BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Aqua Ohio, Inc. to Increase Its Rates and Charges for Its Waterworks Service.	)))	Case No. 16-0907-WW-AIR

OBJECTIONS TO THE STAFF REPORT OF INVESTIGATION AND SUMMARY OF MAJOR ISSUES OF AQUA OHIO, INC.

In accordance with R.C. 4909.19(C), Ohio Adm. Code 4901-1-28(B), and the Commission's December 1, 2016 Entry in this docket, Aqua Ohio, Inc. (Aqua or the Company) submits its Objections to the Staff Report of Investigation (Staff Report) and its Summary of Major Issues.

OBJECTIONS TO STAFF REPORT

I. OPERATING INCOME AND RATE BASE

Objection No. 1: Aqua objects to the Staff Report's adjustment to remove projected plant adjustments associated with the Norlick Water Treatment Plant and an HS starter with VFD. (*See* Staff Report at 5.) Aqua contends that contrary to the Staff Report's recommendation, the projects either have been placed in service or will be placed in service by the end of the test year. Aqua contends that the amounts removed by Staff (respectively $900,000 and $117,000) should be included in plant in service, with corresponding adjustments to the associated reserve (respectively $73,270 and $10,341).

Objection No. 2: Aqua objects to the Staff Report's failure to adopt Aqua's proposed accounting treatment of tank painting as a capital expenditure. (*See* Staff Report at 7 & 9.) Tank painting provides benefits over a long period of time, and as Staff recognizes for at least 20 years, and constitutes an asset betterment that allows the tank to reach or exceed its expected life. Therefore, tank painting should be considered and treated as a capital expenditure.

Objection No. 3: Aqua objects to the Staff Report's removal of the costs associated with Route 84 tank painting (*see* Staff Report at 5) without adding the corresponding expenses to the tank-painting schedule in Schedule C-3.7, as would be consistent with Staff's proposed approach.

Objection No. 4: With respect to Staff's removal from plant of $1,231 associated with the Lake White metering pump, Aqua objects to the Staff Report's adjustment of the reserve for only $146 instead of the entire $1,231. (*See* Staff Report at 5.) The adjustment treated the $1,231 as though it were a projected item when it should have been treated as a normal retirement. Under the NARUC Utility Plant Instructions, "When a retirement unit is retired from utility plant, with or without replacement, the book cost thereof shall be credited to the utility plant account in which it is included . . . . [and] the book cost of the unit retired and credited to utility plant shall be charged to the accumulated provision for depreciation applicable to such property."

Objection No. 5: Aqua objects to the Staff Report's exclusion of post-test-year labor expense adjustments. (*See* Staff Report at 10 and Schedule C-3.4.) Ohio law authorizes a water-works company to "propose adjustments to the revenues and expenses . . . for any changes that are, during the test period or the twelve-month period immediately following the test period, reasonably expected to occur." R.C. 4909.15(D). These projected wage increases are just and reasonable and are expected to occur in the twelve-month period following the test period and therefore should be recovered in rates.

Objection No. 6: Aqua objects to the extent the exclusion referenced in the prior objection results in the understatement of employee contribution thrift expense and payroll taxes.

Objection No. 7: Aqua objects to the Staff Report's exclusion of stock-compensation incentives from labor expense. (*See* Staff Report at 8.) The Staff Report states that shareholders should pay for the annual awards. Aqua contends that stock compensation is a vital piece of the Company's overall compensation package. These types of incentives are a more economically efficient way to attract and reward employees than the historical emphasis on traditional fixed pension benefit plans, which have not been offered to new employees since 2003. Stock compensation is an important tool used by the Company to attract and retain highly qualified individuals, which ultimately benefits ratepayers with exceptional performance. Stock compensation should therefore be permitted in Labor Expense.

Objection No. 8: Aqua objects to the extent the Staff Report's adjustments described in the prior objection caused the understatement of payroll taxes included in rates.

Objection No. 9: Aqua objects to the Staff Report's adjustment to test-year consumption in the Lake Erie West jurisdiction to assume increased consumption. (*See* Staff Report at 8.) As the Staff Report recognizes, Aqua has been experiencing a significant and continuing downward trend in consumption. In view of these known trends, adjustments to actual consumption should not be made to impute an increase in water usage.

Objection No. 10: Aqua further objects that, even if consumption is adjusted, the Staff Report failed to recognize or account for the additional variable costs associated with the production of such water.

Objection No. 11: Aqua objects to the Staff Report's failure to include the expense associated with Route 84 tank painting (which Aqua had proposed to capitalize) in the Staff Report's proposed tank-painting schedule. (*See* Staff Report at 9.) The amount associated with Route 84 tank painting to be added to the schedule is $277,210.

Objection No. 12: Aqua objects to the Staff Report's failure to include the correct amount associated with painting the Tiffin Washwater tank in the Staff Report's proposed tank-painting schedule. The correct amount is $204,428.

Objection No. 13: Aqua objects to the Staff Report's reclassification of expenses associated with well cleaning in the Applicant's Tiffin district. (*See* Staff Report at 10.) Aqua does not object to the reclassification of the expense, only the amount of the adjustment. The Staff Report adjustment removed from expenses the entire actual amount that had been capitalized, or $27,074. This was in excess of the amount actually included in the original maintenance operations adjustment, which included only a projected expense of $20,000. The adjusted miscellaneous expense on Staff Schedule C-3.16 should be $174,922, reducing the adjustment to ($20,000).

Objection No. 14: Aqua objects to the Staff Report's adjustment to property taxes. (*See* Staff Report at 11.) The Staff Report's calculation of the assessed value percentage recognized sewer plant as both plant-in-service and taxable property, which was incorrect because only water property was included in the State of Ohio's December 31, 2014 Assessed Valuation. Aqua's 2015 Annual Report filed with the Department of Taxation states that Aqua "exclude[d] the value of Aqua's waste water system in Franklin County as it is tax exempt per Ohio Revised Code 6111.01." The inclusion of sewer property resulted in an understatement of the assessed-value percentage, which in turn resulted in an understatement of Aqua's jurisdictional Ohio property tax.

Objection No. 15: Aqua objects to the Staff Report's adjustment to excise tax. (Staff Report at Schedule C-3.20b.) Aqua objects to the Staff Report's $1,528,725 adjustment to operating revenue to reflect sales for resale. Under the state's instructions regarding the calculation of excise taxes, only sales to federal government agencies are exempt. Sales for resale are only exempt if made to water utilities that pay the excise tax; Aqua had no such sales in the test year. The adjustment for sales to federal government agencies should only have been $10,386. Aqua also objects to the Staff Report's adjustment for the $25,000 exemption. Staff should only have adjusted for the jurisdictional portion of this exemption, which is $15,650.

Objection No. 16: Aqua objects to the Staff Report's adjustment related to the Federal Insurance Contributions Act (FICA) tax. (*See* Schedule C-3.20c.) The Staff Report's adjustment reflected the calculation of FICA tax on only the O&M portion of labor expense, and excluded capitalized labor expense, whereas Aqua's actual liability for FICA taxes included in the test year is based on total labor expense (*i.e.*, both O&M and capital labor expense).

Objection No. 17: Aqua further objects to the Staff Report's FICA tax adjustment on the grounds that Staff failed to adjust wages not subject to FICA in accordance with the Staff Report's exclusions related to incentive compensation.

Objection No. 18: Aqua further objects to the Staff Report's FICA tax adjustment on the grounds that the amount of wages not subject to FICA should be at 100 percent not the O&M percentage since taxes are calculated and expensed based on total wages.

Objection No. 19: Aqua further objects to the Staff Report's FICA tax adjustment on the grounds it failed to account for the IRS's release of the revised wage base limit for Social Security tax. At the time of the wage update, the limit was for 2016 and was $118,500. The new limit that will begin January 1 is $127,200. This revised amount should be considered when calculating the wages not subject to the tax.

Objection No. 20: Aqua objects to the Staff Report's adjustments related to State and Federal Unemployment Taxes (SUTA and FUTA, respectively). (*See* Schedule 3.20c.) With respect to both taxes, the Staff Report's adjustment reflected the incorrect exclusion of summer employees from employee counts. These taxes are paid on all employees and thus their share of these taxes should not have been excluded from test-year expense.

Objection No. 21: Aqua further objects that the Staff Report's SUTA and FUTA adjustments double-counted the allocation percentages applicable to jurisdictional employees performing tasks under the operating contract and thus overstated the reduction attributable to the allocation. The calculation contained in the Staff Report used a jurisdictional allocation of employees and also applied an operating-contract adjustment. The latter adjustment is already reflected in the jurisdictional allocation percentages and thus should not have been applied.

Objection No. 22: Aqua further objects that the Staff Report's SUTA and FUTA adjustments reflected the calculation of SUTA and FUTA tax on only the O&M portion of labor expense, and excluded capitalized labor expense, whereas Aqua's actual test-year liability for these taxes is based on total labor expense (*i.e.*, both O&M and capital labor expense).

Objection No. 23: Aqua objects to the extent that any and all of the Staff Report's foregoing adjustments cause the understatement of the depreciation expense included in rates.

Objection No. 24: Aqua objects to the extent that any and all of the Staff Report's foregoing adjustments cause the understatement of the property tax included in rates.

Objection No. 25: Aqua objects to the extent Staff's adjustments described in these objections affect the calculation of federal income tax included in rates.

II. RATE OF RETURN

Objection No. 26: Staff's selection criterion of including water utilities with a market capitalization greater than $1 billion results in a proxy group that does not reflect the increased business risk faced by Aqua due to its smaller relative size. Because Staff's recommended common equity cost rate is based upon the market data of a group of companies that is less business risky based upon size than Aqua, Staff's recommended common equity cost rate understates the true common equity cost rate to Aqua. In addition, Staff's selection of a greater than $1 billion market capitalization criterion excludes four water utilities which are closer in size and therefore closer in business risk to Aqua than the four companies upon which Staff relied.

Objection No. 27: Staff's application of the Discounted Cash Flow (DCF) model understates the cost of common equity for Aqua because of several inputs into the model. First, Staff incorrectly uses the sum of the last four quarterly dividends for the calculation of its dividend yield, and not the most current dividend multiplied by four. The use of historical dividends runs counter to the prospective nature of the cost of equity and ignores existing expectations for each proxy company's dividend payments. Second, Staff gives undue weight to Value Line growth rates, giving 50% weight compared with 25% weight to Reuters and Yahoo growth rates, respectively. Since all of the publications referenced above are in the public domain and are investor-influencing, one should consider all sources equally.

Objection No. 28: For the reasons given above, Aqua Ohio, Inc. objects to the understatement of Staff's rate of return conclusions, including the recommended return on equity (ROE) ranging from 9.36% to 10.38%, because: (*1*) Staff's proxy group does not reflect the increased relative business risk faced by Aqua Ohio due to its smaller size relative to Staff's proxy group; and (*2*) Staff's incorrect application of the DCF model.

III. RATES AND TARIFFS

Objection No. 29: Aqua objects to the Staff Report's recommendation that Aqua's contract with Whirlpool Corporation "be revised to be based on the CPI – Water and Sewerage

Maintenance." (Staff Report at 16.) Aqua objects that the Staff Report failed to recognize that the contract is both bilateral and subject to State and Federal constitutional protections and cannot be revised without the consent of both parties.

Objection No. 30: Aqua further objects to the Staff Report's recommendation to revise the Whirlpool contract because the current contract was reviewed and approved as just and reasonable by the Public Utilities Commission of Ohio and the Staff Report did not demonstrate that there has been any changed circumstance that renders the contract unjust or unreasonable.

Objection No. 31: Aqua further objects to the Staff Report's recommendation to revise the Whirlpool contract because the Staff Report failed to demonstrate that the recommended revision would not result in the loss of one of Aqua's largest customers and a corresponding increase in the cost of service to be borne by Aqua's remaining customers.

Objection No. 32: Aqua objects to the Staff Report's recommendation that, with respect to revenue distribution, the "Sales for Resale class[] should be incurring more of the costs." (Staff Report at 18.) Revenue from the sales for resale class is predominantly determined by contract. The Staff Report failed to recognize that such contracts are both bilateral and subject to State and Federal constitutional protections and cannot be revised without the consent of both parties.

Objection No. 33: Aqua objects to the Staff Report's recommendation that Aqua's "proposal to install meters at its discretion is unreasonable." (Staff Report at 24.) The language cited by the Staff Report as unreasonable was taken verbatim from Ohio American Water Company's prior tariff and the same language is contained in Aqua's existing consolidated tariff, both with the approval of the Commission, which confirms that neither the concept nor the implementing language should be considered unjust or unreasonable.

Objection No. 34: Aqua further objects to the Staff Report's recommendation that Aqua's meter-change tariff is unreasonable because the Staff Report fails to acknowledge that the language does not prohibit or hinder Aqua and the Staff from further discussion and consideration of additional data with respect to meter changes.

Objection No. 35: Aqua objects to the Staff Report's recommendation that the "grandfathered sprinkler head rate issue should be addressed in this proceeding." (Staff Report at 26–27.) Aqua contends that this issue should be addressed in a future proceeding and in conjunction with the preparation of a new cost of service study that takes the issue and surrounding circumstances into account.

IV. SHARED SERVICES COST ALLOCATION REVIEW

Objection No. 36: Aqua objects to the Staff Report's recommendation pertaining to shared-service cost allocations because it is unnecessary, sufficient guidance is currently provided to employees, and cost assignments are reviewed. The cost-allocation methods in question have resulted in just and reasonable allocations of shared-services costs, and all allocations are selected under direct management supervision and guidance, are subject to multiple layers of review, and are appropriately documented.

Objection No. 37: Aqua objects to the Staff Report's recommendation "that Aqua America should fully articulate and document the tangible criteria being used by supervisors as they select which accounting unit to direct their staffs to employ, through a set of written policies and procedures" and the recommendation "that Aqua America train its staff on its cost allocation methodology and use of accounting units." (Staff Report at 40.) Aqua objects because this recommendation is unnecessary and implies that Aqua America does not currently employ such systems or achieve such objectives.

Objection No. 38: Aqua further objects that under Ohio law, neither the Staff nor the Commission possesses jurisdiction to order a non-public-utility parent company, including Aqua America, to take the actions specified in the shared-services cost-allocation recommendations.

V. MANAGEMENT AND OPERATIONS REVIEW

Objection No. 39: Aqua objects to the Staff Report's recommendation that Aqua "be directed to engage an external auditor . . . . to be paid for by Aqua America from non-regulated funds, but [to] be chosen by and under the direction of the Staff . . . . to examine the budgetary and non-budgetary control processes actually utilized by Aqua America in the initiation and delivery of its IT projects . . . ." (Staff Report at 44.) Aqua contends that the Staff Report inadvertently failed to properly interpret the data provided and that, properly explained and understood, the data demonstrates neither significant cost overruns on several initiatives nor a lack of necessary documentation or appropriate authorization in connection with such initiatives.

Objection No. 40: Aqua further objects to the Staff Report's recommendation for an external IT audit on the grounds that neither the Staff nor the Commission possesses jurisdiction under Ohio law to order a non-public-utility parent company, including Aqua America, to take the actions specified in the recommendation.

Objection No. 41: Aqua further objects to the Staff Report's recommendation for an external IT audit on the grounds that Staff failed to consider the impact of numerous substantial changes implemented before and during the test year regarding the initiation, development, and delivery of IT projects. These changes render any additional audit unnecessary and an inefficient use of resources.

SUMMARY OF MAJOR ISSUES

Major Issue No. 1: Return on Equity

Aqua contends that Staff's recommended Return on Equity, ranging from 9.36% to 10.38%, is too low to permit the Company to earn a reasonable return under the circumstances, and therefore is unjust and unreasonable.

Major Issue No. 2: Rate Base

Aqua contends that the Staff Report's rate-base adjustments unreasonably exclude assets and capital expenses that are just and reasonable, used and useful in providing service, and therefore properly recoverable in rates.

Major Issue No. 3: Operating Income

Aqua contends that the Staff Report unreasonably excludes test-year expenses that are just and reasonable, as well as known and quantified post-test year expenses, which are also just and reasonable.

Dated: December 19, 2016

Respectfully submitted,

/s/ Andrew J. Campbell

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ATTORNEYS FOR AQUA OHIO, INC.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Objections to Staff Report was served by electronic mail this 19th day of December, 2016 to the following:

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