

COMMONWEALTH OF PENNSYLVANIA



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February 13, 2017

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

Re: Pa. Public Utility Commission
v.
City of Dubois – Bureau of Water
Docket No. R-2016-2554150

Dear Secretary Chiavetta:

Attached for electronic filing is the Office of Consumer Advocate's Reply Exceptions to the Recommended Decision in the above-referenced proceeding.

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

Respectfully submitted,

/s/ Harrison W Breitman
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Attachment

cc: Honorable Mark A. Hoyer
Certificate of Service

229591

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-2016-2554150
 :
 City of Dubois – Bureau of Water :

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate’s Reply Exceptions to the Recommended Decision, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 13th day of February, 2017.

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I. INTRODUCTION

On June 30, 2016, City of DuBois (City) filed Supplement No. 22 to Tariff Water - Pa. PUC No. 4, with the Public Utility Commission (PUC or Commission) to become effective August 29, 2016 at Docket No. R-2016-2554150. In its original filing, City of DuBois proposed an annual increase in base rate revenues of \$257,604. This represented an approximate 33.6% increase in the City's rates to its PUC-jurisdictional ratepayers who reside outside of the City. In rejoinder, the City revised its proposed PUC-jurisdictional annual revenue requirement increase to \$229,551. City Exh. CEH-3RJ.

If the City's entire original request were approved, the total bill for an outside-city residential customer using 3,800 gallons of water per month with a 5/8-inch meter would see an increase in their bill from \$25.57 to \$34.17, or approximately 33.6% per month. The City serves approximately 697 customers outside the City in Sandy Township, Clearfield County, Pennsylvania.

The OCA's adjustments pertained to the City's proposed rate base, including plant additions and cash working capital, cost of capital, including capital structure, the cost of equity, and the tax factor, depreciation expense, operations and maintenance expenses, including administrative and general expenses, chemicals and rate case expense. The OCA's adjustments to the City's updated rejoinder position resulted in the OCA's recommended revenue requirement increase of no more than \$50,418. See Tables I and II, attached to the OCA's Main Brief. The OCA also made recommendations regarding unaccounted for water calculations and estimates, customer complaint logs, and exercising isolation valves that are necessary to provide safe and reasonable service. These recommendations were addressed in the City/OCA Stipulation.

On January 9, 2017, the Office of Administrative Law Judge issued the Recommended Decision (RD) of ALJ Hoyer. The R.D. recommended rejecting the City's proposed Supplement No. 22 because the rates contained therein are not just and reasonable or otherwise in accordance with the Public Utility Code and applicable regulations. The R.D. further recommended, *inter alia*, that the Commission issue an Opinion and Order directing the City to file a tariff allowing for recovery of no more than \$97,534 in additional base rate revenue. ALJ Hoyer's recommendation adopted the OCA's adjustments to plant additions, operation and maintenance expenses, including administrative and general expenses, rate case expense, chemicals, and depreciation expense. Furthermore, ALJ Hoyer adopted the OCA's adjustments to cost of capital, including capital structure, as well as the cost of equity recommended by the Bureau of Investigation and Enforcement (I&E). The OCA files these Reply Exceptions in response to the Exceptions of the City filed on February 2, 2017. A complete discussion of each issue in these Reply Exceptions can be found in the OCA's Main and Reply Briefs.

II. REPLY EXCEPTIONS

REPLY TO CITY EXCEPTION 1: The ALJ Correctly Rejected the City's Claimed Rate Base Additions. R.D. at 8-17; OCA M.B. at 9-15; OCA R.B. at 3-8.

The ALJ adopted the OCA's adjustment to remove five rate base additions based on the evidence that showed that the projects had not been started, and would not be complete during the future test year. R.D. at 8-17. In its Exception, the City inappropriately requests that the Commission take judicial notice of invoices allegedly related to claimed rate base additions. City Exc. at 2-5. According to the Commission's procedural rules:

(b) After the record is closed, additional matter may not be relied upon or accepted into the record unless allowed for good cause shown by the presiding officer or the Commission upon motion.

52 Pa. Code § 5.431(b).

The City has been aware during this proceeding that it had not provided sufficient information to support its claim. City witness Spanos testified that providing the OCA with a start or completion date was an unreasonable expectation. *See* City St. 3R at 3. In the R.D., ALJ Hoyer determined as follows:

On November 10, 2016, a hearing was held in this proceeding. **That was the time for the City to put in its evidence regarding rate base. No additional evidence regarding the five adjustments proposed by the OCA was offered by the party with the burden of proof in this proceeding – the City.**

R.D. at 16 (emphasis added).

Indeed, multiple invoices that the City attaches to its Exception are dated before the date of the evidentiary hearing. *See* City Exc. App. A. at 7-10. Multiple interrogatories were submitted to the City which requested information pertaining to the City's claimed rate base additions. *See* I&E-R.B.-7-D and 8-D, OCA-V-1 through OCA-V-3 (attached to OCA St. 1).

The record for this proceeding was closed on December 21, 2016 by Order of ALJ Hoyer. *See* Second Interim Order Addressing Outstanding Motions to Strike, Striking Attachment 1 to Sandy Township's Main Brief and References Thereto, and Closing the Hearing Record. According to the Commission's procedural rules, if the City wanted to submit additional evidence after the record is closed, the City may file a petition to reopen the proceeding for the purpose of taking additional evidence. 52 Pa. Code § 5.571 provides the process for seeking to reopen a record prior to final Commission action.¹ As discussed below, in

¹ Specifically, a party may file a petition to reopen at any time after the record is closed but before a final decision is issued. 52. Pa. Code § 5.571.

this case, the City chose not to submit evidence during the litigation phase of the case. Even now, the City has not followed the Commission's rules regarding reopening the record.

Taking judicial notice of extra-record documents submitted after the ALJ's R.D. is not consistent with the Commission's regulations. In addition, it would deprive the OCA of due process. 52 Pa. Code §5.408 is not intended as a means for a party to submit extrajudicial evidence. Moreover, requesting that the Commission take judicial notice of documents that were not offered to any party to the proceeding, including ALJ Hoyer, is unreasonable. The OCA has not been permitted to conduct discovery, have an expert review the documents, or cross-examine witnesses in relation to these newly submitted documents. The first time that the OCA was made aware of the existence of these documents was upon receipt of the City's Exceptions. With less than 10 days to respond in Reply Exceptions to the City's Exceptions, the OCA is incurably disadvantaged by the City's attempt to submit additional evidence that was neither shown to any other party nor ALJ Hoyer.

Additionally, the OCA respectfully disagrees that the City dutifully updated its rate base claim to reflect additional developments throughout the FTY. *See* City Exc. at 4; City Exc. at App. A. This is illustrated by the City's attachment of Appendix A to their Exceptions, which includes documents dated before the evidentiary hearing date. *See* City Exc. at App. A. Only now, after the R.D. has been issued and after the OCA has filed its Exceptions, is the OCA being informed of alleged updates to the City's litigated rate base claim. Instead of taking judicial notice of extrajudicial documents that disregards Commission regulation and deprives all parties of due process, the Commission should adopt ALJ Hoyer's reasoned determinations regarding the City's additions to rate base.

Lastly, in its Exception the City argues that, should the PUC decline to judicially notice newly submitted documents, the PUC should still reverse ALJ Hoyer's recommendation because the City believes that reasonably anticipated capital expenditures should be included in rate base when evidentiary hearings are held prior to conclusion of the test year. *See* City Exc. at 4.² This argument was put forth in the City's Reply Brief and rejected by ALJ Hoyer in the R.D.. R.D. at 15-16. The R.D. correctly concluded that only costs that are known and measurable should be included in rates and only projects that are used and useful within the chosen test year should be reflected in the calculation of revenue requirement. R.D. at 16; OCA M.B. at 9-15; OCA St. 1 at 4; OCA v. City of Lancaster Sewer, 2005 PaPUC LEXIS 44 at 102-03 (Lancaster 2005). Normally, a utility would provide evidence that it, for example, had retained a contractor for a project and that it was taking steps to move the project forward so that it would be completed during the future test year. In this case, the City did not provide any such information on the five projects. As such, it is reasonable to remove those projects from its claimed rate base in this case.

REPLY TO CITY EXCEPTION 2: The ALJ Properly Recommended a Rate Base Deduction for a Vacant Home. R.D. at 18-20; OCA M.B. at 15-17; OCA R.B. at 8-9.

The City included in rate base a home owned by the City which was previously used for the Water Treatment Plant Superintendent but is now vacant. OCA M.B. at 15-17; OCA St. 1 at 28. In its Exception, the City argues that ALJ Hoyer erred in adopting the OCA's recommended deduction of a vacant home from rate base because ALJ Hoyer allegedly failed to properly give

² The invoices included in Appendix A appear to include costs that are unrelated to the Water Fund, such as "Sewer Line Repairs" and "Crosswalk Striping." Additionally, it is not clear what portion, if any, of certain invoices is applicable to the Water Fund. The invoices in Appendix A have no clear relationship with the \$113,200.64 the City claims to have incurred since the hearing.

appropriate weight to the City's testimony. City Exc. at 6. At the evidentiary hearing, after being confronted with a newspaper article confirming that City Manager Suplizio asked City Council to begin planning for demolition of the vacant home, City Manager Suplizio testified to the fact that he wanted the vacant home to be demolished. See Tr. at 45; OCA M.B. at 16.

The City also argued that it was plant held for future use. As discussed in the OCA's Main Brief, the vacant home does not meet the requirements for plant held for future use. See OCA M.B. at 15-17. In Pa. PUC v. West Penn Power Co., a utility sought to include in rate base plant held for future use which did not have a definite plan for being put into service. 1979 PaPUC LEXIS 37, *37 (West Penn). The utility argued that the Commission in the past included measures of value amounts for plant held for future use when a public utility made expenditures to acquire property when it knows the property will be needed in the future and when the property is of a unique character insofar as the acquisition of such property, in advance of its being put into actual use, is prudent. *Id.* The Commission determined that "the evidence establishes that the company has frequently revised 'in-service dates,' thus failing to meet our requirement that **plant held for future use must have a definite plan of use within a specific period of time.**" West Penn,*38-39 (emphasis added). This affirms the principle that "[t]he utility will recover the entire cost of the plant over the life of the plant; the customer will be required to pay only for the plant which serves it." *Id.*, *23; *see also*, Application of Duquesne Light Co., 1998 PaPUC LEXIS 167, *149 (Plant that is used and useful today could become not used or not useful tomorrow).

The vacant home fails to meet the requirement that plant held for future use must have a definite plan of use within a specific time frame because there are no current plans regarding the vacant home and no specific time-frame has been offered by the City for the vacant home being

put into use to provide service to ratepayers. OCA M.B. at 15-17; OCA St. 1S at 13. Further, the City Manager testified at the evidentiary hearing that he recommended that the vacant home be demolished and is waiting for City Council to take action regarding his recommendation. Tr. at 43:23-45:20. Since this home is vacant, has no specific time-frame in which it will be put into use, and is not currently used or useful for the provision of water service, the vacant home should be removed from the City's rate base. OCA M.B. at 15-17; OCA St. 1 at 29; OCA St. 1S at 13.

The City argues that the ALJ's R.D., rejecting a vacant home's inclusion in rate base, is premature since the City Council has not yet voted on whether to demolish the property or put it to another use. City Exc. at 6-7. The City's argument misses the key point that at this time, the property is not used and useful. OCA M.B. at 15-17. Moreover, there is no definite plan of use of this vacant property within a specific period of time and the property fails to meet the necessary legal requirements that plant held for future use must have a definite plan of use within a specific period of time. *Id.* In her surrebuttal testimony, Ms. Everette removed the rate base claim because the home "is vacant and is not used or useful for the provision of water service." OCA St. 1S at 29; OCA M.B. at 15.

Accordingly, the OCA submits that the jurisdictional net book value of the vacant home, or \$3,334 should be removed from rate base in accordance with ALJ Hoyer's R.D.. R.D. at 18-20; OCA Table II; OCA Exh. AEE-1S, line 9; OCA M.B. at 15-17; West Penn, *37.

REPLY TO CITY EXCEPTION 3: The ALJ Correctly Recommended that Expenses in Regards to a Vacant Home Should Not Be Charged to the Ratepayers. R.D. at 29; OCA M.B. at 19; OCA R.B. at 11-12.

As described in the OCA's Reply to Exception 2, the City owns a vacant home for which it is claiming that \$3,592 in expenses. OCA M.B. at 19; OCA R.B. at 11-12; City M.B. at 24-25. Expenses related to the vacant home, such as telephone service, will not be incurred because the

home is not being used. In fact, telephone service for the property has been disconnected. *See* I&E-RE-15-D (attached to OCA St. 1); OCA-V-12 (attached to OCA St. 1). Because this home is vacant and is not used or useful for the provision of water service, the expenses related to this home should be removed from the City's claim. R.D. at 29; OCA St. 1 at 29. The OCA submits that ALJ Hoyer's \$3,592 adjustment to expenses and \$572 adjustment to depreciation expense should be adopted. OCA Table II.

REPLY TO CITY EXCEPTION 4: The ALJ Reflected The Appropriate Normalization Period for the City's Rate Case Expense Claim. R.D. at 46-49; OCA M.B. at 40-43; OCA R.B. at 22-26.

In its Exception, the City argues that ALJ Hoyer improperly calculated the normalization period for rate case expense. City Exc. at 7-9. The City claims \$225,505 of rate case expense normalized over a 2.5 year period, for an annual expense of \$90,202. OCA M.B. at 40; OCA R.B. at 25; OCA St. 1S at 27. The OCA did not recommend any adjustment to the level of expense claimed, but recommended the use of a 5 year normalization period, based on historical filing frequency, rather than 2.5 years as proposed by the City. OCA M.B. at 40-43.

As explained in detail in the OCA's Main Brief, the City's last rate case was in 2013, three years prior to this case. OCA M.B. at 40. The case before that was in 2005, or seven years prior, and the case before that was filed nine years before, or in 1996. OCA M.B. at 40; OCA St. 1 at 45. The average time between City of DuBois' last three rate filings is more than six years.³ OCA M.B. at 40-41; OCA St. 1 at 45. In fact, the City's average historical filing history in the last three cases is 6.61 years. OCA M.B. at 41; OCA St. 1 at 45. If the 1996 case is eliminated from the calculation, the average filing frequency is 5.33 years. R.D. at 48; OCA M.B. at 41;

³ The last three cases were filed on the following dates: 8/27/1996, 10/28/2005, and 3/1/2013. The current case was filed on 6/30/2016.

OCA St. 1 at 45. OCA Everette rounded down to 5 years for her recommended normalization period. OCA M.B. at 40-41; OCA St. 1 at 45. ALJ Hoyer determined that the 5.33 actual average filing frequency recommended by I&E was more appropriate. R.D. at 48-49. The OCA did not except to this decision and supports ALJ Hoyer's decision.

The City argues that the ALJ improperly utilized historical filing frequency to determine the rate case expense normalization period. City Exc. at 7-9. The City cites to Pa. PUC v. Lemont Water Co., 1994 PaPUC LEXIS 44, *18-19 (1994) (Lemont) to support its contention that the City's proposed 2.5 year normalization period is proper. See, City Exc. at 8; City M.B at 22. The Commission's determination in the Lemont case, however, states as follows: "we would use a 1.6 year interval for the normalization of the \$120,000 of rate case expense incurred from the litigation of this proceeding. **This interval reflects the Company's historical average interval between rate filings.**" Lemont, *32 (emphasis added). Indeed, in Lemont, the OCA argued for a 2 year normalization period while the Commission determined that a 1.6 year normalization period accurately represented the Company's historical filing period, which was an adjustment of 0.4 years to the OCA's recommendation. Lemont does not support the City's contention that rate case expense should be based on the City's speculative intention to file a rate case rather than the historical average interval between rate filings. In fact, the City's citation to Lemont is to a section of the case that merely recites the parties arguments. See, Lemont, *18-19. The City does not cite to the Commission's determination. *Id.*, *32.

ALJ Hoyer correctly determined that the City's rate case expense must be adjusted to reflect a proper normalization period that is consistent with Commission precedent. See R.D. at 48-49. The Commission has consistently held that rate case expenses are normal operating expenses, and normalization should, therefore, be based on the historical frequency of the

utility's rate filings. Popowsky v. Pa. PUC, 674 A.2d 1149, 1154 (Pa. Commw. 1996); Pa. PUC v. Columbia Water Co., 2009 PaPUC LEXIS 1423 (2009); Lancaster 2005, *84; Pa. PUC v. National Fuel Gas Distribution Corp., 84 Pa. PUC 134, 175 (1995); Pa. PUC v. Roaring Creek Water Co., 73 Pa. PUC 373, 400 (1990); Pa. PUC v. West Penn Power Co., 119 PUR4th 110, 149 (Pa. PUC 1990). In recent cases the Commission reiterated that the normalization period is determined, "by examining the utility's actual historical rate filings, not upon the utility's intentions." Pa. PUC v. City of Lancaster – Bureau of Water, 2011 PaPUC LEXIS 1685, *56-57 (Lancaster 2010); Pa. PUC v. Emporium Water Co., Docket No. R-2014-2402324 Slip Op. (Jan. 15, 2015) (www.puc.state.pa.us/pcdocs/1339803.docx); Pa. PUC v. Metropolitan Edison Co., 2007 PaPUC LEXIS 5 (2007); Lancaster 2005, *84.

The City argues that it was able to reduce its filing frequency in the past because it received additional revenues from the sale of water to shale gas companies. City Exc. at 9. It should be noted that the City states that "[i]mportantly, all parties have conceded that such sales [of water to shale gas companies] are not expected to recur. See City Main Brief, p.25." City Exc. at 9. The OCA made no such concession. Moreover, the City's citation to its own Main Brief in no way offers support to this contention. See City M.B. at 25. Instead, this citation refers to part the City's discussion of the City Manager salary allocation, as well as General Administrative Expenses. *Id.* The OCA has no knowledge of sales of water to shale gas companies the City may or may not make in the future. Furthermore, the OCA does not know whether the City will receive additional revenues from the sale of water in the future. The OCA, however, never conceded that sales of water to shale gas companies are not expected to recur.

The City argues that that it would be "flagrantly unfair" for the Commission to adopt the R.D.'s 5.33 year normalization period because it would allegedly force the City to under-recover

rate case expense. City Exc. at 9. The City further notes that it recovered 40% of its prior rate case expense from the 2013 rate case, which ended in settlement. *Id.*⁴ While the City argues that it is being forced to under-recover rate case expense under OCA's recommended normalization period, the current rate case has not come to a conclusion and it is unknown when the City will file its next rate case. The City attempts to shorten the normalization period for rate case expense by focusing on the percentage of rate case expense the City recovered before choosing to file a rate case. City Exc. at 9. It should be noted that there was no normalization period determined in the City's previous rate case due to a black box settlement. 2013 Settlement, Docket No. R-2013-2350509 at ¶7; OCA M.B. at 41; OCA St. 1S at 26. It is important to note that if the City waits longer than the normalization period before filing its next rate case, it will continue to collect the annual rate case expense as part of annual revenues. OCA R.B. at 25; OCA St. 1S at 27.

For these reasons, and consistent with Commission precedent, the OCA submits that the normalization period should be based off of the historical average interval between rate filings and that ALJ Hoyer's 5.33 normalization period is a reasonable and fair estimate of the City's historical average filing interval.

REPLY TO CITY EXCEPTION 5: The ALJ Properly Rejected the City's Proposed Allocation Factors for City Manager Salary and Benefits Expenses. R.D. at 37-44; OCA M.B. at 25-35; OCA R.B. at 16-21.

1. City Manager Salary

The City claimed that 55.7% of the City Manager's \$124,076 annual salary should be allocated to the Water Fund, which represents a total claim of \$69,093. R.D. at 38. In its

⁴ In its 2013 Settlement, the City increased revenues from the jurisdictional ratepayers by 57.1%. City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 7.

Exception, the City attempts to downplay the City Manager's own job description by placing emphasis on the fact that the City Manager testified as to how he spends his own time on a day-to-day basis. *See* City Exc. at 11. Indeed, the City's allocation of City Manager Suplizio's salary to the Water Fund is entirely based on City Manager Suplizio's unverifiable assertions as to how much of his salary should be allocated to the Water Fund; this is the only part of his salary which is paid exclusively by the ratepayers. OCA M.B. at 25-35. This allocation has changed over time and directly contradicts City witness Heppenstall's two-step allocation method.⁵ Moreover, City witness Heppenstall's two-step allocation method was based solely on interviews with City Manager Suplizio. *Id.* at 29-30; OCA St. 1 at 34-35; City Exh. CEH-1 at 25.

ALJ Hoyer, as the finder-of-fact, did not find City Manager Suplizio's testimony to be credible and stated as follows:

I did not find Mr. Suplizio's testimony that 60% of his time as City Manager is devoted to the Bureau of Water to be credible at all, given all of the other duties and responsibilities. This was the only evidence the City presented to support the salary allocation used in this case. There were no time records kept or provided by the City. I agree with the OCA's allocation of 24% of the City Manager's salary to the Water Fund, which reflects the verified allocation for treasury and finance employees, and recommend this expense adjustment.

R.D. at 42.

Disagreeing with the weight accorded to Mr. Suplizio's testimony by ALJ Hoyer as the fact-finder, the City argues that "more weight should be given to the City Manager's testimony as to his job functions and daily responsibilities, which were provided under oath." City Exc. at

⁵ At the evidentiary hearing, City Manager Suplizio stated "I think 60 percent is probably on the low end." Tr. at 26. It should be noted that City witness Heppenstall determined that the total City Manager salary allocated to the Water Fund is 55.7%, which is in contradiction to City Manager Suplizio's testimony at the evidentiary hearing. *See* City Exh. CEH-2R at lines 13-17.

11.⁶ As discussed herein, the OCA submits that the ALJ accorded the proper weight to Mr. Suplizio's testimony and correctly determined that the proper allocation percentage to use for the remainder of his salary in this case was 24%.

The City states that "for the balance of the City Manager's time not spent on finance-related tasks, it is logical to assume he would be working on the same projects reflected in the Public Works Director's timesheets. *See* Tr. at p. 33, line 2." City Exc. at 10; City M.B. at 26-27. In addition to a lack of support in the evidentiary hearing transcript regarding this contention, assuming that it is logical that the City Manager spends his time in the same manner as the Public Works Director is not supported by the record evidence. OCA M.B. at 32. The City Manager's job description contains a wide scope of duties and does not require specialized knowledge regarding public works. OCA M.B. at 30-31; I&E-RE-30D Part A (attached to OCA St. 1).

In its Exception, the City argues in the alternative that if the Commission chooses to not accept the City's allocation factor, it should impose its own allocation factor. City Exc. at 10. The OCA submits that a purely speculative allocation factor is inappropriate to determine the City Manager's salary allocation to the Water Fund. OCA witness Everette recommends a 24% allocation developed for the treasury and finance employees be used to allocate the City Manager's salary as the work of the treasury and finance personnel is relevant to the City as a whole; similar to the City Manager. OCA M.B. at 33-34; OCA St. 1 at 35. The City agreed in the most recent 2013 settlement that all Administrative and General expenses would be allocated

⁶ It should be noted that while the City argues that Mr. Suplizio's sworn testimony should outweigh ALJ Hoyer's credibility determination, the City also argues that Mr. Suplizio's sworn testimony in regards to the demolition of a vacant home and the reporting of sales of water to the Borough of Falls Creek should not bind the city. *See* R.D. at 19, 91; City M.B. at 10; City R.B. at 7.

to the Water Fund on the basis of actual and measureable costs attributable to the Water Fund. City of DuBois 2013 Settlement, Docket No. R-2013-2350509 at 5. Ms. Everette also testified that, in the next case, the City should be required to provide documentation, including timesheets, demonstrating the appropriate allocation of the City Manager's time. OCA M.B. at 33-34; OCA St. 1 at 34-35. Given that the City Manager oversees financial matters, in addition to numerous other responsibilities, a 24% allocation which reflects the verified allocation for treasury and finance employees to the Water Fund is a reasonable allocation based on the limited information provided by the City. OCA M.B. at 33-34; OCA St. 1 at 35.

As the jurisdictional customers do not receive any benefit from Mr. Suplizio's work in managing the City besides the time he spends on the water department, the OCA recommended an adjustment regarding the allocation of the City Manager's salary to the Water Fund, which results in a jurisdictional portion of \$11,209. OCA M.B. at 34; Table II. ALJ Hoyer's adoption of the OCA's allocation factor is reasonable and should be adopted.

2. Administrative Expense

In its Exception, the City merely expresses general disagreement with ALJ Hoyer's determination. *See* City Exc. at 12-13. The OCA accepts ALJ Hoyer's determination regarding Administrative Expense, which both addresses I&E's concerns with the expense and takes into account the 24% allocation factor for the City Manager's salary which was proposed by the OCA.

REPLY TO CITY EXCEPTION 6: The ALJ's Treatment of WTP Contractual Expenses Was Correct. R.D. at 32-37; OCA M.B. at 21-25; OCA R.B. at 14-15.

The OCA's Main Brief contains a detailed discussion of the Water Treatment Plant Contractual Services expense (WTP Contractual Services expense). *See* OCA M.B. at 21-25.

The only component of the City's claim which is at issue is the \$22,323 portion, which is the "normalization of other expenses" component. City Exc. at 13; OCA M.B. at 22. The City argues that it has demonstrated that the City's filed and adjusted expense is justified and should be accepted without modification. City Exc. at 14; City M.B. at 20. The City's sole argument is that the history of expense is not the best indicator of future expense and it is more appropriate to examine trends rather than use a three year average as was recommended by Ms. Everette. City M.B. at 20. The City provides no legal basis for this argument and no evidence in support of its position.

As discussed in detail in the OCA's Main Brief (*See*, OCA M.B. at 21-25), after the City made its adjustments, the expense in 2015 for this account was still significantly higher than in the previous years. The "other expenses" component for the three year period was as follows:

2013: \$1,825
2014: \$865
2015: \$22,323

OCA M.B. at 22; OCA St. 1 at 31; OCA St. 1S at 16.

As clearly illustrated above, the 2015 expense is significantly higher than prior levels and exceeds both the 2013 and 2014 expenses by a large margin. The City's Main Brief provides no explanation as to how this significantly larger expense level in 2015 is indicative of future expense and the City has not provided support evidencing that the 2015 expense is an ongoing level of expense. As such, and for the reasons stated in ALJ Hoyer's R.D. and the OCA's Main Brief, a three year average of these expenses should be used in order to reflect a normalized level of expense for ratemaking purposes. *See*, R.D. at 32-37. OCA M.B. at 21-25. OCA R.B. at 14-15.

REPLY TO CITY EXCEPTION 7: The ALJ's Treatment of the City's Building/Computer Parts/Supplies/Software Expenses Was Correct. R.D. at 44-46; OCA M.B. at 37-39; OCA R.B. at 21-22.

In its Exceptions, the City states that it confirmed the increased expense in this account in 2015 was due to payments to vendor "RAK Computer Associates," and that the City provided evidence of the expense's ongoing nature. City Exc. at 14-15. The expenses in 2013, 2014, and 2015 were \$186,119, \$175,306, and \$213,227, respectively. OCA M.B. at 37; OCA St. 1 at 41. The 2015 expense for this account is 22% higher than the 2014 expense and is 15% higher than the 2013 expense. OCA M.B. at 38; OCA St. 1 at 41. A breakdown of this expense showed that the primary increase in 2015 was to a computer parts account. The expenses for this specific account are listed below:

2013: \$17,269
2014: \$19,562
2015: \$47,202

OCA M.B. at 38; OCA St. 1 at 41.

Ms. Everette testified that "[t]he 2015 expense was 173% more than the 2013 expense and 141% more than the 2014 expense." OCA M.B. at 38; OCA St. 1S at 24.

The City provided general ledger entries for the computer parts account which showed that the reason for the increase in 2015 was due to the fact that payments to vendor "RAK Computer Associates" increased from \$45 in 2013, to \$1,127 in 2014, to \$23,116 in 2015. OCA M.B. at 38; OCA St. 1 at 41. As explained by OCA witness Everette, "[c]learly, this is a significant increase, as **the 2015 expense is over 20 times as much** as the 2014 expense." OCA M.B. at 38; OCA St. 1 at 41 (emphasis added). Moreover, the overall amount of the City Buildings: Computer Parts/Supplies/Software expense increased significantly from 2014 to 2015. OCA St. 1S at 24. City witness Heppenstall does not provide any explanation as to why the expense more than doubled in one year. OCA M.B. at 38; OCA St. 1S at 24. There is no support

to indicate that the increased expense in 2015 is an ongoing level of expense. OCA M.B. at 38; OCA St. 1S at 24. As such, OCA recommended that it is appropriate to normalize the expense as it is significantly higher than a normal year of expense. OCA M.B. at 38; OCA St. 1 at 41; OCA St. 1S at 24.

ALJ Hoyer was correct when he determined that “It is appropriate to normalize this expense as the 2015 expense is significantly higher than a normal year of the expense.” R.D. at 46. The City’s exception should be denied.

REPLY TO CITY EXCEPTION 8: The ALJ Was Correct in Recommending Adoption of the OCA and I&E’s Proposed Capital Structures. R.D. at 57-63; OCA M.B. at 49-58; OCA R.B. at 28-31.

In its Exception, the City argues that ALJ Hoyer’s adoption of the 70% debt/30% equity capital structure recommended by the OCA and I&E is unreasonable. City Exc. at 15-17. The City argues that the R.D. unreasonably analogizes the City’s circumstances to the circumstances in Lancaster 2010.

The City’s actual capital structure is 99.5% debt/0.5% equity.⁷ OCA M.B. at 49; OCA St. 1S at 6. The R.D. adopts a capital structure of 70% debt/30% equity which is based on the City’s financing of its rate base and is consistent with the ratios shown in the City’s audited financial statements. R.D. at 57-63; OCA M.B. at 49-58; OCA St. 1 at 14-16.

In arguing for the use of the City’s proposed hypothetical capital structure of 50% debt/50% equity, the City attempts to differentiate Lancaster 2010 from the City’s request for a rate increase by noting that Lancaster sought to increase rates by 100% while the City sought to increase rates by 36%. City Exc. at 16-17. Without any legal precedent, the City appears to

⁷ In the OCA’s Main Brief, the reference is to 99.6% debt/0.4% equity (OCA St. 1 at 14-15) which was revised in Ms. Everette’s surrebuttal.

argue that the utilization of a capital structure of 70% debt/30% equity is dependent on the percentage of the rate increase sought by a municipality. City Exc. at 15-17. The City does not provide any support for a threshold, besides noting that Lancaster sought to increase rates by 100%, for which the capital structure adopted in the R.D. would be appropriate. The OCA submits that the percentage of the proposed increase in rates does not, in any way, determine the appropriate capital structure nor does it discredit ALJ Hoyer's recommended capital structure or draw its reasonableness into question.

The City additionally argues that the R.D. fails to balance the interests of the utility and its customers. City Exc. at 16-17. To support this contention, the City cites to Lancaster 2010 and Lancaster 2005. The City states ““In *Lancaster 2010*, the Commission acknowledged its use of a capital structure differing from market norms to necessitate an appropriate upward adjustment to the cost of common equity.” See Lancaster 2010, *73 (establishing that “a higher cost of equity is necessitated by our adoption of the City's actual capital structure”).” City Exc. at 16. The citation provided by the City, however, cites to a discussion of the parties' positions in the case and not to the disposition. See Lancaster 2010, *73. The disposition section of the case regarding cost rate models includes the language noted parenthetically by the City but also includes additional clarifying language and states as follows:

We note that a higher cost of equity is necessitated by our adoption of the City's actual capital structure, *but it is important to note that our allowance of a 10.00% return on equity falls squarely within the range of the DCF results as calculated by the OTS (8.53 to 10.87%)*.

Lancaster 2010, *109 (emphasis added). Furthermore, the Commission rejected Lancaster's 50% debt/50% equity capital structure because it would impose excessive costs on consumers and required consumers to pay equity returns of over 10 percent on debt that costed, on average, 4.66 percent. *Id.*, *83.

The City further attempts to support its argument for the City's proposed hypothetical structure by citing to a disposition in Lancaster 2005. The City states that an actual capital structure was appropriate only when the utility benefits from Pennvest loans and that the City has no Pennvest debt. City Exc. at 16-17. The question of the appropriate capital structure is not limited to those situations where Pennvest debt is present. The actual capital structure should be used unless it is atypical. OCA M.B. at 56-58. The use of the City's proposed hypothetical capital structure is not a proper balancing of ratepayer and City's interests because the City is asking the PUC-jurisdictional customers to pay an equity return of 10.5% on debt that has a weighted cost of 3.02%. OCA R.B. at 37. Through its proposed capital structure, the City is attempting to take low cost debt and get equity returns for it. Generally, the use of a hypothetical capital structure should not increase costs to ratepayers. The City's proposed hypothetical capital structure improperly places too much additional cost on ratepayers and does not properly balance the interests of ratepayers and shareholders. *See Emporium Water v. Pa. PUC*, 955 A.2d 456 (Pa. Commw. 2008) *appeal denied* 599 Pa. 702, 961 A.2d 860 (2008).

The R.D's capital structure is appropriate for ratemaking purposes. It reflects the basis upon which the financing has been done for the City's rate base. Thus, for the City and its ratepayers, it is reasonable for ratemaking purposes and should be adopted.

REPLY TO CITY EXCEPTION 9: The ALJ's Approval of I&E's Cost of Equity Calculation Was Proper. R.D. at 64-74; OCA M.B. at 63-65; OCA R.B. at 32-37.

1. The R.D. Appropriately Recognizes PUC Precedent Regarding Cost of Equity.

The ALJ adopted I&E's cost of equity of 8.62%. R.D. at 65-66. The OCA's recommended cost of equity was 8.25% while the City recommended 10.50%. R.D. at 64. The OCA submits that its cost of equity recommendation is reasonable as discussed in the OCA's

Main and Reply Briefs. *See*, OCA M.B. at 63-65; OCA R.B. at 32-37. However, the OCA submits that the cost of equity should be no more than the 8.62% recommended by ALJ Hoyer. R.D. at 74.

The ALJ did not adopt any of the adjustments made by City witness Walker to his return on equity calculation. R.D. at 71. In its Exception, the City claims that the R.D. misrepresents Commission precedent as “categorically rejecting” cost of equity adjustments. City Exc. at 18. According to the City, this is a “revisionist reading” of prior Commission decisions. *Id.* The City’s cite to the R.D., however, states as follows:

I&E maintains that these adjustments should be categorically denied. That being noted, I&E maintains these adjustments individually are unreasonable and unsupported. I&E M.B., p. 35.

R.D. at 68.

As can be seen ALJ Hoyer did not determine that cost of equity adjustments were categorically inappropriate. *See* R.D. at 68-71. On the contrary, the R.D. individually evaluated each adjustment and ALJ Hoyer explains his reasoning in detail as to why City witness Walker’s adjustments are unreasonable. *Id.* The R.D. should be adopted as will be detailed below.

2. The R.D.’s Denial of the City’s Risk and Leverage Adjustment Was Proper.

In its Exception, the City states that the R.D.’s rejection of specific equity adjustments proposed by the City was unreasonable. While the City states that ALJ Hoyer’s findings are “unreasonable and completely divorced from prior Commission decisions”, the City provides no citation to support this overall claim. City Exc. at 19. ALJ Hoyer specifically cited to Commission precedent, conducted a reasonable evaluation of each individual adjustment, and concluded as follows:

In conclusion, based upon the Commission precedent and upon the individual invalidity of each of these three adjustments, the City’s Risk Adjustment, Size

Adjustment, and Leverage Adjustment all unfairly harm ratepayers, are unnecessary, and are contrary to the public interest that the PUC is charged with protecting.

R.D. at 71.

As explained in the OCA's Main Brief, the City's 70 basis point leverage adjustment and its 25 basis point adjustment for risk differential should be rejected. OCA M.B. at 64-65; OCA St. 1 at 24-25. City witness Walker states that when market value exceeds book value, that indicates that a company is expected to earn more than investors require or higher than its cost of equity. City M.B. at 46. No adjustment to further increase the return on equity is needed in that situation. It should further be noted that the PUC has denied City witness Walker's leverage and risk adjustment in Lancaster 2011. 2011 PaPUC LEXIS *118.

a. The R.D. Appropriately Denied the City's Risk Adjustment.

Regarding City witness Walker's risk adjustment, City witness Walker provides a discussion regarding characteristics of the water business that increase the risk and required return of water utilities in his opinion. This discussion, however, has no bearing on a reasonable return on equity because each of City witness Walker's cost of equity models are market-based and both the OCA's and I&E's cost of equity models are market-based. *See* R.D. at 68-71. Thus, the various analyses of specific water utilities reflect the market's assessment and reaction to all risks confronted in the water utility industry. OCA M.B. at 63-65; OCA R.B. at 32-37.

In Lancaster 2011, the Commission rejected similar analyses by City witness Walker. The Commission rejected the 25 basis point risk adjustment that was proposed by Mr. Walker and is proposed here. Lancaster 2011, *118; OCA M.B. at 65.

City witness Walker's risk adjustment is not necessary because it serves to inflate a return on equity that is determined by the DCF model. OCA R.B at 35. Individually or jointly, OCA

submits that results of City witness Walker's cost methods, as applied to his proxy group, are not appropriate to determine a cost of common equity for the City and supports ALJ Hoyer's determination in the R.D..

b. The R.D. Appropriately Denied the City's Proposed Leverage Adjustment.

The OCA agrees with ALJ Hoyer's rejection of the City's leverage adjustment. City witness Walker's leverage adjustment is illogical because it increases the return on equity for utilities that already have high returns and lowers the return on equity for utilities with low returns. OCA R.B. at 35. In Lancaster 2011, the Commission also rejected any market to book or leverage adjustment. *See, Lancaster 2011*, *118. Ms. Everette noted that City witness Walker did not adjust his recommendation for the fact that his return on equity recommendation "already accounts for the City's leveraged position by imputing 50% equity when the City in fact is only 0.4% equity." OCA M.B. at 64; OCA St. 1 at 24-25.

c. The R.D. Properly Rejects the City's Equity Return Analyses.

The OCA supports ALJ Hoyer's rejection of the City's DCF analysis. In its Exception, the City characterizes I&E's DCF analysis as "overly narrow" due to I&E's growth rate. Ms. Everette explained that investors do not all use the same growth rate or apply the same weight to the various growth estimates. OCA M.B. at 60-61; OCA St. 1 at 18. Ms. Everette noted that analyst projections of growth may be overstated, while historical growth may not equal future growth rates. OCA M.B. at 60-61. Thus, Ms. Everette's analysis considered both historic and projected growth rates to develop her DCF based cost of equity range.⁸

⁸ Ms. Everette summarized her analysis of the five different growth rate indicators, as follows:
The average of each of the five growth analyses are in the range of 3.8% to 6.5% (Exhibit AEE-2, Sch. 4, page 4). The median of each of the five growth analyses are in the range of 3.5% to 6.8%

The evidence before the Commission includes a range of growth rates in addition to I&E's growth rate analysis, including evidentiary support of growth rates below the City's proposed growth rates. Ms. Everette's growth rate range of 3.5% to 6.8% was reasonably calculated and recommends a range of growth rates in which I&E's growth rate falls. OCA M.B. at 60-61; OCA R.B. at 34; OCA St. 1 at 20.

City witness Walker's application of the DCF model is flawed because he relies only on projected growth rates and does not consider historical growth rates. OCA R.B. at 34; OCA St. 1 at 24. Mr. Walker admitted that investors have access to information about historical growth rates that shows negative growth rates, yet he does not consider that in his DCF analysis. Moreover he misstates the published historical earnings growth rate, stating that it is 10.9% but provides no citation for this statement. OCA R.B. at 34; City St. 4 at 43. In fact, the average historical earnings growth rate for the proxy group is 4.7%. OCA R.B. at 34; OCA St. 1 at 24.

Thus, the City's characterization of ALJ Hoyer's adoption of I&E's growth rate as "overly narrow" is flawed and should be rejected.

d. The R.D.'s Tax Adjustment Is Proper.

The ALJ adopted I&E's tax factor adjustment of 18%. R.D. at 73. The OCA recommended a tax factor adjustment of 20%. OCA M.B. at 62. In its Exceptions, the City suggests that ALJ Hoyer adopted I&E's recommended tax adjustment due to a "severe misunderstanding" of the City's proposal. City Exc. at 26. The City does not acknowledge that a tax factor is appropriate despite the fact that the adjustment has been made in other municipal

(Exhibit AEE-2, Sch. 4, page 4). Given these results, I have found an appropriate growth rate range of 5.2% to 6.7%. OCA St. 1 at 20. OCA M.B. at 60-61. Based on the range of results in both historic and projected growth rates when added to her average adjusted dividend yield, Ms. Everette determined that a proper DCF cost of equity is in the range of 7.5% to 9.0%. Id., Exh. AEE-2, Sch. 4, p. 4 OCA M.B. at 60-61.

rate cases and was upheld by the courts. As discussed in the OCA's Main Brief, the PUC used a 20% tax factor in Lancaster 2010. Lancaster 2010, *122; OCA M.B. at 62.

City witness Walker recommended a 9% tax factor adjustment if an adjustment is made by the Commission. OCA St. 1 at 22. However, he calculated an average 13% tax rate by comparing the yields of similarly rated general obligation municipal bonds to investor-owned public utility bonds for a two year period (May 2014 to May 2016). *Id.* The resulting comparison resulted in effective tax rates ranging from -1% to +30%, with the average being 13%. *Id.*

Ms. Everette noted that the 9% tax factor recommended by City witness Walker has numerous flaws. OCA St. 1 at 22. Mr. Walker did not consider that there are multiple other reasons for differences in yields between general obligation bonds and similarly rated investor-owned public utility bonds. *Id.* She concluded that it is not reasonable to calculate the income tax effect by comparing the yields of the two types of bonds. *Id.*

Additionally, the City cites to Lancaster 2005 to support its contention that "only Mr. Walker fully complies with Commission precedent by taking all reasonable steps to measure spreads between comparable corporate and municipal bonds." City Exc. at 26. Lancaster 2005, however, states as follows: "We observe that the methodology of comparing the tax differential between corporate and municipal bonds is not an issue." Lancaster 2005, *153. In the Recommended Decision, ALJ Hoyer states as follows:

Mr. Walker deduces that the appropriate tax adjustment is 9.00%, the lowest of his averaged yield spreads, which is less than half of the amount utilized by I&E and the OCA.

R.D. at 73.

The OCA submits that a tax factor adjustment is appropriate for ratemaking purposes in this case just as it was in Lancaster 2010 and in cases before that (where a higher tax factor adjustment was used). The City's arguments to the contrary should be rejected and ALJ Hoyer's Recommended Decision should be adopted

III. CONCLUSION

For the reasons set forth above and in its Main Brief and Reply Brief, the Office of Consumer Advocate respectfully requests that the Pennsylvania Public Utility Commission deny the Exceptions of the City of DuBois.

Respectfully submitted,



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