**BEFORE**

**THE PUBLIC UTILITIES COMMISSION OF OHIO**

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| In the Matter of the Application of Aqua Ohio, Inc. to Increase its Rates and  Charges for Its Wastewater Service. | )  )  ) | Case No. 21-596-ST-AIR |

**OBJECTIONS TO THE PUCO STAFF REPORT**

**BY**

**OFFICE OF THE OHIO CONSUMERS’ COUNSEL**

Bruce Weston (0016973)

Ohio Consumers’ Counsel

Amy Botschner O’Brien (0074423)

Counsel of Record

Ambrosia E. Wilson (0096598)

Assistant Consumers’ Counsel

**Office of the Ohio Consumers’ Counsel**

65 East State Street, Suite 700

Columbus, Ohio 43215

Telephone: [Botschner O’Brien] (614) 466-9575

Telephone: [Wilson] (614) 466-1292

[amy.botschner.obrien@occ.ohio.gov](mailto:amy.botschner.obrien@occ.ohio.gov)

ambrosia.wilson@occ.ohio.gov

(willing to accept service by e-mail)

Brian M. Zets (0066544)Two Miranova Place, Ste. 700  
Columbus, OH 43215-5098   
**t** 614.221.2121 • **f** 614.365.9516   
**d** 614.857.1377

[Bzets@isaacwiles.com](mailto:Bzets@isaacwiles.com)

March 14, 2022 [www.isaacwiles.com](http://www.isaacwiles.com)

*Special Counsel for the Office of the Ohio Consumers’ Counsel*

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**BY**

**OFFICE OF THE OHIO CONSUMERS’ COUNSEL**

# INTRODUCTION

Aqua Ohio, Inc. (“Aqua”) seeks to increase the annual amount that it charges consumers by an additional $454,404 for wastewater service.[[1]](#footnote-2) Aqua Ohio’s requested increase represents an overall 12.8% increase to its existing base rates. The Public Utilities Commission of Ohio Staff (“Staff Report”)[[2]](#footnote-3) and its auditor Larkin & Associates, PLLC (“Audit Report”) recommend an increase to consumers in the range of $167,839 to $256,662.[[3]](#footnote-4) OCC’s analysis has produced a lowered and more reasonable amount of $135,996 for Aqua wastewater charges to consumers as a result of OCC’s lower rate of return recommendation.[[4]](#footnote-5)

Larkin & Associates, PLLC (“Larkin”) conducted the audit of the revenue requirement, rate base, and net operating income proposed by Aqua. Larkin subcontracted with Acadian Consulting Group (“ACG”) to address the cost of service, revenue distribution and rate design issues. PUCO Staff performed a rate of return analysis and service monitoring and enforcement investigation. Larkin’s audit report was filed on February 11, 2022. The combined efforts of Larkin, ACG, and the PUCO Staff form the PUCO Staff Report, also filed on February 11, 2022.

The Office of the Ohio Consumers’ Counsel (“OCC”) appreciates the Audit Report analysis and the PUCO Staff Report recommendations that benefit consumers. However, the Staff Report falls short of adequately protecting residential consumers in several ways, as explained in these Objections. The PUCO should adopt OCC’s consumer protections recommendations.

# SUMMARY OF FINDINGS AND RECOMMENDATIONS SUPPORTED BY OCC

The Office of the Ohio Consumers' Counsel ("OCC") supports the following findings, conclusions, and recommendations from the Audit Report (adopted by the Staff Report):

* Larkin correctly removed Aqua’s proposed utility division plant additions that have been determined to not be in service by December 31, 2021.[[5]](#footnote-6)
* Larkin correctly updated the costs for plant additions that are in service by December 31, 2021.[[6]](#footnote-7)
* Larkin correctly removed the cost for the Service Center SAP System because it is not used and useful by date certain.[[7]](#footnote-8)
* Larkin correctly removed service center plant additions not in service by date certain.[[8]](#footnote-9)
* Larkin correctly adjusted depreciation reserve resulting from the adjustments to the divisional and service center plant in service.[[9]](#footnote-10)
* Larkin correctly removed labor expenses that were overstated during the test year.[[10]](#footnote-11)
* Larkin correctly removed incentive compensation expense that is a shareholder responsibility.[[11]](#footnote-12)
* Larkin correctly removed stock-based compensation as it provides no benefit to consumers.[[12]](#footnote-13)
* Larkin correctly reduced payroll tax associated with its adjustments to payroll, incentive compensation and stock-based compensation.[[13]](#footnote-14)
* Larkin correctly excluded a supplemental executive retirement plan (SERP) as it is the responsibility of shareholders.[[14]](#footnote-15)
* Larkin adjusted employee insurance expense related to vacant positions.[[15]](#footnote-16)
* Larkin correctly adjusted rate case expense to reflect a five-year amortization rather than three.[[16]](#footnote-17)
* Larkin adjusted depreciation expense related to all the plant in service adjustments.[[17]](#footnote-18)
* OCC supports the Capital Structure and the Cost of Long-Term Debt recommended in the Staff Report.[[18]](#footnote-19)
* The recommendations regarding the revenue recovery mechanisms, including revenue allocation and rate design, made in Section 5, Rate and Tariff Review of the Larkin Audit Report and the Acadian Consulting Group (ACG), are reasonable. These recommendations appear to be adopted by Staff in its Report given that there are no additional recommendations by the PUCO Staff. OCC has no objections to Larkin’s recommendations. However, OCC reserves the right to modify our position if the recommendations are altered.
* ACG correctly recommends that the Commission apply any revenue requirement adjustment across residential and non-residential customer classes on an equal basis. [[19]](#footnote-20)
* ACG correctly recommends that the Commission not only reject the Applicant’s proposed fixed customer charge increases but also eliminate all meter charges for all classes and territories.[[20]](#footnote-21)
* ACG correctly supports the Applicant’s proposed transition from a three-step declining rate block structure to a two-step declining rate block structure in Franklin County.[[21]](#footnote-22)

However, the Staff Report should have gone further and recommended additional adjustments for the benefit of consumers, including:

* The PUCO Staff Report is in error because the revenue requirement is overstated and unreasonable resulting from a rate of return that is too high based on a review of current market conditions and Aqua’s business and financial risk.

OCC reserves the right to supplement its testimony in this case should any of the Staff Report's findings, conclusions or recommendations noted above that OCC supports are no longer supported by the PUCO Staff.

# OBJECTIONS TO THE PUCO STAFF REPORT

OBJECTION 1: As a result of OCC’s other objections below (including OCC’s proposed change to rate of return), the Staff Report’s recommended rate increase is too high for consumers and would result in consumers paying unjust and unreasonable rates under R.C. 4905.22, 4909.15, 4909.154 4909.17 and 4909.18.

## A. Revenue Requirement

The PUCO Staff’s recommended increase to consumers of $167,839 - $256,662 is too high for consumers and would result in unjust and unreasonable rates.[[22]](#footnote-23) OCC objects to the PUCO Staff-recommended revenue requirement and resulting revenue and rate increase recommended for Aqua. The PUCO Staff’s recommendations are unreasonable and unlawful, and the recommended revenue requirement for Aqua is excessive. The recommendations utilized a rate of return that is not just and reasonable. The specific objections from which these overall conclusions are drawn are detailed below in OCC’s objections to the PUCO Staff’s recommendations regarding these matters.

Additionally, OCC objects to each component of the PUCO Staff Report’s recommended revenue requirement and rate increase recommended for Aqua Wastewater consumers to the extent that OCC objections have an impact on the calculation of the recommended revenue requirement (e.g., rate of return).

## B. Rate of Return

As described in our Objections below, the PUCO Staff Report’s recommended rate of return range of 6.51% -7.04%[[23]](#footnote-24) is too high based on current market conditions and Aqua’s business and financial risks, and it is too high for consumers to pay. It is thus unjust and unreasonable for consumers to pay Aqua a water distribution charge based on this range of rate of return. A more reasonable rate of return would be in the range of 6.10%- 6.32%. The Staff Report’s recommended return on equity range of 8.99% - 10.00%[[24]](#footnote-25) is also too high and thus unjust and unreasonable for consumers to pay.

Specifically, the cost of equity and the rate of return proposed in the PUCO Staff Report do not reflect current market conditions or the business and financial risks facing a regulated water utility such as Aqua. Furthermore, Staff’s analysis is inconsistent with the analysis and approach used in the Staff Reports of many prior rate cases.[[25]](#footnote-26) The PUCO Staff has not provided any explanation for why it changed its approach.

OBJECTION 2: The Staff Report erred by using the average of the yields of the 20-year and 30-year U.S. Treasury Bonds as the risk-free rate used in the Capital Asset Pricing Model (“CAPM”). The inclusion of the yields of 20-year U.S. Treasury Bonds in calculating the risk-free rate overstates the estimated cost of equity of Aqua under the CAPM analysis causing a rate of return that results in unjust and unreasonable rates for consumers to pay.

PUCO Staff’s use of the yields of 20-year U.S. Treasury Bonds as part of the calculation of the risk-free rate overstates the estimated cost of equity of Aqua under the CAPM analysis.[[26]](#footnote-27) In the CAPM analysis, a risk-free rate is typically based on the current actual yields of long-term US government bonds with ten years or longer maturity.[[27]](#footnote-28) A more reasonable risk-free rate would be the average of the 10-year and 30-year U.S. Treasury Bonds. The use of the yields of the 10-year and 30-year government bonds in calculating the risk-free rate is well-established and widely used by many analysts when applying the CAPM.[[28]](#footnote-29)

There is no explanation why the PUCO Staff Report used the yields of the 20-year bonds, and not the yields of the 10-year bonds in this proceeding as the risk-free rate for the CAPM analysis.[[29]](#footnote-30) As the yields of the 20-year bonds (for example, 2.07% in 2021) tend to be much higher than the yields of the 10-year bonds (for example, 1.50% in 2021), using the yields of 20-year U.S. Treasury Bonds as the risk-free rate overstates the estimated cost of equity of Aqua under the CAPM analysis. OCC objects to Staff’s use of the average of the yields (interest rates) of the 20-year and 30-year U.S. Treasury Bonds as the risk-free rate for the CAPM analysis.

Instead, Staff should have used the average of the 10-year U.S. Treasury Bonds (1.50%) and the 30-year U.S. Treasury Bonds (2.16%) for the six-month period of March 1 to August 31, 2021, which leads to a risk-free rate of 1.83% for the CAPM.[[30]](#footnote-31) The PUCO Staff Reports of prior rate cases have used the average of the yields of 10-year and 30-year U.S. Treasury bonds as the risk-free rate and should do so here.[[31]](#footnote-32)

OBJECTION 3: The Staff Report erred by including the results of ComparableEarnings (“CE”) analysis, which included the estimated return on equity of 13.53% earned by companies from various industries with vastly different business and financial risks from a regulated utility in calculating the cost of equity. The inclusion of this unrelated and unreasonably high earned return on equity of 13.53% overstates the cost of equity of Aqua causing a rate of return that is too high and results in unjust and unreasonable rates for consumers to pay.

To protect Aqua’s consumers, OCC objects to the PUCO Staff’s use of the results of the Comparable Earnings Review (“CE Review”), such as the estimated return on equity of 13.53% earned by companies from various industries (Group 1), in calculating the cost of equity.[[32]](#footnote-33) These companies are in various industries with vastly different business and financial risks from those associated with a regulated water utility such as Aqua. The average earned return on equity of these companies should not be used in setting the cost of equity of Aqua. The inclusion of this unrelated earned return on equity of 13.53% from other industries unreasonably overstates the cost of equity of Aqua, a regulated water utility.

The problem with using the CE Review in the Staff Report is that it selected a peer group consisting of companies in unregulated industries with totally different business and financial risks than a regulated water utility like Aqua. The resulting return on equity of 13.53% is clearly unreasonable and unreliable (much too high) as a proxy in estimating the cost of equity of Aqua when other accepted rate of return methodologies have generated a cost of equity of either 8.36% (from CAPM) or 8.30% (from DCF).[[33]](#footnote-34)

In recent PUCO rate case Staff Reports,[[34]](#footnote-35) the cost of equity was calculated by the average of the Capital Asset Pricing Model (“CAPM”) and Discounted Case Flow (“DCF”) analysis. The results from the Comparative Earnings analysis were rarely used in prior rate cases. The Staff Report has provided no explanation why the CE Review should be added in estimating a reasonable cost of equity for Aqua in this proceeding.

OBJECTION 4: The Staff Report inappropriately increased the cost of equity by allowing an adjustment for equity issuance and other costs, causing a recommended cost of equity (or return on equity) range of 8.99% to 10.00% that is too high and thus results in unjust and unreasonable rates for consumers to pay**.**

To protect Aqua’s consumers, OCC objects to the inclusion of an allowance for generic and hypothetical issuance and other costs proposed in the Staff Report.[[35]](#footnote-36) By including this additional allowance, the Staff Report increased the recommended cost of equity from a range of 8.89% to 9.89% to a range of 8.99% to 10.00%. This added allowance to the baseline cost of equity is unnecessary and unreasonable. There is no evidence in the Staff Report that Aqua is likely to incur the equity issuance and other costs recently or in the future or the magnitude of these costs.[[36]](#footnote-37)

OBJECTION 5: The Staff Report’s recommended rate of return range of 6.51% to 7.04% is too high based on current market conditions and Aqua’s business and financial risks, resulting in rates that are too high and are unjust and unreasonable for consumers to pay. A more reasonable rate of return would be 6.32% or lower.

To protect Aqua’s consumers, OCC objects to the recommended rate of return range of 6.51% to 7.04% in the Staff Report.[[37]](#footnote-38) The Staff Report’s recommended rate of return range of 6.51% to 7.04% is too high based on current market conditions and Aqua’s business and financial risks. It is thus unjust and unreasonable for consumers to pay Aqua a water distribution charge based on this range of rate of return.

Ohio consumers served by Aqua have faced frequent and significant rate increases in the last five years. This rate increase, if approved, would be the fifth increase in rates (including the three System Improvement Charges) granted by the PUCO since March 2017.[[38]](#footnote-39)

Aqua’s frequent and significant rate increases in recent years indicate the need to select a lower but reasonable rate of return to lessen the impact of any further rate increase to Aqua’s consumers. At the same time, the frequent use of the System Improvement Charge (two in 2019 and one in 2020) by Aqua has reduced considerably the so-called regulatory lag and the business and financial risks of Aqua. This in turn should lead to a lower authorized rate of return for Aqua.

OCC’s recommended rate of return in the range of 6.10% to 6.32% with a midpoint of 6.21% reflects proper and reasonable modifications to the rate of return analysis included in the Staff Report.[[39]](#footnote-40) This range of rate of return is also consistent with the well-established regulatory principles that (1) a rate of return should not result in unjust and unreasonable rates; (2) a rate of return should be based on current market conditions and returns available from alternative investments; (3) a rate of return should be based on providing sufficient fund for a regulated utility to continue its normal course of business; and (4) a rate of return is not a guarantee for the regulated utility to receive excessive returns on its invested capital.[[40]](#footnote-41)

If the upper bound rate of return recommended in the Staff Report (7.04%) were adopted, Aqua would collect approximately $120,665 annually in additional and unreasonable charges from its wastewater consumers.[[41]](#footnote-42)

# CONCLUSION

To protect consumers from paying rates that are unjust, unreasonable and unlawful, the PUCO should adopt OCC’s recommendations set forth in these objections, which are further developed in OCC’s testimony.

Respectfully submitted,

Bruce Weston (0016973)

Ohio Consumers’ Counsel

*/s/ Amy Botschner O’Brien*

Amy Botschner O’Brien (0074423)

Counsel of Record

Ambrosia E. Wilson (0096598)

Assistant Consumers’ Counsel

**Office of the Ohio Consumers’ Counsel**

65 East State Street, Suite 700

Columbus, Ohio 43215

Telephone: [Botschner O’Brien] (614) 466-9575

Telephone: [Wilson] (614) 466-1292

[amy.botschner.obrien@occ.ohio.gov](mailto:amy.botschner.obrien@occ.ohio.gov)

ambrosia.wilson@occ.ohio.gov

(willing to accept service by e-mail)

Brian M. Zets (0066544)Two Miranova Place, Ste. 700  
Columbus, OH 43215-5098   
**t** 614.221.2121 • **f** 614.365.9516   
**d** 614.857.1377

[Bzets@isaacwiles.com](mailto:Bzets@isaacwiles.com)

[www.isaacwiles.com](http://www.isaacwiles.com)

*Special Counsel for the Office of the Ohio Consumers’ Counsel*

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the Objections was served on the persons stated below via electronic transmission, this 14th day of March 2022.

*/s/ Amy Botschner O’Brien*

Amy Botschner O’Brien

Assistant Consumers’ Counsel

The PUCO’s e-filing system will electronically serve notice of the filing of this document on the following parties:

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| [Robert.eubanks@ohioAGO.gov](mailto:Robert.eubanks@ohioAGO.gov)  [Chelsea.Fletcher@ohioAGO.gov](mailto:Chelsea.Fletcher@ohioAGO.gov)  Attorney Examiners:  Michael.williams@puco.ohio.gov  [David.Hicks@puco.ohio.gov](mailto:David.Hicks@puco.ohio.gov) | [Christopher.miller@icemiller.com](mailto:Christopher.miller@icemiller.com)  [Nicole.woods@icemiller.com](mailto:Nicole.woods@icemiller.com)  [lawdirectormarion@gmail.com](mailto:lawdirectormarion@gmail.com) |

1. *See* Application of Aqua Ohio, Inc. to Increase its Rates and Charges for its Wastewater Service (“Application”) Schedule A (June 28, 2021). [↑](#footnote-ref-2)
2. A Report by the Staff of the Public Utilities Commission of Ohio, Case No. 51-596-ST-AIR (February 11, 2022). [↑](#footnote-ref-3)
3. Audit of the Application to Increase Rates of Aqua Ohio Wastewater, Inc. for the Period January 1, 2021 through December 31, 2021 (“Audit Report”), Schedule A page 1 of 2, Case No. 21-596-ST-AIR (February 11, 2022). [↑](#footnote-ref-4)
4. *See*, Direct Testimony of William R. Willis, WRW Attachment 1 (March 14, 2022). [↑](#footnote-ref-5)
5. Larkin Audit Report at 3-5. [↑](#footnote-ref-6)
6. *Id*. [↑](#footnote-ref-7)
7. *Id*. [↑](#footnote-ref-8)
8. Larkin Audit Report at 3-7. [↑](#footnote-ref-9)
9. *Id*. at 3-8. [↑](#footnote-ref-10)
10. *Id*. at 3-9, 10. [↑](#footnote-ref-11)
11. Larkin Audit Report at 3-10, 11-12. [↑](#footnote-ref-12)
12. *Id*. at 3-12, 13-15. [↑](#footnote-ref-13)
13. *Id*. at 3-15. [↑](#footnote-ref-14)
14. *Id.* at 3-15, 16. [↑](#footnote-ref-15)
15. *Id*. at 3-16. [↑](#footnote-ref-16)
16. *Id*. [↑](#footnote-ref-17)
17. *Id*. at 3-16, 17. [↑](#footnote-ref-18)
18. Staff Report at 8. [↑](#footnote-ref-19)
19. Larkin Audit Report at 5-10. [↑](#footnote-ref-20)
20. Larkin Audit Report at 5-18. [↑](#footnote-ref-21)
21. Larkin Audit Report at 5-19. [↑](#footnote-ref-22)
22. Staff Report at 6 and it refers to the Larkin Audit Report, Schedule A (February 11, 2022). [↑](#footnote-ref-23)
23. Staff Report at 8. [↑](#footnote-ref-24)
24. Staff Report at 11. [↑](#footnote-ref-25)
25. *See*, Direct Testimony of Daniel J. Duann at 8-11, Case No. 21-596-ST-AIR (March 14, 2022). [↑](#footnote-ref-26)
26. Staff Report at 9. [↑](#footnote-ref-27)
27. Duann Direct Testimony at 8-9. [↑](#footnote-ref-28)
28. *Id*. [↑](#footnote-ref-29)
29. *Id*. at 8-9. [↑](#footnote-ref-30)
30. *See* <https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2021>. [↑](#footnote-ref-31)
31. Duann Direct Testimony at 9. [↑](#footnote-ref-32)
32. *See* Staff Report at 10. [↑](#footnote-ref-33)
33. Duann Direct Testimony at 11. [↑](#footnote-ref-34)
34. *See,* for example, PUCO Case No. 20-1651-EL-AIR et al., Staff Report at 21-22 (July 21, 2021), (AES Ohio Distribution Rate Case) and Case No. 16-907-WW-AIR et al., Staff Report at 12-13 (November 17, 2016) (Aqua Ohio Rate Case). [↑](#footnote-ref-35)
35. Staff Report at 10-11. [↑](#footnote-ref-36)
36. Duann Direct Testimony at 12. [↑](#footnote-ref-37)
37. Staff Report at 8. [↑](#footnote-ref-38)
38. *See*, *In re Application of Aqua Ohio, Inc. for Authority to Assess a System Improvement Charge*, Case No. 18-0337-WW-SIC, 3.66% increase approved (February 6, 2019); *In re Application of Aqua Ohio, Inc. for Authority to Assess a System Improvement Charge*, Case No. 19-0567-WW-SIC, 3.733% increase approved (October 23, 2019); *In re Application of Aqua Ohio, Inc. for Authority to Assess a System Improvement Charge*, Case No. 20-0532-WW-SIC, 3.498% increase approved (September 23, 2020); *see* Staff Report at 1-3; Duann Direct Testimony at 12-13. [↑](#footnote-ref-39)
39. Staff Report at 8-10. [↑](#footnote-ref-40)
40. Duann Direct Testimony 5-6. [↑](#footnote-ref-41)
41. Duann Direct Testimony at 18. [↑](#footnote-ref-42)