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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio-
American Water Company to Increase Its
Rates for Water and Sewer Service.

Case No. 11-4161-WS-AIR

OHIO-AMERICAN WATER COMPANY'S
OBJECTIONS TO
STAFF REPORT OF INVESTIGATION

As required by R.C. 4909.19, Rule 4901-1-28 of the Ohio Administrative Code and the Attorney Examiner's Entry of February 1, 2012,¹ Ohio-American Water Company ("Ohio American" or "Company") submits the following Objections to the Staff Report of Investigation filed in this proceeding on January 31, 2012 ("Staff Report").

OBJECTIONS

Operating Income and Rate Base

Objection No. 1. Ohio American objects to Staff's use of a 34% Federal Tax rate calculating the Gross Revenue Conversion factor. (Staff Report at 3; Schedule A-1.1.) While there are some marginal rates lower than 35% that are used to calculate federal income tax, all additional operating income that is a result of a rate increase included in this filing would be taxed at 35%. The use of a 34% federal income tax rate lowers the revenue requirement necessary to generate the proper net income that should be recognized in this case.

¹The February 1 Entry also directs each party filing objections to "also file a brief summary of the issues it designates as major issues, in order of their importance, for purposes of the notice required by Section 4903.083, Revised Code." Entry at Finding 3. A subsequent Entry issued on February 13 establishes a schedule for local public hearings, as well as the form of notice for publication. Because the February 13 Entry specifies the major issues to be listed in the published notice (*see* Finding 9), Ohio American has not filed a separate summary of major issues.

Objection No. 2. Ohio American objects to Staff's adjustment to exclude from date certain rate base Electric Pumping Equipment at Lake White in the amount of \$29,515 and a PH Meter in Marion in the amount of \$3,740. (Staff Report at 4; Schedule B-2.2a1 and B-2.2a2.) These items were mostly retired prior to Ohio American filing Case No. 09-0391-WS-AIR. A portion of the Lake White Electric Pumping Equipment was retired in September 2005, with the remainder being retired in October 2010. The two Marion PH Zeta Meters were retired in May 2003 (\$2,479.85) and September 2005 (\$1,259.54), with those retirements totaling \$3,739.39. Since these items were retired prior to the start of this case and are not a part of the Company's Rate Base for this case, there is nothing more to retire. Staff's proposed adjustment to retire these items would result in a double counting of the retirement of these assets. Ohio American also objects to the Corporate Office Exclusion in the amount of \$6,084 relative to Other Tangible Plant (Staff Report at 5 and 6; Schedule B-2.2a5). The rate base exclusion of \$6,084 is unsubstantiated and, as such, this exclusion should not be made.

Objection No. 3. Ohio American objects to Staff's adjustment excluding \$89,040 in deferred depreciation expense. (Staff Report at 8; Schedule B-6.) Staff's adjustment does not consider supplemental information provided on October 31, 2011 in response to Staff Data Request No. 12. If the unamortized deferred depreciation balance is not included in rate base, the relationship between the rate base and the capital structure will not be consistent because Ohio American's rate base will be improperly reduced by an amount which has not yet flowed to the income statement/retained earnings.

Objection No. 4. Ohio American objects to Staff's calculation of Contributions in Aid of Construction. (Staff Schedule B-6.) Staff Schedule B-6 reflects Contributions in Aid of Construction (Line (2) of the schedule) at (\$1,081,681) for Water C and (\$1,685,885) for

Wastewater, or a total of (\$2,767,566). Staff Schedule B-6 references Staff Workpaper WPB-6.2 as the source for these numbers. Staff has used a different allocation methodology than the Company in calculating the remaining CIAC to be considered for rate case purposes. The Company's calculation is correct and should be recognized and used instead of Staff's.

Objection No. 5. Ohio American objects to Staff's Federal Income Tax calculation (Staff Report at 11; Schedules C-3.6 and C-4) to the extent that other objections made by the Company would flow through to Federal Income Tax, thus over or understating the results.

Rate of Return

Objection No. 6. Ohio American objects to Staff's selected proxy group. Staff's selected proxy group is flawed in the following respects: 1) the proxy group does not reflect the increased business risk faced by Ohio American relative to its comparable group of water utilities; 2) the proxy group does not reflect the slightly less financial risk of Ohio American; and 3) Staff's selection criterion of including water utilities with a market capitalization greater than \$500 million excludes two water utilities which are closer in size to Ohio American than the four companies Staff relied upon and, therefore, closer in business risk.

Objection No. 7. Ohio American objects to Staff's application of the capital asset pricing model (CAPM). Staff's application of the CAPM is flawed in the following respects: 1) Staff utilized a historical yield on U.S. Treasury bonds as the risk-free rate instead of the more appropriate forecasted rate; 2) Staff inappropriately averaged the historical yield on 10-year U.S. Treasury bonds with the historical yield on 30-year U.S. Treasury bonds; 3) Staff incorrectly calculated the market equity risk premium using the total return on long-term U.S. Treasury bonds and not the income return; 4) Staff incorrectly utilized only the historical market equity

risk premium without also evaluating a prospective market equity risk premium; and 5) Staff did not include an empirical CAPM analysis to reflect the fact that the empirical Security Market Line (“SML”) described by the CAPM is not as steeply sloped as the predicted SML.

Objection No. 8. Ohio American objects to Staff’s application of the Discounted Cash Flow (“DCF”) method. Staff’s application of the DCF method is flawed in the following respects: 1) Staff exclusively and inappropriately relies upon a non-constant growth version of the DCF; 2) Staff inappropriately relies on historical growth in Gross National Product (“GNP”) as a proxy for long-term growth; 3) Staff implicitly rejects its constant growth DCF results; and 4) Staff uses erroneous data in its DCF analyses.

Rate and Tariffs

Objection No. 9. Ohio American objects to Staff’s recommendation for the Company to reduce the customer charge from \$11.50 to \$8.55 by excluding from this charge costs associated with public fire protection and the customer-related portion of management fees. Public fire protection costs are fixed costs that are not recovered through public fire hydrant rates and should be included in the customer cost. The customer-related portion of the management fee is directly related to the costs of the Call Center and other customer-related costs such as billing and collecting.

Service Monitoring and Enforcement

Objection No. 10. Ohio American objects to Staff’s finding that the Company has not had regular meetings with the City of Marion and that the Company has not complied with Marion’s permitting requirements. (Staff Report at 44-45.) Ohio American has met with Marion

City Officials at least monthly since May 2010. The isolated incidents where Ohio American did not apply for excavating permits prior to beginning work does not justify Staff's recommendation that Ohio American develop revised procedures for obtaining permits.

Objection No. 11. Ohio American objects to Staff's finding that certain additional improvements to the Ashtabula District Plant are estimated to be completed by December 31, 2011. (Staff Report at 46.) The improvements are estimated to be completed by December 31, 2012, subject to the availability of capital funds.

Objection No. 12. Ohio American objects to Staff's recommendation to prepare and plan a schedule to replace the balance of the Imperial Biscayne System #2 distribution mains, including installing meter pits necessary for the completion of metering the system, by the end of 2013. (Staff Report at 47-48.) The current mains are located in customers' back yards. Replacement mains and meter pits would be installed in front yards and street rights-of-way. The cost to complete this work would result in an extremely high investment per customer in this area, which would ultimately be borne by other customers.

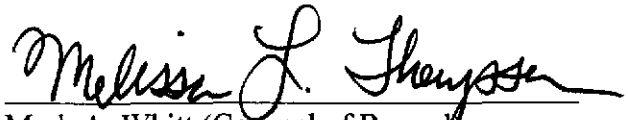
Objection No. 13. Ohio American objects to Staff's recommendation that the Company make the repairs recommended in the TIC inspection report for the Mansfield area Imperial Biscayne concrete tank "within 6 months of the issuance of the opinion and order in this case." (Staff Report at 49.) The Commission should allow this work to be completed within twelve months of issuance of the opinion and order so that the Company is not penalized for factors beyond its control which may prevent completion of the work in six months.

Objection No. 14. Ohio American objects to Staff's recommendation that the Company "expand its lead services elimination practice to include main replacements, main relocations, service leaks, and main breaks where lead services have been exposed." (Staff Report at 50.)

Lead services are currently replaced whenever required under the action level rules in O.A.C. Rules 3745-81-80 through 3745-81-89. It would not be prudent or cost-effective for Ohio American to replace all known lead services, regardless of whether replacement is required under Ohio EPA rules.

Dated: March 1, 2012

Respectfully submitted,

A handwritten signature in black ink, reading "Melissa L. Thompson". The signature is written in a cursive style with a horizontal line underneath.

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CERTIFICATE OF SERVICE

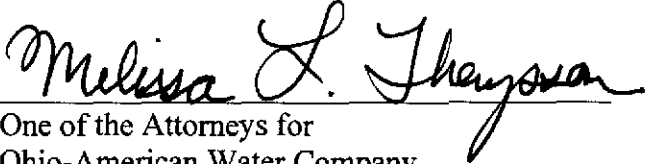
I hereby certify that a copy of the foregoing Objections to Staff Report of Investigation was served by electronic mail on the 1st day of March, 2012, to the following:

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