifies that the Commission will consider evidence regarding acquisitions in determining whether a premium under Section 523 is warranted. 52 Pa. Code § 69.721(g). The ALJ concluded that an acquisition premium was not warranted in this case because “Columbia has not established that Marietta [MGWC] was a less viable system or that it has improved service to those customers as envisioned by Section 69.721.” R.D. at 48. The ALJ also stated that Columbia’s acquisition of MGWC did not satisfy the requirements of Section 1327 of the Code, 66 Pa. C.S. § 1327, and noted that the *Acquisition Policy Statement* provides that an acquisition premium may be requested where an acquisition (1) falls outside of the parameters of Section 1327 and (2) the utility has demonstrated a track record of acquiring smaller and less viable systems and improving service to customers. *Id*.

**c. Exceptions**

In its Exception, Columbia argues that the ALJ erred in recommending rejection of Columbia’s claim for rate of return premiums for exemplary performance and acquisition incentives. R.D. at 46-48. Columbia states that, as acknowledged by the ALJ, it is a small, “local” water company, and does not have the luxury of a large staff. Despite not having the staffing and operational advantages of larger companies, Columbia submits that it still has managed “to provide exemplary service and acquire two smaller, less viable water companies and made significant improvements to those companies so their customers could enjoy the same high quality of water service at reasonable rates that Columbia’s customers enjoy.” CWC Exc. at 15. Columbia submits that the ALJ wrongly denied Columbia’s requests for performance and acquisition premiums. “At the very least, the ALJ should have used his discretion to lean more toward Columbia’s rate of return and capital structure positions due to its history of doing these good things instead of adopting I&E’s punitive recommendation of its first time rate of return witness.” *Id*.

With regard to the requested performance premium, Columbia submits that the record in this case establishes that it has provided outstanding service and commitment to the community over the past several years. Columbia states that “[i]t is hard to imagine a record containing more support for a management efficiency premium – especially from a ‘small,’ local water company that doesn’t have the luxury of a large staff overseeing operations – than the record established in this case.” *Id*. at 16. Columbia again refers to the evidence in the record, *supra*, that it believes supports the award of a performance premium in this proceeding. *Id*. at 17-19.

Columbia states that its performance certainly has been equal to, and in most cases has exceeded, the performance of Aqua Pennsylvania, Inc. (Aqua) for which Aqua was awarded a 22 point premium by the Commission.[[26]](#footnote-26) Columbia states that the Commission awarded a premium to Aqua based on its finding “that Aqua’s managerial performance related to its water quality, customer service and low income program continues to be laudable and should be a factor in its cost of common equity.”[[27]](#footnote-27) Columbia submits that the Commission awarded a performance premium to Aqua even though the record in that case showed that there were severe water quality issues, including water sources that exceeded safe drinking water levels and hard water, promised infrastructure improvements that were not completed, excessively high unaccounted for water levels, and an ineffective customer assistance program. CWC Exc. at 20. Columbia submits that the record in this case shows none of those types of problems with Columbia’s water quality or service, and that its performance clearly has exceeded the base requirements. “Indeed, it would be most difficult to imagine how a company the size of Columbia could do more.” *Id*. at 20-21. Accordingly, Columbia submits that the Commission should exercise its discretion by granting Columbia a rate of return premium based on its managerial performance.

With regard to its requested acquisition premium, Columbia submits that the ALJ’s reasoning in evaluating the factors required under Section 69.721(g) is unclear, but under any scenario it is incorrect. CWC Exc. at 21. First, Columbia refers to the ALJ’s statement that Columbia did not satisfy the requirements of Section 1327, R.D. at 48, and states that it never made any claim under Section 1327. Second, Columbia submits that if the ALJ’s statement suggests that Columbia does not qualify for a premium under Section 69.721(g) because it did not satisfy Section 1327, then “that is wrong because not qualifying under Section 1327 is exactly what would allow you to claim a Section 69.721(g) premium. However, if this statement is suggesting that Columbia’s MGWC acquisition qualifies for Section 69.721(g) treatment, then that is correct; however, his evaluation of the second factor is still incorrect.” *Id*. at 22.

Columbia submits that the second factor in evaluating a claim under Section 69.721(g) is whether a utility has demonstrated a track record of acquiring and improving the service provided to customers of smaller and less viable water systems. Columbia argues that it has satisfied this standard. With regard to a “track record” of acquisitions, Columbia refers to its acquisition of the Mountville Municipal System in 1998 and the Marietta Gravity Water Company in 2012, and submits that these acquisitions demonstrate a goal of acquiring and improving less viable systems. Columbia believes that, given its size, two acquisitions in the past fifteen years demonstrate the “track record” contemplated by the *Acquisition Policy Statement*. As its witness explained, due to its small size Columbia is not in a position to acquire too many systems in a short period of time. Columbia submits that its acquisition strategy has been responsible and prudent and should be rewarded by the Commission at this time. *Id*. at 22-23.

With regard to the ALJ’s finding that Columbia has not established that MGWC was less viable or that Columbia had improved its system, Columbia submits that the testimony of its general manager shows otherwise. “Certainly, the amount of improvements that the Company has made to both systems shows that the systems were in need of extensive repair and thus ‘less viable.’” *Id*. at 23. Columbia states that it should be rewarded for its actions of purchasing neighboring water companies and spending the time, effort and money to upgrade their systems so their customers can enjoy the same quality water service as Columbia’s customers. *Id*. at 24.

**d. Reply Exceptions**

In its Reply Exceptions, I&E argues that the ALJ correctly rejected both premiums requested by the Company. With regard to the requested performance premium, I&E submits that the *Aqua* case cited by Columbia is not analogous to the instant proceeding. I&E states that the 2011 Management Audit of Columbia found that it needed minor improvement for all assessed areas except customer service, where it met expected performance levels. In addition, I&E argues that the Commission awarded 22 basis points to Aqua based both on management performance *and* in recognition of Aqua’s acquisition of troubled water systems. I&E notes that the Commission rejected a performance premium in Columbia’s last rate case, where it determined that Columbia’s management performance was adequate, but did not warrant a premium. I&E R.Exc. at 18-19.

With regard to the requested acquisition premium, I&E submits that Columbia failed to demonstrate a track record of acquiring and improving the service to the customers of smaller and less viable water systems that would justify an upward adjustment to the cost of common equity. I&E notes that the 1998 acquisition of the Mountville Municipal System occurred fifteen years ago. I&E argues that the Company has filed at least four base rate cases (not including the instant proceeding) since that time, and has had more than sufficient opportunity to request an acquisition adjustment. “As such, the request for an adjustment to the claimed return on equity based upon the acquisition of the Mountville Municipal System is no longer timely.” *Id*. at 20-21. With regard to the acquisition of the MGWC, I&E argues that the ALJ properly determined that Columbia did not establish that it was a less viable system, or that Columbia had improved service to its customers. While acknowledging that the Commission found both acquisitions to be in the public interest, I&E argues that Columbia failed to demonstrate that it should be awarded a rate of return premium for such actions. *Id*. at 21.

In its Reply Exceptions, the OCA presents arguments that are similar to those made by I&E. In addition, the OCA argues that, when determining whether performance incentives should be awarded, there is nothing in Sections 523 or 1501 of the Code that requires the Commission to distinguish among utilities based on their size. “Customers of small utilities, like customers of large utilities, are entitled to safe, adequate, and reliable service under the provisions of the Public Utility Code.” OCA R.Exc. at 10.

**e. Disposition**

Upon consideration of the record and the arguments made by the Parties, we shall deny the performance and acquisition premiums requested by Columbia.

With regard to the requested premium for managerial performance, we conclude that Columbia’s managerial performance, while commendable, has not risen to the level of supporting an added premium to its rate of return on common equity. We agree with the ALJ’s points that all regulated utilities are required to provide safe, adequate, reasonable and efficient service as a matter of law under Section 1501 of the Code, and that an appropriate rate of return on common equity assumes efficient and reasonable management of a utility. Accordingly, a utility must be doing significantly more than providing efficient and reasonable service to justify the receipt of a performance premium. We also note that we denied a similar premium requested by Columbia in its last rate case for its performance in 2007 and 2008 on the basis that Columbia had not provided sufficient evidence to warrant a positive managerial performance factor adjustment. *2009 Rate Case Order* at 93.

With regard to the requested acquisition premium, we agree with I&E and the OCA that the 1998 acquisition of the Mountville Municipal System occurred too long ago to support an acquisition premium in this proceeding. While we previously determined that the 2012 acquisition of the Marietta Gravity Water Company was in the public interest, and this recent acquisition is relevant to the instant proceeding, we conclude that the acquisition of one smaller company is not necessarily sufficient to demonstrate a “track record” of acquiring smaller and less viable water systems as contemplated by our *Acquisition Policy Statement* at 52 Pa. Code § 69.721. Although we agree with the Company that a smaller utility like Columbia is not in a position to acquire multiple systems in a short period of time, the Commission has “broad latitude” when determining whether an acquisition premium is appropriate in a particular case. *See,* 52 Pa. Code § 69.721(g). Given our determinations to adopt the Company’s actual capital structure, and to authorize the inclusion of the depreciated PennVest plant in the Company’s rate base, we conclude that an acquisition premium is not appropriate in this particular case. We note that the Company itself argued that, given the rejection of the requested premiums by the ALJ, “[a]t the very least, the ALJ should have used his discretion to lean more toward Columbia’s rate of return and capital structure positions due to its history of doing these good things . . .” CWC Exc. at 15. Columbia’s Exceptions recognize that the decision regarding whether or not to award a rate of return premium should be made after considering all of the issues in a given proceeding. On balance, we conclude that an acquisition premium is not appropriate in this particular proceeding.

## E. **Revenues -** **Merchandising Sales and Jobbing Work**

**1. Positions of the Parties**

The OCA recommended adding $15,762 of revenue from Merchandising Sales and Jobbing Work to Columbia’s above-the-line operating revenue. This amount included the sale of billing data to the Lancaster Area Sewer Authority (Authority) and the Borough of Columbia (Borough); payment for assisting the Borough with turn-ons and turn-offs; funds received from the sale of meters (salvage); insurance proceeds for a damaged fence and compressor; and the sale of bulk water. I&E recommended increasing the Company’s operating revenue for ratemaking purposes by $9,932 for the sale of the billing data to the Borough and the Authority. Columbia accepted this adjustment of $9,932 to its operating revenue, but disagreed with the remaining $5,832 adjustment recommended by the OCA. Instead of including this revenue as operating revenue, the Company argued that it should be booked to depreciation reserve. CWC M.B. at 16-17.

**2. ALJ’s Recommendation**

The ALJ rejected the OCA’s $5,830 addition to operating revenue for the sale of bulk water, meters and damage insurance, and concluded that the Company’s position on this issue was correct. R.D. at 22-23.

**3. Exceptions and Reply Exceptions**

In its third Exception, the OCA argues that the remaining $5,830 in merchandising sales and jobbing work should be included in the Company’s above-the-line operating revenue. The OCA reasons that, because the expenses associated with these revenues were charged to operating expenses for ratemaking purposes, customers should get the benefit of the additional revenues. OCA Exc. at 21.

The OCA asserts that, notwithstanding Columbia’s statement that funds received from the sale of meters and insurance should be recorded to the accumulated depreciation reserve and not recognized as revenue for book and ratemaking purposes, Columbia does not actually follow this procedure. According to the OCA, the Company did not credit the revenues to the depreciation reserve, but instead charged the repairs to M&S expense, and reflected the revenues as a credit to the expense. The OCA argues that, since the Company charged the expenses related to these revenues to expense accounts that are claimed in this case, the revenues received by the Company to offset these expenses should be considered as above-the-line operating revenue. *Id*. at 21‑22. The OCA also submits that, in the Company’s last rate case, the Commission approved the inclusion of nearly identical revenues of $12,662 as above-the-line operating revenue.

**4. Reply Exceptions**

In its Reply Exceptions, Columbia asserts that the ALJ correctly accepted the Company’s position on this issue.[[28]](#footnote-28) Columbia argues that, relative to the other items for bulk water sales and customer disconnect revenue, an average basis calculation will not reflect the lack of stability in these items, and that these items are not under the direct control of the Company. Tr. at 133-134. Columbia asserts that these revenues should be booked to the depreciation reserve for the respective plant items under the Uniform System of Accounts. According to Columbia, this position was corroborated by I&E witness Wilson who agreed. I&E St. 2-SR at 3:4-19. For these reasons, Columbia submits that the OCA’s Exception on this issue should be denied. CWC R.Exc. at 21-23.

**5. Disposition**

We concur with the ALJ that the OCA’s proposed adjustment should be rejected. For the reasons proffered by the Company, these revenues should be booked to the depreciation reserve for the respective plant items under the Uniform System of Accounts.

## **F. Expenses**

### 1. PennVest Plant Depreciation Expense

This issue has been resolved in the section pertaining to the rate base treatment of the PennVest plant book depreciation reserve, *supra*. The claimed depreciation expense of $115,913 shall be allowed, consistent with the inclusion of the undepreciated PennVest plant in rate base.

### 2. Acquisition Adjustment

**a. Positions of the Parties**

Columbia requested that an amount related to the 2012 acquisition of MGWC be reflected in the Company’s expenses in this case. Columbia proposed that the $225,581 acquisition adjustment be amortized over fifteen years at $15,039 annually. Columbia emphasized that it was seeking “a 15-year amortization of the expenses incurred, not the price of the assets in the sales agreement that was in excess of the original cost [of MGWC’s assets] less depreciation.” CWC M.B. at 18. Columbia did not include the cost of MGWC assets in its rate base.

The OCA characterized the Company’s claimed amount of $225,581 as representing “the amount of the purchase price less the net original cost.” OCA M.B. at 27. The OCA also characterized the amount as “the amount of expense the Company incurred in the process of acquiring the MGWC assets.” *Id*. In response to the Company’s statement that it simply was seeking a 15-year amortization of the *expenses* it incurred in acquiring MGWC, the OCA argued that “the expenses incurred are part of the purchase price adjustment.” *Id*. at 30. The OCA based this conclusion on the testimony of its witness that the total purchase price of MGWC included closing costs, expenses incurred, etc. *Id*.

The OCA then argued that the Company’s claimed expense related to the acquisition of MGWC should be rejected because the Company is not eligible for an acquisition adjustment under Section 1327 of the Code. The OCA contended that Section 1327(a) establishes nine criteria that must be met “before a utility can claim an acquisition adjustment in rate base and an amortization of the acquisition adjustment in expenses.” *Id*. The OCA argued that Columbia failed to satisfy subsections (a)(3) and (a)(7) of Section 1327. *Id*. at 27-30.

In the event that the claimed expenses would not be considered to be an acquisition adjustment subject to Section 1327 of the Code, the OCA argued that the Company would not be eligible for recovery of its expenses through a fifteen-year amortization because the Company failed to request permission to defer the costs for later for recovery. The OCA also argued that the Company was not eligible for recovery of its costs because it had allocated 100% of the costs to the Columbia Division. *Id*. at 30-31.

In response, Columbia reiterated that it was not claiming an acquisition adjustment under Section 1327. Columbia argued that, even if its claim was evaluated under Section 1327, that statutory provision only created an “express lane” for the approval of acquisition adjustments, and did not preclude utilities from requesting cost recovery under ordinary procedures. Finally, the Company argued that the filing of a petition for approval of the deferral of costs is not a prerequisite to cost recovery. CWC R.B. at 29-30.

**b. ALJ’s Recommendation**

The ALJ agreed with the OCA that Columbia’s claimed expense of $15,039, representing a fifteen year amortization of $225,581 in expenses incurred while acquiring the Marietta system, should be rejected. R.D. at 26.

**c. Exceptions**

In its Exceptions, Columbia argues that the ALJ erred in recommending rejection of the Company’s claim for extraordinary and nonrecurring expenses related to the acquisition of the Marietta Gravity Water Company. Columbia argues that the disallowance would create a disincentive for future acquisitions that are in the public interest. CWC Exc. at 26.

Columbia emphasizes that its claim for the amortization of these extraordinary and nonrecurring expenses is *not* an acquisition premium under Section 1327. Columbia states that the ALJ recommended rejection of its claim under Section 1327 based upon the OCA’s mischaracterizations of its claim. Columbia asserts that, as set forth in its Main Brief at 18-19 and its Reply Brief at 29-30, the Company’s claim is not an acquisition premium under Section 1327. *Id*. at 26-27. “The Company is ***not*** claiming an acquisition premium under Section 1327. . . The Company is simply requesting a 15-year amortization of the expenses incurred, ***not*** any price of the assets . . .” *Id*. at 27, citing CWC St. 2R at 19:9-12. The Company reiterates that it is not making a rate base claim under Section 1327 for the difference between the sale price of the assets and the depreciated book value of the assets. Rather, it is seeking the recovery of expenses related to obtaining a new franchise and the right to serve from the Commission. Columbia asserts that all Parties – particularly the OCA – knew that Columbia was claiming only acquisition expenses, and not an acquisition premium under Section 1327. *Id*.

Columbia argues that denial of these costs would create disincentives for future acquisitions, such as Columbia’s acquisition last year of the neighboring and financially challenged Marietta Gravity Water Company that the Commission found to be in the public interest.[[29]](#footnote-29) Rejecting this claim for acquisition costs and requiring Columbia to “absorb” $225,581 would punish it for acquiring a smaller, less viable water company. *Id*. at 26.

Columbia further argues that any argument by the OCA that its claim constitutes retroactive ratemaking is incorrect. The Company submits that the Commission routinely grants recovery of expenses that are extraordinary and non-recurring. Columbia asserts that the Commonwealth Court has approved the recovery of “extraordinary expenses” that are “a substantial, one-time expense or a substantial item that will not appear as a continuing expense and could otherwise never be recovered in rates because, like the weather-related expenses, it would be normalized out of the test year as abnormal.”[[30]](#footnote-30) *Id*. at 27-28.

Columbia submits that, if the ALJ’s recommendation to eliminate all the expenses is adopted, at a minimum and in the alternative, the Company’s expenditures related to the Commission proceedings to obtain a certificate of public convenience, and related regulatory approvals such as security certificates to finance the transaction for transferring the environmental and related permits into the Company’s name, should be capitalized.  The costs relative to the certificate of public convenience and regulatory approvals were $110,772 for legal services, $9,431.52 for consulting services, and $748.30 for newspaper publication. CWC Exc. at 28, citing Tr. at 138. The Company states that, under this alternative scenario, the total capitalized investment would be $120,952.[[31]](#footnote-31) *Id*. at 28. The Company argues that the OCA’s argument that this alternative claim should be rejected on the basis that there is no evidence that the Company actually capitalized these costs should be rejected. Columbia notes that the Commission is not bound, for *ratemaking* purposes, by how a claim is treated by a utility on its books. “It is common practice in *ratemaking* for claims to be moved from rate base to expense items or vice versa or between expense categories regardless [of] how a Company treated it on its books.” *Id*. at 29.

**d. Reply Exceptions**

In its Reply Exceptions, the OCA argues that, contrary to the Company’s position, its claim is an “acquisition adjustment” subject to Section 1327. In the alternative, in the event that the claim is not deemed to be an acquisition adjustment subject to Section 1327, the OCA argues that the Company is not eligible for amortization of the acquisition costs because (1) the Company allocated all of the costs to the Columbia Division; and (2) the Company should have filed a petition with the Commission requesting authorization to defer the costs for future recovery. OCA R.Exc. at 15-16.

The OCA also argues that the acquisition costs cannot be included in rate base because (1) the Company has not claimed an associated depreciation time period; and (2) costs cannot be capitalized unless they satisfy the requirements of Section 1327. The OCA acknowledges that Section 1327 was added to the Code in 1990 as “an exception to the rule that only original cost, and not any premium above cost, could be included in rate base and in rates.” *Id*. at 17. The OCA argues, however, that “Section 1327 is the only way under the Public Utility Code, to request an acquisition adjustment.” *Id*.

**e. Disposition**

We concur with the ALJ that Columbia’s claimed expense of $15,039, representing a fifteen year amortization of $225,581 in expenses incurred while acquiring the Marietta system, should be rejected. These acquisition costs should be addressed in a future proceeding when the assets of the MGWC are proposed to be included in rate base and the parties to that proceeding can address the extent to which these acquisition costs should be included in rate base pursuant to Section 1327 of the Code.

### 3. **Engineering Contractual Services**

**a. Positions of the Parties**

The OCA objected to a portion of Columbia’s claimed Engineering Contractual Services expense of $13,500. Specifically, the OCA objected to the inclusion of two invoices from Ronald F. Weigel Consulting that totaled $5,505. The Company described the services provided by Mr. Weigel as follows:

Mr. Weigel monitored public meetings, orders issued by the Commission, and rulemakings of potential interest to, or affecting, the Company. Assisted management in evaluating potential regulatory filings and reviewed filings prepared by the Company’s lawyers or consultants.

OCA St. 1 at 22-23 (quoting CWC response to OCA Set III-31).

The OCA first argued that this amount should be transferred to Rate Case Expense based on the assumption that the invoices related to the preparation of the current rate case. *Id*. In rebuttal, the Company clarified that Mr. Weigel’s services were, instead, related to the acquisition of MGWC and for ongoing monitoring of the Commission. CWC St. 1R at 3. The OCA then argued that the entire expense should be disallowed based on the assumption that the services related to the acquisition of the Marietta Division. OCA St. 1R at 8:3-10. In rejoinder, the Company provided examples of some regulatory matters unrelated to the acquisition of MGWC for which it would use a consultant like Mr. Weigel. Tr. 110-111; CWC Rejoinder Exhs. 1, 2.

**b. ALJ’s Recommendation**

The ALJ agreed with the OCA and recommended that $5,505 of the Company’s expense for Engineering Contractual Services be disallowed. The ALJ reasoned that Columbia never identified what portion – if any – of the disputed invoices were unrelated to the acquisition of the MGWC. The ALJ stated that, “because Columbia has not met the criteria for the utility to include an amortization of the acquisition adjustment expenses and it is not appropriate for the Columbia Division to pay all of the acquisition expenses related to the purchase of the MGWC, and because it appears that Mr. Weigel’s services are related directly to that acquisition and not to this rate case, this $5,505 expense must be removed.” R.D. at 27.

**c. Exceptions and Reply Exceptions**

No Party filed an Exception to the ALJ’s recommendation on this issue.

**d. Disposition**

We agree with the ALJ that the Company’s $5,505 claim for “engineering services” should be rejected. We find that in response to the challenge by the OCA, the Company has not met its burden of proof that these services are either unrelated to the acquisition of the MGWC or related the preparation of the instant rate proceeding.

### 4. **Bad Debt Expense**

**a. Positions of the Parties**

Columbia claimed *pro forma* bad debt expense of $11,000. The OCA argued that the claim should be adjusted downward by $1,808 to reflect a four year historical average of $9,192. OCA St. 1 at 24-25; OCA St. 1S at 9-12. The OCA contended that 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.

Columbia argued that an increase in the bad debt expense of $564 over its 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. Columbia argued 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.

**b. ALJ’s Recommendation**

The ALJ recommended that the OCA’s adjustment be rejected. The ALJ stated that both the OCA’s and Columbia’s approaches to this issue are reasonable. However, the ALJ concluded that the OCA did not offer a convincing argument with respect to why its methodology should be preferred. R.D. at 28.

**c. Exceptions**

In its fourth Exception, the OCA argues that the utility has the affirmative burden to establish the justness and reasonableness of every component of its rate request, and that there is no similar burden for a party proposing an adjustment to a utility base rate filing. The OCA stated that the Company’s actual bad debt expense for 2009, 2010, 2011 and 2012 was $7,115, $10,567, $8,650, and $10,436, respectively. OCA St. 1 at 24. The OCA argues that, because the actual bad debt expense is not a linear progression but fluctuates from year to year, the historic average should be used to establish the Company’s bad debt expense. The OCA submits that its adjustment is consistent with the Commission’s traditional approach to this issue. The OCA also disputes the Company’s argument that the rate increase at the conclusion of this proceeding will cause an increase in bad debt expense. OCA Exc. at 23-26.

**d. Reply Exceptions**

In reply, Columbia refers to the testimony of its witness that the Company should use audited numbers to establish bad debt expense, not estimates derived from averages as the OCA suggests. Columbia also refers to the public input testimony of Columbia’s Borough Manager that Columbia is an economically challenged community with a disproportionately high percentage of low-income households, senior citizens and rental housing. CWC R.Exc. at 19.

**e. Disposition**

We concur with the ALJ that the OCA’s methodology is reasonable. However, in light of Columbia’s observation that its service area is an economically challenged community with a disproportionately high percentage of low-income households, senior citizens and rental housing, we are not inclined to make the reduction to the Company’s claim as proposed by the OCA. Accordingly, we shall adopt the ALJ’s recommendation to reject the OCA’s proposed adjustment.

### 5. Employee Salaries and Wages

**a. Positions of the Parties**

The Company claimed $820,483 in Salaries and Wages. An allocation of $25,597 to Marietta reduced the amount claimed in this proceeding to $794,886. OCA M.B. at 36.

The Company stated that, overall, it allocated an average of 8% of total salaries (for both hourly and salaried employees) to the Marietta Division. The Company allocated 15% of its salaried employee expense to Marietta on the basis that, on average, salaried employees are spending about six hours per week on Marietta Division tasks. The percentage of hourly employees allocated to the Marietta Division varied by individual employee based on their time sheets since the acquisition in October 2012. CWC St. 1R at 2:14-3:8.

The OCA disagreed with Columbia’s allocation of its hourly employees to Marietta, and argued that data from a few months of time sheets is not a reasonable basis upon which to allocate wages over the course of a year. The OCA submitted that hourly employees should be allocated to Marietta using the same 15% allocation percentage that was used by the Company for the allocation of salaried employees. “In other words, the OCA recommends applying the Company’s 15% allocation factor to the Salaries and Wages of all applicable salaried and hourly employees.” OCA M.B. at 37. The OCA noted, however, that not all employees do work for the Marietta Division; therefore, the OCA did not recommend allocating any of the salaries and wages of these particular employees to Marietta. The allocation of all remaining (or “applicable”) employees to the Marietta Division using a 15% factor resulted in the OCA recommending a downward adjustment of $4,117 to the Company’s claim for Salaries & Wages. *Id*. at 37, 39.

The Company argued that the OCA’s adjustments are not fact-based. The Company stated that the OCA’s witness has never spent any time observing how much time Columbia employees spend on Marietta Division tasks; is not an expert in water utility system operations; and did not attend the July 24, 2013 tour of the Company’s facilities and operations that was requested by the OCA and I&E. In contrast, the Company pointed out that its witness on this issue works on a day-to-day basis managing the Company. CWC M.B. at 23.

After the Parties revised their respective positions during the course of this proceeding, the remaining contested claims pertained to the OCA’s adjustments to the Foreman’s salary and the Service Person’s salary. CWC M.B. at 23-25.

**b. ALJ’s Recommendation**

The ALJ agreed with Columbia’s position on this issue, and recommended that the OCA’s proposed adjustments be rejected.

**c. Exceptions**

In its Exception, the OCA argues that, in general terms, it proposed adjustments to a number of the Company’s allocations to the Marietta Division to reflect a more accurate allocation of costs to that division.[[32]](#footnote-32) The OCA states that the ALJ rejected most of the OCA’s adjustments (with the exceptions of accounting expense and office expense) and characterized the OCA’s proposed adjustments as “what adjustments its witness wants.” R.D. at 29. The OCA argues that this criticism is unfounded, and submits that its witness has recommended adjustments that comport with acceptable ratemaking procedures and policies. OCA Exc. at 26-27.

With regard to this specific issue, the OCA submits that the ALJ rejected the OCA’s adjustments (for the Foreman’s and Service Person’s salaries) because he agreed with Columbia that the allocation may need to be adjusted in future cases. R.D. at 30. The OCA avers that this is the nature of allocation issues and should not be the basis to reject the OCA’s adjustment. The OCA states that the Company allocated only 4.22% of the Foreman’s salary and 2.31% of the Service Person’s salary to the Marietta Division based on time spent on Marietta tasks during a three-month period in 2012. The OCA argues that data from a few months of time sheets is not a reasonable basis to allocate wages over the course of a year. The OCA submits that, until at least a year’s worth of data is available, its recommended allocation of 15% is fair and reasonable. The OCA states that its updated recommended Salaries & Wages adjustment is $3,637. OCA Exc. at 28.

**d. Reply Exceptions**

In response to the OCA’s general objection to the ALJ’s recommendations to reject several of the OCA’s adjustments based on a general “Marietta” allocation factor of 15%, the Company asserts that its claims were based on “real world” allocations made by its general manager, Dave Lewis,[[33]](#footnote-33) who works on a day-to-day basis managing the Company. CWC R.Exc. at 20. The Company states that “[i]t is simply impossible for someone who has no experience working with the water company – and who has never even been there – to make remote suppositions on the amount of time a Columbia employee spends or should spend working on Marietta Division tasks.” *Id.*

The Company submits that the ALJ correctly rejected the OCA’s speculative allocations of Columbia’s employees’ time to the Marietta Division, and instead correctly accepted Columbia’s allocations based on its general manager’s “real world” allocations and the fact that “Columbia employees must still do Columbia Division work.” CWC R.Exc. at 20, citing R.D. at 29.

With regard to the OCA’s corresponding adjustment to the Company’s payroll tax claim, Columbia states that this allocation similarly is based on the OCA’s flawed and speculative allocations of the Company’s employee salaries and wages to the Marietta Division.

**e. Disposition**

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

### 6. Allocation of Pensions and Benefits Expense to the Marietta Division

**a. Positions of the Parties**

Columbia claimed a Future Test Year Pensions & Benefits expense of $147,054. GDS Exh. 1 at 1-15. This claim includes expenses for Pensions, Disability/Life Insurance, Health Insurance and Employee Recognition. OCA St. 1 at 18-19 (citing OCA-I-29). The OCA noted that the Company did not allocate any pension and benefits expenses to the Marietta Division. Consistent with its position on the allocation of salaries and wages, *supra*, the OCA argued that these claims represent a portion of employee costs that should be allocated to the Marietta Division, and recommended adjustments of $8,648 of health insurance expenses, $4,846 of pension expenses, and $765 of disability/life insurance expenses. OCA M.B. at 40-44.[[34]](#footnote-34)

**b. ALJ’s Recommendation**

The ALJ stated that, once again, the OCA’s witness applied the allocation percentage provided by Mr. Lewis for salaried employees. The ALJ reasoned that the approach by the OCA’s witness is not more reasonable than Columbia’s proposal to extrapolate an allocation from data for hourly employees that Columbia has deemed insufficient or to allocate zero costs to the Marietta Division until sufficient data is available. Therefore, the ALJ rejected the OCA’s proposed adjustments. R.D. at 30.

**c. Exceptions and Reply Exceptions**

The OCA’s Exceptions to the ALJ’s rejection of its adjustments and the Company support of its claims in the Reply Exceptions mirror their arguments on the allocation of salaries and wages to the Marietta Division, discussed, *supra*. OCA Exc. at 30. CWC R.Exc. at 21.

**d. Disposition**

Consistent with our disposition of the allocation of salaries and wages to the Marietta Division, *supra*, we are not inclined to adjust the Company’s claims until there is more comprehensive historical data upon which to develop a more accurate allocation. Accordingly, the OCA’s proposed adjustments are rejected.

### 7. Pension Adjustment

**a. Positions of the Parties**

As noted*, supra*, Columbia claimed a total pension expense of $59,682. The OCA asked Columbia to provide evidence of the most current pension deposit. In response, Columbia provided a copy of a check showing a payment of $57,944. On this basis, the OCA recommended an adjustment of $1,738 to reflect the amount that the OCA contended is not supported by the record. OCA M.B. at 42.

**b. ALJ’s Recommendation**

The ALJ opined that, just because the most current pension deposit does not reflect the total claimed expense, does not demonstrate that the total number is invalid. The ALJ reasoned that if there is an actual $1,738 shortfall in the allowance for pension expense, then this is an amount that Columbia must nevertheless make good. Therefore, the ALJ rejected the OCA’s proposed adjustment. R.D. at 30-31.

**c. Exceptions and Reply Exceptions**

In its Exceptions, the OCA argues that there is no evidence that the actual payment for pension expense was less than the estimate provided in the Company’s original filing. OCA Exc. at 29. In its Reply Exceptions, the Company supports the ALJ’s argument that if there were a shortfall in its pension expense, “then Columbia would have to make that payment good to the provider.” CWC R.Exc. at 21.

**d. Disposition**

We shall adopt the ALJ’s recommendation to reject the OCA’s adjustment. The Company’s claim represents a three percent increase in pension costs above the actual payment during the test year. It is not unreasonable to expect that pension costs will increase by at least that much going forward.

### 8. **Disability and Life Insurance**

**a. Positions of the Parties**

Columbia claimed a Disability/Life Insurance expense of $10,176, which would be an increase of 10% over the 2012 claim. The OCA averred that the invoice provided in response to discovery supports a claim of only $9,147. OCA St. 1 at 34, citing CWC response to OCA-III-26. OCA witness Everette recommended that the Company’s claim related to Disability/Life Insurance should be reduced by $1,029 ($10,176 - $9,147). In rebuttal, Company witness Lewis testified that the Company received the renewal notice for the disability/life insurance premium and it has increased by $1,659. CWC St. 1R at 11. In the OCA’s view, Columbia did not provide any support for this claimed increase or provide a time period for which the expense is allegedly increasing.

The OCA also recommended that a portion of the Disability/Life Insurance claim be allocated using the same (updated) calculations recommended for other Pension and Benefits expenses, *supra*, for each full-time employee who is partially allocated to the Marietta Division. Therefore, the OCA recommended 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. OCA St. 1 at 34; OCA St. 1S at 22.

**b. ALJ’s Recommendation**

The ALJ rejected the OCA’s downward adjustment of $1,029. The ALJ accepted Mr. Lewis’ sworn testimony that the disability/life insurance premium has increased, “as both honest and accurate.” R.D. at 31.

The ALJ also found that the OCA’s argument for re-allocation of the portion of the disability/life insurance expense to the Marietta Division is not practicable. The ALJ agreed with Columbia that the allocations of disability and life insurance benefits were based upon the percentage of the employee’s time allocated to the Marietta Division and not the actual costs of the person’s benefits. CWC St. 1R at 11:9-13. The ALJ concluded that the OCA’s recommended negative adjustment of $765 to Columbia’s disability and life insurance claim is too speculative and rejected the OCA’s adjustment. R.D. at 32.

**c. Exceptions and Reply Exceptions**

It its Exceptions, the OCA disagrees with the ALJ’s finding that its proposed adjustments are too speculative. The OCA submits that the Company did not provide any documentation or specify a time period for the alleged increase in the insurance premium. OCA Exc. at 29-30. In response, the Company argues that this cost is known and measurable and doubts that the OCA would ask the Commission to ignore the notice of the premium increase if it were a decrease in insurance rates. CWC R.Exc. at 21.

**d. Disposition**

We will accept the sworn testimony of the Company’s witness Lewis that the disability/life insurance premium will increase. Also, consistent with our disposition of the OCA’s other proposed reallocations of personnel costs to the Marietta Division, we find that it is premature to make any adjustments to the Company’s proposed allocation. Accordingly, we shall reject both of the OCA’s proposed adjustments to the Company’s claim for disability/life insurance claims.

### 9. **Employee Recognition**

**a. Positions of the Parties**

Columbia’s Pensions and Benefits claim includes $6,051 for “Employee Recognition.” OCA St. 1 at 35 (citing CWC response to OCA-1-29). This claim includes a Hershey Park outing and the employee/officers year end banquet. *Id.* OCA witness Everette recommended that these items be removed from expenses for ratemaking purposes because they are not part of the employees’ compensation. OCA St. 1 at 35-36; OCA St. 1S at 22.

I&E witness Wilson also recommended that the entire claim be denied. I&E St. 2 at 10. I&E noted that a similar expense claim was disallowed by the Commission in the Company’s last rate proceeding. I&E M.B. at 36 (citing the *2009 Rate Case Order* at 10-11). I&E stated that a review of that Order discloses that the Commission agreed with the ALJ in that proceeding that, consistent with previous Commission decisions, Columbia’s employee entertainment expenses should not be included in either expenses or rate base. *Id.*

Columbia’s witness Mr. Lewis testified that the Hershey Park tickets and the year-end banquet are economic benefits the Company has been providing for years which are calculated to retain and compensate employees. (CWC St. 1R at 12:30) He averred that Columbia is a tiny Company and must use benefits like this to keep highly skilled workers and to compete with other private water utilities, as well as municipal water and wastewater authorities. Tr. at 112-113. Mr. Lewis also testified that it is well known that the pool of workers with waterworks skill and experience is shrinking and Columbia must use creative means like this to retain the talent necessary to provide the level of water service that the Commission and customers demand. Columbia submitted that the banquet is an equally important tool to foster, retain, and provide reinforcement and feedback for workers who perform very well. CWC M.B. at 29.

**b. ALJ’s Recommendation**

The ALJ agreed that the Commission has consistently disallowed these types of entertainment expenses as they are not necessary to the provision of public utility service. R.D at 32 (citing *Pa. PUC v. Pennsylvania-American Water Co.*, 1993 Pa. PUC LEXIS 79, \*121-23 (*PAWC 1999*). The ALJ also found that Columbia did not provide specific information about the year-end banquet to demonstrate that it qualifies as an “employee recognition” dinner. R.D. at 32. The ALJ reasoned that “While Mr. Lewis argues that these expenses are necessary for the Company to attract and retain skilled employees (CWC St. 1R at 12), they are simply not valid expenses consistent with established ratemaking principles.” *Id.* The ALJ adopted the $6,051 adjustment.  *Id.*

**c. Exceptions and Reply Exceptions**

In its Exceptions, Columbia argues that the ALJ erred in recommending rejection of Columbia’s claim for certain employee compensation package expense. Columbia submits that the ALJ accepted the OCA’s and I&E’s argument that the expenses are entertainment expenses and not related to the provision of service. The Company argues that this is simply not the case. The Company argues that the expenses are part of its overall compensation package that is necessary to retain and attract skilled workers. CWC Exc. at 30-31.

Columbia states that “[b]oth OCA and I&E exaggerate this claim as some frolic or detour unrelated to retaining and attracting skilled labor as part of an overall compensation package.” *Id*. at 30. Columbia submits that it explained this compensation package issue in much greater detail in this proceeding than it did in the prior rate case. The Company notes that its general manager Mr. Lewis testified that, “this is not a trip to Hershey Park. It is not a picnic at the park.” CWC Exc. at 30 (citing Tr. at 112). Mr. Lewis went on to explain that the Company provides Hershey Park tickets to its employees as an economic benefit as part of their overall compensation package and employees use their ticket when they want during the year. *Id.* The Company states that employees must use the tickets on their own time, perhaps on a weekend, or take a vacation day to use it. *Id.* at 30-31.

The Company avers that such claims have been accepted by the Commission. Columbia cites *Pa. PUC v. York Water Co.*, 62 Pa. P.U.C. 459 at 487 (1986) where Columbia submits that the Commission allowed expenses related to an end of year service award banquet. *Id*. at 31. The Company states that the Commission determined that an award dinner or banquet gave the utility the opportunity to recognize employees for service to the utility and its customers. The Company explained that the Commission reasoned that this recognition would, in turn, foster improved employer-employee relations and result in a more satisfied and effective work force. Columbia argues that the same result should apply here. *Id*.

In response to the Company’s Exceptions, the OCA provided the following summary of cases where it avers that the Commission has disallowed similar claims. The OCA stated:

The Commission has consistently disallowed these types of entertainment expenses based on its reasonable determination that they are not necessary in the provision of public utility service. *See* *Pa. P.U.C. v. Pennsylvania-American Water Co.*, 79 PaPUC 25, 62-63 (1993) (*PAWC 1993*) (expenses for entertainment and gifts inappropriately included in utility’s rates because they did not directly relate to the provision of quality water service); *see* *also* *Pa. P.U.C. v. Citizens Utilities Water Co. of Pa.*, 169 PUR4th 552, 584-85 (1996) (disallowing expenses for gifts, flowers, in-house luncheons and horticultural service despite the Company’s claim that these items improved employee morale). Only expenses directly related to “employee recognition” dinners are permitted. *See* *PAWC 1993* at \*123; *Pa. P.U.C. v. Pennsylvania-American Water Co.*, 1995 PaPUC LEXIS 170, \*38-39 (*PAWC 1995*).

OCA R.Exc. at 18.

**d. Disposition**

Upon a review of the record in this proceeding, we find that the Company has not put forward sufficient evidence to demonstrate that these expenses are necessary to retain its employees. Accordingly, these expenses are not necessary for the provision of public utility service and shall be rejected.

### 10. Vehicle Insurance

**a. Positions of the Parties**

Columbia claimed $6,900 in the future test year for vehicle insurance. OCA St. 1 at 37-38; OCA St. 1S at 23-25. The OCA’s witness, Ms. Everette, recommended that Columbia’s vehicle insurance expense should be adjusted downward by allocating $589 or 8.49% to the Marietta Division. OCA St. 1S at 24. In response to interrogatory OCA-III-48, Columbia stated that “other vehicles on the policy were used by workers when doing work for the Marietta Division.” OCA St. 1 at 37. Columbia further indicated that “[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. The OCA contended that the delayed allocation of vehicle insurance costs to the Marietta Division is not appropriate for ratemaking purposes, and Ms. Everette used the same allocation percentage for vehicle insurance as she used for employee salaries and wages to adjust the vehicle insurance claim. OCA M.B. at 47.

The Company also claimed that the costs of its vehicle insurance are increasing and requested an increase of $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. In the alternative, the OCA suggested that a portion of the increase be allocated to the Marietta Division. OCA M.B. at 48.

**b. ALJ’s Recommendation**

The ALJ reasoned that to accept the OCA’s recommended alternative adjustment, he would have to ignore the testimony of Mr. Lewis on this point. The ALJ cited the following testimony of Mr. Lewis that the Company presented in its Main Brief:

Mr. Lewis testified that the Marietta Division has its own vehicle, and, thus, most of the vehicle costs are associated with that vehicle. (Tr. at 114) He explained that many of the employees that do Marietta Division work do not use vehicles; for example, customer service personnel, the office manager, and the production superintendent. Even meter readers mainly walk and only use the vehicle to get to the service area. (Tr. at 114) He further explained that the vehicle use associated with the Marietta Division is minimal even when you include the hours of those employees that do Marietta Division tasks and use vehicles and, if anything, it is less than 4 percent, which is the amount of time the Company allocated for the foreman and the meter readers and other employees who do Marietta tasks. (Tr. at 114-115) The Company’s vehicle costs will go up if they are used substantially for the Marietta Division, and those additional costs will be allocated to the Marietta Division. (Tr. at 115).

Columbia M.B. at 29-30. Based on Mr. Lewis’ testimony, the ALJ rejected the OCA’s proposed alternative adjustment. R.D. at 33.

**c. Exceptions and Reply Exceptions**

In its Exceptions, the OCA avers that the ALJ did not address the fact that these statements are inconsistent with the statements made by the Company in its response to discovery. The OCA submits that in the Company’s Main Brief, it argued 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. The OCA states that despite the Company’s argument in its Main Brief, the Company’s position here is inconsistent with earlier statements made by the Company. The OCA notes that, in response to its interrogatory 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. The OCA argues that 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. The OCA concludes that, 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 Exc. at 31.

In support of its argument that the Company’s claimed increase in vehicle insurance should be rejected, the OCA submits that the purpose of the test year concept is to capture all revenues and all expenses and match them at a point in time. The OCA avers that 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 arguments, the OCA renews its recommendation that 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 Exc. at 31-32.

In response to the OCA’s proposed adjustment to reject the increase in the Company’s vehicle insurance premium, Columbia avers that, like the increase in the disability and life insurance, *supra*, the cost increase is known and measurable and the rate will be in effect at the time the insurance premium increase becomes effective. CWC R.Exc. at 22.

**d. Disposition**

Consistent with our disposition concerning the increase in life and disability insurance premiums, *supra*, we will accept the Company’s argument that the increase in vehicle insurance is known and measurable and should be allowed. Also, consistent with our disposition of the OCA’s other proposed reallocations of personnel costs to the Marietta Division, we find that it is premature to make any adjustments to the Company’s proposed allocation of vehicle insurance. Accordingly, we shall reject both of the OCA’s proposed adjustments to the Company’s claim for vehicle insurance.

### 11. Worker’s Compensation Insurance

**a. Positions of the Parties**

The OCA recommended that Columbia’s claimed expense of $24,500 for worker’s compensation insurance should be adjusted to reflect an allocation of $2,938 or 11.99% to the Marietta Division. The Company has allocated 3.8% of its worker’s compensation premium expense to the Marietta Division based on actual hours worked on Marietta Division tasks. CWC M.B. at 31. In addition to allocating a portion of this expense for Columbia employees that perform tasks for the Marietta Division, the OCA noted that the Marietta Division does not carry its own worker’s compensation insurance and the proposed charge to Columbia’s ratepayers includes the costs of insurance for employees that only work for the Marietta Division. OCA M.B. at 48-49. OCA witness Everette explained the proposed 11.99% allocation as follows:

The Marietta Division’s three employees are included in CWC’s claim for workers’ compensation insurance. This means that I must use total salaries in developing the allocation. The total salaries allocated to the Marietta Division, including the three employees who are allocated 100%, represent 11.99% of total salaries (shown on line 29 of Schedule 2S). Therefore, 11.99% of workers’ compensation insurance should be allocated to the Marietta Division. This is based on my acceptance of Mr. Lewis’ statement that “The amount to be allocated should be based upon the actual amount of time allocated to the Marietta Division” (CWC Statement No. 1R, Page 13, Lines 16-17).

OCA St. 1S at 25.

The Company also increased its claim by $2,752 based on information it received from its carrier during this case regarding an increase in its workman’s compensation premium. The OCA recommended complete rejection of this increase because it falls outside of the future test year.[[35]](#footnote-35) OCA M.B. 42.

**b. ALJ’s Recommendation**

The ALJ acknowledged that the Marietta Division does not carry its own workman’s compensation insurance for Marietta employees and recommended that the OCA’s adjustment be rejected. The ALJ also found that because Columbia must provide worker’s compensation insurance for its employees, the total increase in the premium should be allowed. R.D. at 34.

**c. Exceptions and Reply Exceptions**

In its Exceptions the OCA argues that the Company has the burden of proof to establish that the 3.8% allocation is proper. However, aside from only a “conclusory” statement by the Company witness Lewis, the OCA contends that the Company has provided no evidence or data to support this allocation. The OCA also argues that, as with the Company’s claim for vehicle insurance, *supra*, the increase in worker’s compensation insurance 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 expenses and match them at a point in time. OCA Exc. at 33.

In its Reply to the OCA Exceptions, the Company avers that the statement by Mr. Lewis regarding the allocation of worker’s compensation insurance costs to the Marietta Division is not “conclusory” as the OCA suggests. Columbia argues that Mr. Lewis gave credible testimony as the general manager in charge of the everyday operations of the Company. The Company also submits that the ALJ correctly included the increase in the worker’s compensation premium because it is known and measurable and will be in effect when the new rates go into effect. CWC R.Exc. at 22.

**d. Disposition**

Consistent with our disposition of the increase in life and disability insurance premiums and vehicle insurance, *supra*, we will accept the Company’s argument that the increase in worker’s compensation insurance is known and measurable and should be allowed. Also, consistent with our disposition of the OCA’s other proposed reallocations of personnel costs to the Marietta Division, we find that it is premature to make any adjustments to the Company’s proposed allocation of worker’s compensation insurance. Accordingly, we shall reject both of the OCA’s proposed adjustments to the Company’s claim for worker’s compensation insurance.

### 12. Accounting Expense

**a. Positions of the Parties**

Columbia claimed $28,300 for Accounting Contractual Services. GDS Exh. 1 at 1-15. The OCA witness Everette recommended that 12% of this cost should be allocated to the Marietta Division based on the number of customers in the Marietta Division relative to the whole company. OCA St. 1 at 42. The resulting adjustment to the Company’s claim is a decrease of $2,364. OCA Exh. AEE-1, Sch. 1, line 26. In support of her allocation, Ms. Everette noted that the costs of necessary services, such as Accounting, are built into the Marietta Division’s rates. She argued that allowing Columbia to recover the full cost of preparing and filing the tax return and audit would permit Columbia to double-collect this expense. OCA St. 1 at 42-43.

Company witness Lewis objected to any allocation of the expense on the basis that the Company expects overall accounting costs to go up as a result of the acquisition of the MGWC. CWC St. 1R at 14. He stated that the two divisions will keep separate books, budgets and depreciation calculations that will be used for the consolidated tax filings and audits. Tr. 115. As a result, Mr. Lewis contended that the Columbia Division’s accounting costs will not go down or somehow get “shared” with the Marietta Division, but instead the accounting costs will increase and the additional costs will get allocated to the Marietta Division. CWC St. 1R at 14.

**b. ALJ’s Recommendation**

The ALJ agreed with the OCA that, because the two divisions keep separate books, budgets and depreciation calculations, and as accounting costs are built into the Marietta Division’s rates, to allow the inclusion of those costs in this case would be to allow double recovery. The ALJ found that the OCA’s methodology is reasonable and $2,364 of the Company’s claim should be attributed to the Marietta Division. R.D. at 35.

**c. Exceptions and Reply Exceptions**

In its Exceptions, Columbia states that there is an error in the ALJ’s logic. The Company submits that the fact that the two divisions keep separate books, budgets and depreciation calculations is why the accounting costs should not be shared. Columbia emphasizes that the accounting work is *separate* for each division, not *shared****.*** Therefore, the accounting costs should be kept *separate*, not *shared*. CWC Exc. at 32 (emphasis supplied). In addition, the Company argues that, because the accounting costs are already built into Marietta’s rates, allocating any additional costs to the Marietta Division would actually result in double billing Marietta’s customers, not Columbia’s. *Id.*

Columbia avers that, in allocating the $2,364 of accounting expense, the ALJ relies on the arbitrary and speculative 12% allocation factor of the OCA, which the ALJ rejected on numerous occasions, and also rejected the testimony of the Company’s general manager who has first-hand knowledge of the Company’s operations. *Id.* The Company states, as Mr. Lewis explained, “our accountants have estimated that our accounting cost will increase by approximately 15% due to increased effort and time that will be associated with the separate Marietta Division books.” CWC St. 2R at 14:11-13; DTL R.Exh. 2. The Company explains that this statement is not meant to show that Columbia’s accounting costs will increase, but is a projection of future accounting expenses over and above those already allocated to both divisions and which will be associated with additional Marietta Division work. Columbia submits that these expenses will be allocated solely to the Marietta Division when they occur. CWC Exc. at 32.

In its Reply Exceptions, the OCA explains that one of the invoices the Company submitted to support its claim was for the Company’s tax preparation and audit in the amount of $19,700. The OCA submits that the Company stated that it will file one tax return and one audit that includes both divisions. The OCA avers that this indicates that the $19,700 expense for the joint filing will be borne by the Columbia ratepayers, but the Marietta customers also will benefit from the expense. OCA R.Exc. at 20. The OCA points out that its 12% allocation to the Marietta Division only applies to the $19,700 cost of the audit and tax preparation and not the Company’s total accounting costs. *Id.* at 21.

**d. Disposition**

Because the OCA’s proposed allocation of accounting costs is limited to the audit and tax preparation, and the OCA has demonstrated that the Marietta Division will benefit from these services, we shall adopt the OCA’s adjustment.

### 13. Office and Utilities Expenses

## a. Positions of the Parties

The Company has made a future test year claim for Office and Utility expenses of $18,000. OCA St. 1 at 46; OCA St. 1S at 29-30. The OCA argued that this claim should be adjusted downward by $774 to reflect a 4.3% allocation to the Marietta Division. OCA St. 1S at 30. The Office and Utility expenses are for software support, financial software, and office computers. OCA St. 1 at 46. These costs are “related directly to the number of bills [the Company] prints and sends and to the payments [the Company] receives.” CWC St. 1R at 16. The Columbia Division produces 105,600 bills per year and the Marietta Division produces 4,690 bills per year. CWC St. 1R at 16. Both Columbia and the OCA agree that 4.3% is an accurate reflection of the Office and Utility expenses that should be allocated to the Marietta Division. OCA St. 1S at 30; CWC St. 1R at 16.

**b. ALJ’s Recommendation and Disposition**

Because both Columbia and the OCA agreed on the allocation and the adjustment, the ALJ recommended that 4.3% or $774 of the Office and Utility expenses should be allocated to the Marietta Division. R.D. at 35. We concur. Notably, however, this adjustment is not reflected in the Company’s revised claim and, therefore, the adjustment will be made as part of this Opinion and Order.

### **14. Officer Salaries and Director Fees**

Columbia claimed $68,000 for salaries of officers, directors and majority shareholders and $62,500 for directors’ fees and expenses in this proceeding. GDS Exh. 1 at 1-15. The OCA recommended a downward adjustment based on the reasonableness of these costs, and an adjustment to allocate a portion of these expenses to the Marietta Division. OCA St. 1 at 47, 56-57, 59-61; OCA St. 1S at 30-34, 37.

**a. Adjustment to Reduce Salaries and Fees**

**i. Positions of the Parties**

The OCA argued that the evidence in this proceeding shows that the compensation of the Company’s officers and directors is excessive in relation to the time spent on Columbia business. The OCA averred that the amount of officers’ salaries and directors’ fees that is charged to ratepayers should reflect the actual contribution provided to Columbia by its officers/directors. The OCA’s recommendation reduces the officers’ salaries expense by $12,456 and reduces directors’ fees by $20,995, or a total reduction of $33,451 from the Company’s claim of $130,835. OCA St. 1 at 55-57. The OCA’s witness explained that Columbia may choose to set salaries and fees at any level; its Board of Directors is accountable to the shareholders. OCA St. 1 at 54-55. However, the OCA submitted that only the amount of those salaries and fees that the Commission determines is just and reasonable may be reflected in rates. *Id.* at 54-56. The OCA opined that reasonableness should be measured based on each officer’s and director’s contribution to the provision of safe and adequate service. *Id.*

The OCA’s witness determined that the rate paid to the Company President was most realistic. OCA St. 1 at 53, 56. Mr. Nikolaus averaged $178 per hour as a director and $206 per hour as an officer from 2010 to 2012. *Id.* Ms. Everette applied Mr. Nikolaus’ average rate of pay to the average total annual hours worked by the officers and directors from 2010 to 2012, which was 274 hours and 230 hours, respectively. *Id*. at 56-57. This resulted in a reduction of $12,456 to the claim for officers, and $20,995 to the claim for directors, or a total reduction of $33,451. OCA Table II, line 31; OCA Sch. 1S, line 31. As a result, the OCA’s recommendation allowed $97,384 for officers’ salaries and directors’ fees expenses.

In response to the OCA’s proposed adjustment, Columbia averred that its officers and directors are being compensated for the quality of their work, not just the quantity. CWC St. 1 at 19-20; CWC St. 1R at 18, 21-22.

**ii. ALJ’s Recommendation**

The ALJ found that the OCA’s argument was based on hours and dollar amounts that are entirely hypothetical, and which take no recognition of any unique qualities of individual officers or of the challenges they face or the services they render to a company with its own unique business environment. Therefore, the ALJ agreed with Columbia that the OCA, if not “engaging in micromanaging and invading the Company’s managerial discretion,” is coming very close to it. The ALJ concluded that Columbia’s request is reasonable and the OCA’s recommendation to reduce the officers’ salaries expense by $12,456 and the directors’ fees by $20,995, for a total reduction of $33,451, should be rejected. R.D.at 37.

**iii. Exceptions and Reply Exceptions**

In its Exceptions, 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.” The OCA submits that it has not challenged the quality of work provided by the officers and directors, but rather is evaluating the active contribution of these individuals to the Company’s provision of water service. The OCA avers that the shareholders may pay any amount, but the hours spent on Company business are a reasonable check on the amount recoverable in rates. Therefore, contrary to the ALJ’s conclusion, the OCA argues that it is not micromanaging the Company’s business; 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. The OCA opines that accepting the ALJ’s approach would allow any amount to be claimed, because it is so difficult to measure the quality of the work provided by the officers and directors. The OCA states that this position is not reasonable for ratemaking purposes. OCA Exc. at 34‑35.

In its reply to the OCA Exceptions, the Company notes that its claim for officer and director salaries is substantially less than the $80,800 that was approved for Officers and $68,000 that was approved for Directors in the Company’s last rate case. The Company submits that the OCA has not provided any evidence that the performance of its officers and directors has lessened in any way. The Company points out that its General Manager, Mr. Lewis, testified that the Company has provided exemplary performance in the past several years, including significant management, analysis and decision making regarding the acquisition of a neighboring water company. The Company also points out that the Company’s officers and directors have not had an increase in their salaries and fees since 2009, and the Company is not requesting an increase in this proceeding. CWC R.Exc. at 23-24.

**iv. Disposition**

As we stated in our Opinion and Order addressing the Company’s last rate proceeding, “[d]etermining the employment practices and compensation of its directors, officers, and employees is within the managerial discretion of a public utility.” *2009 Rate Case Order* at 34-35 (internal citations omitted). However, we recognize that the OCA is requesting that we adjust the amount of officers’ and directors’ compensation that is recovered from ratepayers and not make a determination on the actual compensation that is paid by the Company. Based on our review of the record in this proceeding, we find that the Company’s request of $68,000 for the salaries for officers, directors and majority shareholders and $62,500 for directors’ fees and expenses is reasonable, particularly since the Company has reduced its request from the last proceeding.

**b. Allocation to the Marietta Division**

**i. Positions of the Parties**

The OCA argued that Columbia did not allocate any of the officers’ salaries or directors’ fees to the Marietta Division. OCA St. 1 at 47 (citing the Company’s response to OCA Set III-14). The OCA noted that, as a result of the acquisition of the MGWC, the officers and directors of the Columbia Division are also the officers and directors of the Marietta Division. The OCA contended that it is therefore unreasonable to charge the Columbia Division customers for the entire cost of the officers and directors. OCA St. 1R at 36-37. Moreover, the OCA pointed out that the Marietta Division has officers’ salaries and directors’ fees built into its existing base rates. OCA St. 1 at 57-58. The OCA opined that to allow the Columbia Division to include the full amount of these costs in Columbia Division rates would allow the Company to double collect on these expenditures. OCA M.B. at 63.

The OCA’s witness Everette recommended that 15% of the total officers’ salaries and directors’ fees allowed by the Commission be allocated to the Marietta Division. OCA St. 1 at 58. The OCA’s adjustment is based on the assumption 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*. Because the OCA recommended that a total expense of $97,384 for officers’ salaries and directors’ fees ($56,444 and $40,940, respectively) be recognized for ratemaking, 15% of this allowance results in an allocation of $14,608 to the Marietta Division. OCA Table II; OCA Sch. 1S, line 32.

I&E witness Wilson recommended that, in the absence of a formal study of time spent between Marietta Division and Columbia Water issues, 12% or $5,512 of the officers, directors and majority stockholders salaries of $66,144 should be allocated to the Marietta Division.[[36]](#footnote-36) Ms. Wilson’s adjustment of $5,512 is based on the fact that the Company allocated 13% of total wages to the Marietta Division. Ms. Wilson submitted that a 12% allocation is reasonable until a year’s worth of actual data becomes available. I&E M.B. at 34.

**ii. ALJ’s Recommendation**

The ALJ stated that he was unwilling to impose the OCA’s and I&E’s proposed adjustments based on hypothetical calculations and rejected their proposed allocations to the Marietta Division. However, the ALJ opined that the Company cannot continue indefinitely arguing that record keeping and cost allocation among its divisions is too complex or that not enough time has passed to develop precise allocations. The ALJ reasoned that implicit within the “not enough time has passed” argument is the implication that at some point enough time *will* have passed to allow greater precision in the Company’s accounting. R.D. at 41-42.

**iii. Exceptions and Reply Exceptions**

The arguments raised in I&E’s and the OCA’s Exceptions mirror their arguments presented on this issue, *supra.* In the Company’s Reply Exceptions, Columbia points out that it had adjusted its claim by allocating 4.3% of the officers’ and directors’ compensation to the Marietta Division and that this allocation is reasonable based on Mr. Lewis’ experience with the Company. CWC R.Exc. at 25.

**iv. Disposition**

Consistent with our disposition of the OCA’s other proposed reallocations of other expenses to the Marietta Division, we find that it is premature to increase the allocation of officers’ and directors’ compensation above the 4.3% proposed by the Company. Accordingly, we shall reject the adjustments proposed by I&E and the OCA and adopt the adjustment proposed by the Company.

### 15. Rate Case Expense

**a. Positions of the Parties**

In its original filing, Columbia requested $252,800 in *pro forma* rate case expense, to be normalized over three years in the amount of $84,267. Supporting Data for Supplement No. 60 to Tariff-Water Pa. P.U.C. No. 7, at 1-16. In a rejoinder exhibit, Columbia averred that it increased the requested rate case expense amount to $258,412, to be normalized over three years in the amount of $86,137. CWC M.B. at 45.

**b. ALJ’s Recommendation**

The rate case expense was not discussed by the ALJ in the body of his Recommended Decision.

**c. Exceptions and Reply Exceptions**

In its Exceptions, Columbia argues that the ALJ erred by not including any allowance for rate case expense in the Recommended Decision or its appended tables. Columbia requests that its updated claim of $258,412 be used as the allowable rate case expense, to be normalized over three years in the amount of $86,137. CWC Exc. at 35-36.

In reply, the OCA asserts that the original claim of $84,267 was included in the *pro forma* expenses listed in Tables I and II to the Recommended Decision, and therefore is included in the ALJ’s calculation of allowable revenue. The OCA also argues that Columbia’s upward revision to the rate case expense should be rejected because Columbia’s attorney represented that it was not updating its rate case expense. OCA R.Exc. at 24 (citing Tr. 149-150). Furthermore, the OCA contends that Tables I and II to the Company’s Main Brief show that the Company did not claim an additional amount for rate case expense beyond its original claim. Accordingly, the OCA argues that the updated amount should not be considered. OCA R.Exc. at 24.

**d. Disposition**

We agree with the OCA that the original *pro forma* rate case expense was included in the ALJ’s calculations of the total revenue requirement. We also agree with the OCA that Columbia did not make a claim for an additional amount of rate case expense above the amount requested in its original filing. Therefore, no adjustment for rate case expense is warranted in our determination of the Company’s revenue requirement.

### 16. **Taxes**

**a. Positions of the Parties**

I&E requested an adjustment to state taxes, as reflected on I&E Table II at the line “Interest Synchronization” that reflects an amount of ($1,573) as shown in the “State Tax Effect” column. That figure represents the difference between Columbia’s interest expense and the interest expense recommended by I&E that is based on I&E’s recommended rate base multiplied by the weighted debt cost rate. I&E M.B. at 36; (citing Appendix A, Table II).[[37]](#footnote-37)

**b. ALJ’s Recommendation**

The ALJ stated that because he was recommending the 5% cost of debt proposed by I&E, he found that I&E’s proposed tax adjustment is appropriate because this is the only way to adjust taxes for the interest expense being proposed by I&E versus that being proposed by Columbia. R.D. at 42.

**c. Exceptions and Reply Exceptions**

In its Exceptions, Columbia argues that the ALJ erred in adopting the effective tax rates at the time of the Company’s filing instead of present rates, resulting in an allowable net operating income shortfall of $254,707. CWC avers that instead of the current effective rates, the ALJ mistakenly uses effective state and federal tax rates of 7.6803051% and 17.462862%, respectively, based upon $975,430 of allowable net income as set forth on Table 1 of the Recommended Decision. The Company recommends that, to reflect the effect of accumulated deferred taxes as a current expense to the Company, the current effective state tax rate is 12.968537% and the effective federal tax rate is 38.107911% based upon the Recommended Decision’s $975,430 of allowable net operating income. CWC Exc. at 24-**25.**

In response to the Company’s Exceptions, the OCA submits that the Company’s proposed state tax rate of 12.97% and federal tax rate of 38.11% do not represent an accurate calculation of the effective tax rate. The OCA avers that the Company is implying that the effect of accumulated deferred taxes as a current expense “influences the fact that the effective tax rate is higher than the marginal tax rates.” OCA R.Exc. at 14. The OCA explains that, because the Company is required to normalize depreciation for ratemaking purposes, the federal effective tax rate will never be higher than the marginal tax rate. The OCA also explains that for state taxes, deferred taxes would only make the effective tax rate higher than the marginal tax rate when, at some future point in time, the deferred taxes are actually being paid by the Company. The OCA notes that this is not the case here. *Id.*

**d. Disposition**

We disagree with the Company’s position that the ALJ mistakenly used effective tax rates. Instead, the ALJ followed the standard practice of applying statutory rates to his adjustments and recommended rate increase. While no correction is necessary to adjust the effective tax rates, as proposed by the Company, we find that a correction is necessary to increase income tax expense due to a double counting of a deduction of taxable income related to Contributions in Aid of Construction. CWC St. 2R at 20. To correct this error, the income taxes reflected in the Recommended Decision will be increased to reflect the tax effect of increasing taxable income by $214,095.

## G. Rate Design

As discussed, *supra*, the Company proposed to allocate any proposed increase in revenue across-the-board to all customer classes and between the customer and consumption charges. CWC St. 2 at 15. I&E and the OCA support this allocation and the ALJ recommended its adoption. I&E St. 3 at 16; OCA St. 1 at 672; R.D at 48. Accordingly, we shall approve this allocation of the increase in the Company’s allowable revenues.

## H. Miscellaneous - Continuation of the Requirement for Time Records

**1. Positions of the Parties**

The OCA stated that in the Company’s last rate case, the Commission directed Columbia, in its future rate cases, to provide an account of time spent by officers on Columbia business in relation to all other business interests. *2009 Rate Case Order* at 55‑56, 138. The OCA pointed out that all of the Company’s officers and directors are part-time and have outside business interests. The OCA submitted that the information provided on the time sheets allowed the OCA to evaluate the reasonableness of the Company’s claims. The OCA averred that because the Company has maintained Marietta as a separate division, keeping adequate time records will improve the accuracy of the allocation of officers’ and directors’ time between the two divisions. OCA M.B. at 59-61.

The Company pointed out that time sheets for officers and directors are not required for any other Class A utility in Pennsylvania. Columbia argued that the Company is being unfairly singled out, and the requirement should be eliminated on that basis alone. The Company explained that both positions are salaried positions and never were and never will be hourly positions. The Company avers that the officers’ and directors’ compensation goes way beyond how much time they spend inside the office walls, but instead has everything to do with the level of experience and expertise they bring to the table, their responsibilities to the customers, shareholders and community, the quality of the corporate direction they provide, the quality of the decisions they make, the quality of service that they demand of the employees, and the legal exposure they assume. CWC R.B at 63-65.

**2.** **ALJ’s Recommendation**

The ALJ recommended that the Commission’s directive in its *2009 Rate Case Order* should continue in this case. The ALJ stated that Columbia cannot have it both ways and argue lack of time and experience with the Marietta Division acquisition on one hand, but refuse reasonable accountability on the other. The ALJ explained that Columbia has made a good faith effort to comply with the Commission’s directive, and recommended that it continue to do so. R.D. at 38.

**3. Exceptions and Reply Exceptions**

In its Exceptions, the Company argues, *inter alia*, that the ALJ’s rejection of the OCA’s proposed adjustment to compensation of officers and directors based on an hourly rate is a clear indication that this time sheet requirement is not needed on a going forward basis. CWC Exc. at 33.

The OCA explains that it based its request for time sheets on the statutory requirement that the Company support every element of its claim with specific evidence to show it is reasonable for ratemaking purposes. 66 Pa. C.S. § 315(a); *see also* 66 Pa. C.S.   
§ 1301, *et seq*. The OCA submits that the Commission agreed with the OCA that, in light of the officers/directors’ multiple other business interests, the officers/directors should provide an actual accounting for their hours, relative to those interests, in future cases. OCA R.Exc. at 22 (citing *2009 Rate Case Order* at 41).

**4. Disposition**

We agree with the Company that the officers’ and directors’ compensation should not be linked to the precise amount of time that they spend on Company business. Rather, their compensation should recognize the quality of the direction they provide, the quality of the decisions they make, and the quality of service that ratepayers experience as a result of their direction. In reviewing the record developed in this proceeding regarding the compensation of officers and directors, it appears that the time sheets kept by officers and directors made little contribution to our disposition of those issues. Accordingly, we shall reject the ALJ’s recommendation, and discontinue the directive in our *2009 Rate Case Order* that Columbia’s officers and directors maintain time sheets. That being said, we note that this proceeding has highlighted the need for Columbia to provide additional data in its future proceedings to support the Company’s proposed allocations of costs between the Columbia and Marietta Divisions. Accordingly, we expect that, in future proceedings, the Company will be in a position to provide information regarding the time spent by its officers and directors and other Company personnel on Columbia Division and Marietta Division issues.

**IV. CONCLUSION**

Based on our review, evaluation, and analysis of the record evidence, we conclude that Columbia is entitled to an opportunity to earn income available for a return of $1,111,677. *See*, Tables I, attached hereto and made a part hereof. In furtherance of such objective, Columbia is authorized to establish rates that will produce jurisdictional operating revenues not in excess of $4,576,634. The increase in annual operating revenues authorized herein of $534,970 is approximately 69% of the $773,210 originally sought and an increase of approximately 13.5% over revenues generated through current rates. The approved cost of equity of 9.75% is reasonable, appropriate and in accord with the record evidence. As such, the Exceptions filed by the various Parties hereto, are granted or denied, as discussed, *supra*. Accordingly, the ALJ’s Recommended Decision is adopted only to the extent that it is consistent with this Opinion and Order; **THEREFORE,**

**IT IS ORDERED:**

1. That the Exceptions filed by the Columbia Water Company on December 6, 2013, to the Recommended Decision of Administrative Law Judge Dennis J. Buckley, are granted or denied, consistent with this Opinion and Order.

2. That the Exceptions filed by the Bureau of Investigation and Enforcement on December 6, 2013, to the Recommended Decision of Administrative Law Judge Dennis J. Buckley, are granted or denied, consistent with this Opinion and Order.

3. That the Exceptions filed by the Office of Consumer Advocate on December 6, 2013, to the Recommended Decision of Administrative Law Judge Dennis J. Buckley, are granted or denied, consistent with this Opinion and Order.

4. That the Recommended Decision of Administrative Law Judge Dennis J. Buckley is adopted only to the extent that it is consistent with this Opinion and Order, and is otherwise rejected.

6. That the Columbia Water Company shall not place into effect the rates contained in Supplement No. 60 to Tariff Water-Pa. P.U.C. No. 7, which have been found to be unjust and unreasonable and, therefore, unlawful.

7. That the Columbia Water Company is hereby authorized to file tariffs, tariff supplements, or tariff revisions containing rates, provisions, rules and regulations, consistent with the findings herein, designed to produce jurisdictional operating revenues not in excess of $4,576,634.

8. That the Columbia Water Company’s tariffs, tariff supplements, or tariff revisions may be filed upon less than statutory notice and, pursuant to the provisions of 52 Pa. Code §§ 53.31 and 53.101, may be filed to be effective for service rendered on and after the date of entry of the instant Opinion and Order.

9. That the Columbia Water Company shall file detailed calculations with its tariff filing, which shall demonstrate to this Commission’s satisfaction that the filed rates comply with the proof of revenue, in the form and manner customarily filed in support of compliance tariffs.

10. That the Columbia Water Company shall comply with all directives, conclusions and recommendations contained in the instant Opinion and Order that are not the subject of individual ordering paragraphs as fully as if they were the subject of specific ordering paragraphs.

11. That the Columbia Water Company shall allocate the authorized increase in operating revenue to each customer class and rate schedule within each class in the manner prescribed in this Opinion and Order.

12. That the Complaint filed by the Office of Consumer Advocate in this proceeding at Docket No. C-2013-2363612 be terminated and marked closed.

13. That the Complaint filed by the Office of Small Business Advocate in this proceeding at Docket No. C-2013-2363728 be terminated and marked closed.

14. That the Complaint filed by Vincent Collier in this proceeding at Docket No. C-2013-2364726 be terminated and marked closed.

15. That the Pennsylvania Public Utility Commission’s inquiry and investigation at Docket R-2013-2360798 be terminated and marked closed.



**BY THE COMMISSION,**

Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: January 9, 2014

ORDER ENTERED: January 23, 2014











1. Neither the OSBA nor Mr. Collier filed a Main Brief, a Reply Brief, Exceptions or Reply Exceptions in this proceeding. [↑](#footnote-ref-1)
2. I&E proposed removing the original cost of the PennVest plant of $4,902,136 from rate base, less the associated $1,853,844 in accrued depreciation. I&E St. 3-SR at 1‑2, 8. I&E proposed an overall measure of value of $10,748,415. [↑](#footnote-ref-2)
3. *PennVest Loan Obligations for Water and Sewer Companies – Statement of Policy*, 52 Pa. Code §§ 69.361 – 69.364 (*PennVest Policy Statement*). [↑](#footnote-ref-3)
4. I&E explains that the Company’s annual depreciation expense claim is $739,260, determined by taking the original cost annual depreciation of $984,321 less the annual depreciation expense associated with CIAC of $245,061. I&E states that the Company provided a breakdown of the $984,321 original cost annual depreciation expense as of December 31, 2013, and a breakdown of the annual depreciation expense associated with CIAC. The Company used the straight line/average service life method and the average service life methodology. I&E Exc. at 14, n. 6, citing I&E St. 3 at 12-13; CWC Exh. 1 at 1-3. [↑](#footnote-ref-4)
5. The OCA refers to the ALJ’s Recommended Decision in *Pa. PUC v. Columbia Water Co.*, Docket No. R-00974007 (R.D. issued November 20, 1997). [↑](#footnote-ref-5)
6. The OCA states that Parties agreed on a PennVest-specific rate in the 1993 case because the revenue increase related solely to the Company’s proposed principal/interest surcharge. *1993 PennVest 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. OCA Exc. at 7, n.2, citing OCA St. 1S at 38, 41-42. [↑](#footnote-ref-6)
7. *See, e.g., Pa. PUC v. Columbia Water Co.*, Docket No. R-00038428 (Order entered July 17, 2003); *Pa. PUC v. Columbia Water Co.*, Docket No. R-00050611 (Order entered July 14, 2005). [↑](#footnote-ref-7)
8. The OCA states that the 1997 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. OCA Exc. at 10, n. 3. [↑](#footnote-ref-8)
9. Columbia cites 26 U.S.C. § 168(c); IRS Pub. 946 (2-15-13). [↑](#footnote-ref-9)
10. The Company states that, to its knowledge, the Commission has never accelerated the annual depreciation expense for utility assets to match the term of the funding for those assets. Because depreciation of the PennVest plant was not accelerated, the Company argues that adoption of the adjustment would leave undepreciated assets floating in limbo. “No law or rate making procedure establishes, or even contemplates, the removal of assets from rate base upon the retirement of debt.” CWC R.Exc. at 9, n. 9. [↑](#footnote-ref-10)
11. The Company submits that the CIAC approach must be eliminated because there were no upfront cash payments from customers. The Company states that the only other method for removing (establishing a zero value for) the PennVest assets from rate base would have been toaccelerate the annual depreciation expense to twenty years (which the Company has not been doing) to match the PennVest loan period. However, the Company submits that there are several problems with this approach, as follows: the Company did not in fact accelerate its annual depreciation expense; the Commission would have had to approve the reduction in the plant’s useful life to twenty years at the time the assets were placed on the books; accelerated depreciation is rarely adopted for ratemaking purposes; the life expectancies of the assets and annual depreciation rates had to be determined during the 1993 case, not retroactively during a rate case proceeding in 2013; and even then accelerated depreciation over twenty years would have been in conflict with the Internal Revenue Code. Columbia asserts that the PennVest assets have been and continue to be depreciated for ratemaking purposes utilizing the 4% Compound Interest Method. CWC R.Exc. at 9-10, n. 10, citing CWC St. 2R at 20:16-17. [↑](#footnote-ref-11)
12. As examples of non-volumetric, flat PennVest surcharges, Columbia cites *Pa. PUC v. Olwen Heights Water Service Co.*, Docket No. R-00040011 (Order entered April 7, 2005) (surcharge of $21.02 per customer); *Pa. PUC v. Wilbar Realty Co.*, 88 Pa. PUC 1 (Order entered June 16, 1998) (surcharge of $28.80 per customer); *Pa. PUC v. Mountain Spring Water*, Docket No. R-00984346, 1998 WL 8422814 (Order entered July 24, 1998) (surcharge of $39 per customer). [↑](#footnote-ref-12)
13. The OCA cites *Pa. PUC v. Total Envtl. Solutions, Inc. – Treasure Lake Water Div.*, 2008 PaPUC LEXIS 1227, \*22, 24-25, 29 (*Treasure Lake*); *Pa. PUC v. Mechanicsburg Water Co*., 1993 PaPUC LEXIS 112, \*34-35 (*Mechanicsburg*); *Pa. PUC v. Borough of Media Water Works*, 72 Pa. PUC 144, 150-51 (1990) (*Media*). [↑](#footnote-ref-13)
14. CWC St. 3R at 2-3; *2009 Rate Case Order* at 71. [↑](#footnote-ref-14)
15. *Id*. [↑](#footnote-ref-15)
16. *Pa. PUC v. Carnegie Natural Gas Co.*, 54 Pa. P.U.C. 381 (Order entered July 17, 1980) (*Carnegie*). [↑](#footnote-ref-16)
17. *Carnegie* at 393. [↑](#footnote-ref-17)
18. *Carnegie* at 393. [↑](#footnote-ref-18)
19. We note that Columbia’s Main Brief also states that its witness recommended a ROE of 11.55% and an overall rate of return of 9.09%. CWC M.B. at 50. The discrepancy is not explained. [↑](#footnote-ref-19)
20. The OCA also recommended a downward adjustment to the Company’s cost of long term debt from 5.0% to 4.85%. OCA M.B. at 69. [↑](#footnote-ref-20)
21. According to Columbia, the Commission affirmed the tendency of the DCF model to misstate investors’ required return in 2007 in its Opinion and Order at *Pa. PUC v. PPL Gas Utilities Corporation*, Docket No. R‑00061398 (Order entered February 8, 2007). However, Columbia refers to the portion of the Commission’s Opinion and Order that merely summarized the ALJ’s recommendation in that case to adopt a leverage adjustment to compensate for the differences between market prices and book value. Although the Commission itself adopted a leverage adjustment, it did not state that a leverage adjustment was necessary when a DCF analysis is used. [↑](#footnote-ref-21)
22. CWC St. 3 at 2-3. [↑](#footnote-ref-22)
23. I&E refers to Columbia’s statement that 9.15% would be the lowest authorized ROE in the country for a water utility, at least since 2011 (without provisions for double leverage). CWC Exc. at 10. [↑](#footnote-ref-23)
24. I&E cites *Pa. PUC v. Consumers Pennsylvania Water Company - Roaring Creek Division*, 87 PA PUC 826 (1997); *Pa. PUC v. Roaring Creek Water Company*, 81 PA PUC 285, 323, 150 PUR 4th 449, 483-488 (1994*); Pa. PUC v. York Water Co.*, 75 PA PUC 134, 153-167 (1991); *Pa. PUC v. Equitable Gas Company*, 73 PA PUC 345-346 (1990); and *Pa. PUC v. Philadelphia Suburban Water Company*, 71 PA PUC 593, 623-632 (1989). [↑](#footnote-ref-24)
25. The OCA calculated the increased revenue requirement as follows: Using the Company’s proposed equity ratio of 64.4%, a 0.25% equity premium would result in a 0.16% increase to ROR (64.45% x 0.25% = 0.16%). Sch. DWD‑1 at 1. Using the rate base claimed in Columbia’s revised rebuttal testimony of $13,796,707, each 0.25% adder would result in an additional $34,492 of revenue requirement ($13,796,707 x 0.25% = $34,492). OCA M.B. at 86, n. 34, citing GDS Rebuttal Exh. 3 at 3. [↑](#footnote-ref-25)
26. *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket No. R-00072711 (Order entered July 31, 2008) (*Aqua*).  [↑](#footnote-ref-26)
27. *Aqua* at 50. [↑](#footnote-ref-27)
28. With regard to the OCA’s argument that similar expenses were accepted by the Company as operating revenue in the Company’s last rate case, Columbia states that its witness, who was not the rate expert in the last case, testified that he disagrees that these adjustments should have been accepted by the Company. Tr. at 134. Furthermore, Columbia argues that the Commission encourages settlements, and just because the Company accepted an adjustment in a previous rate case settlement does not preclude a different outcome in a subsequent case. [↑](#footnote-ref-28)
29. *Joint Application of the Columbia Water Company and Marietta Gravity Water Company,* Docket No. A-2012-2282219 (Order entered August 30, 2012). [↑](#footnote-ref-29)
30. *Popowsky v. Pa. PUC*, 869 A.2d 1144, 1153 n. 24 (Pa. Cmwlth. 2005); *UGI Corp. v. Pa. PUC*, 410 A.2d 923, 933-934 (Pa. Cmwlth. 1980) (expenses allowed for studies involving the feasibility of proposals to enhance the utility’s supply capability); *Popowsky v. Pa. PUC*, 695 A.2d 448, 452-53 (Pa. Cmwlth. 1997) (expenses allowed for costs associated with change in accounting method). [↑](#footnote-ref-30)
31. The Company states that this would be at the Company’s recommended rate of return of 9.10%. This would equal an additional net operating income of $11,007. The income taxes would amount to $6,032 for a total increase in revenues of $17,039, which is higher than the Company’s $15,039 as claimed in this proceeding by $2,000. CWC Exc. at 28. [↑](#footnote-ref-31)
32. The OCA proposed adjustments to: 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. [↑](#footnote-ref-32)
33. The Company submits that its general manager, Dave Lewis, testified that the Company allocated an average of 8% of its employees’ time to the Marietta Division; however, the specific percentage varied by employee. Columbia’s allocations to the Marietta Division were based on Mr. Lewis’ first-hand knowledge of Columbia’s operations. Mr. Lewis is the Vice President and General Manager of Columbia, and has been employed by Columbia for eight years. Prior to that, he worked for ARRO Consulting, Inc., providing engineering services to Columbia for approximately fifteen years. CWC St. 1 at 1:7-17. He is responsible for the day-to-day management of the Company, including the oversight and management of the business office (three employees), the distribution department (nine employees), the water production department (five employees), and several part-time/seasonal employees. CWC St. 1   
    at 1:20-23. [↑](#footnote-ref-33)
34. The OCA also proposed other adjustments to the Company’s health insurance, pension expense, and disability/life insurance claims which are addressed, *infra*. [↑](#footnote-ref-34)
35. The OCA noted that, as an alternative to rejecting the Company’s claim for a premium increase, the Commission should adopt the 11.99% allocation of worker’s compensation costs to the Marietta Division. OCA M.B. at 42. [↑](#footnote-ref-35)
36. I&E notes that the Company revised its claim for officers, directors and majority stockholders salaries from $68,900 to $66,144 as a result of the Company’s proposal to allocate 4% of this claim to the Marietta Division. GDS Exh. 3(Revised) at 2. [↑](#footnote-ref-36)
37. We note that I&E also proposed a corresponding $4,817 federal tax adjustment for interest synchronization. CWC M.B. Appendix A, Table II. [↑](#footnote-ref-37)