



December 21, 2018

VIA E-FILE

Jonathan P. Nase

Direct Phone 717-773-4191
Direct Fax 215-372-2340
jnase@cozen.com

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
Harrisburg, PA 17120

**Re: Pennsylvania Public Utility Commission v. Hidden Valley Utility Services, L.P.
(Wastewater and Water); Docket Nos. R-2018-3001307 and R-2018-3001306**

Reply Brief of Hidden Valley Utility Services, L.P.

Dear Secretary Chiavetta:

Enclosed for filing with the Pennsylvania Public Utility Commission is the Reply Brief of Hidden Valley Utility Services, L.P., in the above-referenced proceeding. Copies of the brief are being served on the Presiding Officers, Deputy Chief Administrative Law Judge Mark A. Hoyer and Administrative Law Judge Katrina L. Dunderdale, and on all parties, as indicated on the enclosed Certificate of Service.

Thank you for your attention to this filing. Should you have any questions or concerns, please contact me.

Sincerely,

COZEN O'CONNOR

By: Jonathan P. Nase
Counsel for *Hidden Valley Utility Services, L.P.*

JPN
Enclosure

cc: Honorable Mark A. Hoyer (including MS Word version)
Honorable Katrina L. Dunderdale (including MS Word version)
Per Certificate of Service
James M. Kettler

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission, <i>et al.</i>	:	
	:	
v.	:	Docket Nos. R-2018-3001306,
	:	R-2018-3001307 <i>et al.</i>
Hidden Valley Utility Services, L.P.	:	

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing **Reply Brief of Hidden Valley Utility Services, L.P.**, upon the parties, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party).

VIA E-MAIL AND FIRST CLASS MAIL:

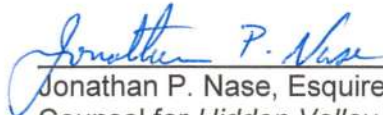
Allison Kaster, Esquire
Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor West
P.O. Box 3265
Harrisburg, PA 17105-3265
E-mail: akaster@pa.gov
Counsel for the *Bureau of Investigation and Enforcement*

Christine Maloni Hoover, Esquire
Lauren Castor, Esquire
Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101-1923
E-mail: CHoover@paoca.org
LCastor@paoca.org
Counsel for *Office of Consumer Advocate*

Robert Kollar
1374 Langport Drive
Pittsburgh, PA 15241
E-mail: bob@kkacpas.com

William H. Stewart, Esq.
Vuono & Gray, LLC
310 Grant Street
Suite 2310 Grant Building
Pittsburgh, PA 15219
E-mail: wstewart@vuonogray.com
Counsel for *Hidden Valley Foundation Inc.*

December 21, 2018



Jonathan P. Nase, Esquire
Counsel for *Hidden Valley Utility Services, L.P.*

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**DEPUTY CHIEF ADMINISTRATIVE LAW
JUDGE MARK A. HOYER
AND
ADMINISTRATIVE LAW JUDGE
KATRINA L. DUNDERDALE**

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2018-3001307
	:	
Hidden Valley Utility Services, L.P. –	:	
Wastewater	:	
And	:	
Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2018-3001306
	:	
Hidden Valley Utility Services, L.P. – Water	:	

**REPLY BRIEF OF
HIDDEN VALLEY UTILITY SERVICES, L.P.**

Jonathan P. Nase, Esquire (PA ID No. 44003)
Cozen O'Connor
17 North Second Street, Suite 1410
Harrisburg, PA 17101
Phone: (717) 773-4191
E-mail: jnase@cozen.com

Dated: December 21, 2018

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	BACKGROUND AND PROCEDURAL HISTORY.....	1
III.	LEGAL STANDARD.....	1
IV.	SUMMARY OF ARGUMENT	1
V.	QUALITY OF SERVICE.....	6
A.	The Rate Increase and the Non-Unanimous Settlement.....	8
B.	Factors and Standards for Determining Whether to Deny a Rate Increase, In Whole or In Part, Pursuant to Sections 523 and 526 of the Code.....	11
1.	Seriousness of the service deficiency and the consequences for ratepayers	11
2.	Past efforts to improve service.....	13
3.	Present efforts to improve service.....	17
4.	Consequences of the Commission’s Decision	19
5.	Ability of the Company to Pay the Costs of Providing Service	21
6.	Constitutional Rights of the Utility.....	22
7.	Need for Deterrence.....	24
8.	Consistency with Prior Commission decisions.....	25
9.	Other relevant factors.....	26
C.	On Balance, the Above Factors Support Approving the Settlement.....	26
D.	Conclusion of Law Ostensibly Concerning Quality of Service	27
VI.	INDEPENDENT AUDIT	27
VII.	NON-UNANIMOUS SETTLEMENT PETITION AND JOINT STIPULATION	28
A.	REVENUE REQUIREMENT.....	29
B.	RATE STRUCTURE	31
C.	ANNUAL REPORTS.....	31
VIII.	CONCLUSION.....	32

TABLE OF AUTHORITIES

	Page(s)
United States Constitution	
U.S. Const. amend. V.....	23
U.S. Const. amend. VIII.....	24
U.S. Const. amend. XIV § 1	24
 Federal Cases	
<i>Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia</i> , 262 U.S. 679 (1923).....	22, 23
<i>Federal Power Commission v. Hope Natural Gas Co.</i> , 320 U.S. 591 (1944).....	5, 23, 25
 Pennsylvania Constitution	
Pa. Const. Art. I, § 13.....	24
 State Cases	
<i>Bell Tel. Co. v. Driscoll</i> , 343 Pa. 109 (1941).....	28
<i>Metropolitan Edison Co. v. Pa. Pub. Util. Comm'n</i> , 437 A.2d 76 (Pa. Cmwlth. 1981).....	28
 Pennsylvania Public Utility Commission Cases	
<i>Application of Hidden Valley Utility Services, L.P.</i> , Docket Nos. A-210117 and A-230101 (Recommended Decision issued May 27, 2005, Final Order entered July 15, 2005).....	1, 5
<i>McCloskey v. Hidden Valley Utility Services, L.P.</i> , Docket Nos. C-2014-2447138 and C-2014-2447169 (Initial Decision issued September 9, 2016, Opinion and Order entered January 18, 2018, Order on Reconsideration entered May 3, 2018)	<i>passim</i>

<i>Pa. Pub. Util. Comm'n v. Clean Treatment Sewage Company</i> , Docket Nos. R-2009-2121928, <i>et al.</i> (Opinion an Order entered April 22, 2010)	6, 11, 17
<i>Pa. Pub. Util. Comm'n v. Deer Haven, LLC d/b/a Deer Haven Sewer Company</i> , 2011 Pa. PUC LEXIS 1864 (Opinion and Order entered May 19, 2011)	20, 21, 25
<i>Pa. Pub. Util. Comm'n, et al. v. Delaware Sewer Company</i> , Docket No. R-2014-2452705 (Opinion and Order entered July 30, 2015)	20, 21, 25
<i>Pa. Pub. Util. Comm'n, et al. v. Lake Latonka Water Company</i> , 1989 Pa. PUC LEXIS 231(Recommended Decision issued November 28, 1989, Final Order entered October 16, 1989).....	6, 20, 25
<i>Pa. Pub. Util. Comm'n v. Pennsylvania Gas and Water</i> , 1986 Pa. PUC LEXIS 104 (May 22, 1986)	6, 18, 25
<i>Pa. Pub. Util. Comm'n v. Pennsylvania Gas and Water Co.</i> , 1986 Pa. PUC LEXIS 113 (April 25, 1986)	5, 11, 18, 25
<i>Pa. Pub. Util. Comm'n v. Peoples TWP, LLC</i> , Docket No. R-2013-2355886 (Opinion and Order entered December 19, 2013)	30

State Statutes

66 Pa. C.S. § 523.....	<i>passim</i>
66 Pa. C.S. § 526.....	<i>passim</i>
66 Pa. C.S. § 1501.....	<i>passim</i>

State Regulations

52 Pa. Code § 41.14	16
52 Pa. Code § 69.1201	5, 7, 11
52 Pa. Code § 69.1201(c)(3)	16
52 Pa. Code § 69.1201(c)(4)	19
52 Pa. Code § 69.1201(c)(6)	13
52 Pa. Code § 69.1201(c)(8)	24
52 Pa. Code § 69.1201(c)(10).....	26

I. INTRODUCTION

Hidden Valley Utility Services, Inc. (“Hidden Valley” or the “Company”) files this Reply Brief to respond to the Main Briefs of the Office of Consumer Advocate (“OCA”) and the Hidden Valley Foundation, Inc. (“Foundation”).

II. BACKGROUND AND PROCEDURAL HISTORY

Hidden Valley fully addressed the background and procedural history of this case in pages 4-11 of its Main Brief.

III. LEGAL STANDARD

Hidden Valley fully addressed the applicable legal standard in pages 14-16 of its Main Brief.

IV. SUMMARY OF ARGUMENT

Hidden Valley received its certificate of public convenience to provide water and wastewater service in 2005. *Application of Hidden Valley Utility Services, L.P.*, Docket Nos. A-210117 and A-230101 (Final Order entered July 15, 2005) (“2005 Application Proceedings”). The 2005 Application Proceedings set rates at a level that would allow the Company the opportunity to collect \$182,500 in water revenues and \$392,000 in wastewater revenues for a total of \$575,000. *Application of Hidden Valley Utility Services, L.P.*, Docket Nos. A-210117 and A-230101 (Recommended Decision issued May 27, 2005), pp. 16-17. The Company did not request a rate increase for many years.

In 2017, the Company actually collected \$143,194 in water revenues, HVUS Statement No. 2 (Water), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 6, and \$290,724 in

wastewater revenues, HVUS Statement No. 2 (Wastewater), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 6, for a total of \$433,918. As a result, the Company is presently losing money. In 2017, the net operating income available for return for the water system was (\$51,736), HVUS Statement No. 2 (Water), Direct Testimony of Paul R. Herbert, Exhibit PRH-2, p. 6, and the net operating income available for return for the wastewater system was (\$105,045), HVUS Statement No. 2 (Wastewater), Direct Testimony of Paul R. Herbert, Exhibit PRH-2, p. 6, for a total (loss) of (\$156,781).

Finally, in April 2018, the Company filed for rate relief for both its water and wastewater systems. That request was initially opposed by the Bureau of Investigation and Enforcement (“I&E”), the OCA, the Foundation, Robert Kollar (“Mr. Kollar”), and several customers. In November 2018, Hidden Valley and I&E – the prosecutory arm of the Pennsylvania Public Utility Commission (“Commission” or “PUC”) – filed a Joint Petition for Approval of Non-Unanimous Settlement (“Settlement”). Table 1 compares the revenue requirement in the Company’s original request and in the Settlement.

Table 1. Increase in Revenue Requirement

	Increase in Revenue Requirement in Original Request	Increase in Revenue Requirement in Settlement	Increase in Revenue Requirement in the Settlement as a Percentage of the Increase in Revenue Requirement Originally Requested
Water	\$150,629	\$65,557	43.5%
Wastewater	\$185,432	Step 1 = \$82,227	44.3%
		Step 2 = -\$63,597	
		Step 1 + Step 2 = \$145,824	78.6%

Hidden Valley provides service to a resort community. As a result, many of its customers are part-time residents. The average water and wastewater residential customer is billed based on

a usage of 2,100 gallons per quarter. Table 2 compares the bills for the average residential customer in the Company’s original proposal and the Settlement.

Table 2. Bills for the Average Residential Customer

	Present Quarterly Rates	Quarterly Increase Based on Company’s Original Proposal	Quarterly Increase Based on Settlement	Quarterly Increase in Rates in the Settlement as a Percentage of the Increase in Rates Originally Proposed
Water	\$26.64	\$28.08	\$12.06	45.3%
Wastewater	\$59.76	\$36.66	Step 1 - \$15.82	43.2%
			Step 2 - \$12.83	
			Step 1 + Step 2 = \$28.65	78.2%

In short, if the Settlement is approved, it will result in the first rate hike for Hidden Valley customers since 2005: a total of \$4.02 per month for water service and \$9.55 per month for wastewater service.

In 2018, the Commission ruled that Hidden Valley is not providing reasonable and adequate water and wastewater service to its customers. *McCloskey v. Hidden Valley Utility Services, L.P.*, Docket Nos. C-2014-2447138 and C-2014-2447169 (“*McCloskey*”).¹ The Commission ordered the Company to complete an extensive plan for improvements, and established milestones for completing the plan. In addition, the Commission established enforcement mechanisms to address any failure to meet those milestones.

Thus, this case presents a classic “Catch-22” situation: a financially challenged company needs to make improvements to provide customers with better service, but needs money to do so.

¹ For ease of reference, the various decisions in *McCloskey* will be referenced as follows: the Initial Decision will be referenced as the “September 2016 I.D.,” the Commission’s Order on Exceptions will be referenced as the “January 2018 Order,” the Commission’s Order on the merits regarding Hidden Valley’s Petition for Clarification, Reconsideration or Amendment will be referenced as the “May 2018 Order,” and the January 2018 Order and the May 2018 Order will be referenced collectively as the “*McCloskey* Decisions.”

In its Main Brief, the Company argued that the Settlement should be approved because it provides a reasonable approach to resolving this Catch-22. It argued that the Settlement appropriately balances the interest of the utility and its ratepayers.

The OCA and the Foundation, in contrast, continue to ask the Commission to deny the Company's request for rate relief *in its entirety*. The Main Briefs of the OCA and the Foundation² are more noteworthy for what they do not say than for what they do. They never discuss the present Catch-22 situation, and they fail to propose a practical path forward for addressing that situation. Nor do they address the inconsistency, noted by the ALJ in the Initial Decision in *McCloskey*, September 2016 I.D., p. 31, of pressing the Company to make improvements while simultaneously fighting to deny it the financial wherewithal to do so.

The OCA and the Foundation barely mention the Settlement. Consequently, their Main Briefs include little explanation of why the Commission should impose the “death penalty” of completely denying any rate increase as opposed to the “lesser sentence” of partly denying rate relief – as proposed in the Settlement.

The OCA and the Foundation offer a simplistic analysis: The Commission found the Company in violation of Section 1501; therefore, the “regulatory bargain” between the utility and the ratepayer means that the Commission should not permit the Company to raise rates *at all* until the Company is fully in compliance with Section 1501. Foundation's Main Brief, p. 5; OCA's Main Brief pp. 24-25. As argued in Hidden Valley's Main Brief, this simplistic analysis fails to properly balance the interests of the utility and its ratepayers. Moreover, this simplistic analysis fails to capture the myriad of factors that the Commission has considered in past cases.

² It should be noted that Main Briefs were due to be filed and served in-hand by 4:00 on December 11, 2018. Further Prehearing Order dated July 31, 2018 p. 3 n.1 The Foundation's brief was not served until 10:45 p.m. on December 11, 2018, and was not filed with the Secretary's Bureau until December 12, 2018.

Hidden Valley respectfully submits that, when considering a claim that a utility's rate increase should be reduced, in part or in whole, pursuant to Sections 523 and 526 of the Pennsylvania Public Utility Code ("Code"), 66 Pa. C.S. §§ 523 and 526, the Commission should balance a variety of factors, just as it balances a variety of factors when deciding the amount (if any) of a civil penalty for violating the Code, a Commission regulation or order. 52 Pa. Code § 69.1201 ("Factors and standards for evaluating litigated and settled proceedings involving violations of the Public Utility Code and Commission regulations—statement of policy").

As the Commission stated in *Pa. Pub. Util. Comm'n v. Pennsylvania Gas and Water Co.*, 1986 Pa. PUC LEXIS 113 (April 25, 1986), * 38 ("*PG&W I*"):

... we must not lose sight of the cardinal principle enunciated in [*Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)], which requires the Commission to balance the interests of the investors and the consumers. In this regard, we note that the ultimate goal of our actions here is to protect the public interest and to ensure that adequate service is provided to the customers of PG&W.

To achieve these objectives of balancing the interests of the utility and ratepayers, protecting the public interest, and ensuring adequate service, the Commission has considered – and should continue to consider – the following factors: the seriousness of the service deficiency and its consequences for ratepayers; the utility's past efforts to improve service; the utility's present efforts to improve service; the consequences of the Commission's decision; the utility's ability to pay the costs of providing service; the constitutional rights of the utility; the need for deterrence; consistency with prior Commission decisions; and, other relevant factors. Balancing all of these factors in the instant case, Hidden Valley respectfully submits that the Administrative Law Judges ("ALJs") should recommend approval of, and the Commission should approve, the Settlement, which proposes a partial (rather than a total) denial of the Company's rate request.

V. QUALITY OF SERVICE

Section 523(a) of the Code provides:

§ 523. Performance factor consideration.

(a) Considerations.—The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.

Section 526(a) of the Code provides:

§ 526. Rejection of rate increase requests due to inadequate quality or quantity of service.

(a) General rule.--The commission may reject, in whole or in part, a public utility's request to increase its rates where the commission concludes, after hearing, that the service rendered by the public utility is inadequate in that it fails to meet quantity or quality for the type of service provided.

These sections give the Commission authority to deny a rate increase, in whole or in part, based on the quality of the utility's service. The Commission's authority, however, is discretionary, rather than mandatory. *Pa. Pub. Util. Comm'n v. Clean Treatment Sewage Company*, Docket Nos. R-2009-2121928, *et al.* (Opinion and Order entered April 22, 2010) ("*Clean Treatment*") p. 18; *Pa. Pub. Util. Comm'n, et al. v. Lake Latonka Water Company*, 1989 Pa. PUC LEXIS 231 p. *5 (Recommended Decision issued November 28, 1989; Final Order entered October 16, 1989) ("*Lake Latonka*"). As a result, the questions before the ALJs in this case include: How does the Commission exercise its discretion when deciding a case pursuant to

§§ 523 and 526 of the Code? What factors and criteria does the Commission use? And how do those factors and criteria apply to the instant case?

Relying primarily on *Pa. Pub. Util. Comm'n v. Pennsylvania Gas and Water*, 1986 Pa. PUC LEXIS 104 (May 22, 1986) (“*PG&W I*”), the OCA argues that the Commission should not allow a utility to raise rates *at all* until after the utility has addressed the issues that led the Commission to find a violation of Section 1501 in the first instance. OCA Main Brief p. 18. Hidden Valley respectfully submits that the Commission has used a much more complex analysis. This is demonstrated by the cases discussed in Hidden Valley’s Main Brief, pp. 22-44, which include numerous cases decided after *PG&W II*.

Just as the Commission balances a multitude of factors when deciding how much (if any) of a civil penalty to impose for a violation of the Code, a Commission regulation or order, 52 Pa. Code § 69.1201 (“Factors and standards for evaluating litigated and settled proceedings involving violations of the Public Utility Code and Commission regulations—statement of policy”), in prior cases, the Commission has balanced a number of factors when exercising its discretion to deny a rate increase, in whole or in part, pursuant to 66 Pa. C.S. §§ 523 and 526.

In this section, Hidden Valley briefly summarizes the Settlement, because the OCA’s Main Brief contains several factual errors that need to be corrected before discussing whether the Company’s rate request should be reduced further. Hidden Valley then discusses the factors that the Commission has used in past cases, and applies them to the facts of this case. That analysis indicates that, on balance, the factors and criteria that the Commission has considered in previous cases pursuant to Sections 523 and 526 do not warrant a further reduction in Hidden Valley’s rate request. Finally, Hidden Valley concludes this section by responding to a proposed Conclusion of Law that ostensibly relates to quality of service concerns.

A. The Rate Increase and the Non-Unanimous Settlement

In its April 2018 rate filings, the Company clearly indicated that the average residential customer's bills are based on a usage of 2,100 gallons per quarter. HVUS Statement No. 2 (Water), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 14; HVUS Statement No. 2 (Wastewater), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 14. The quarterly bill for an average residential customer under present rates is therefore \$26.64 for water service and \$59.76 for wastewater service. The Company's original proposal was to increase rates to these customers by \$28.08 per quarter for water service and \$36.66 per quarter for wastewater service. HVUS Statement No. 2 (Water), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 14; HVUS Statement No. 2 (Wastewater), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 14.

On page 12 of its Main Brief, the OCA discusses the rates charged to customers who use 9,000 gallons per quarter. The OCA claims that these rates are for "average water" and "average wastewater" customers. This assertion is incorrect; these customers use more than four times the amount of water that the average Hidden Valley customer uses each quarter. Consequently, their rates are much higher. The Commission's analysis should be guided by the average customer's usage and bills.

As shown in Table 2, the Settlement represents a significant reduction in the Company's rate request for both water and wastewater service. Although the Settlement is a "black box" settlement, it is significant to note that the amount of the water rate increase is virtually identical to I&E's primary litigation position. I&E Statement No. 1-SR (Water), Surrebuttal Testimony of John Zalesky p. 2. As I&E witness Kubas explained, I&E's primary litigation position was to "allow the Company to recover operating expenses and plant claimed in the base rate filing (subject to [certain ratemaking adjustments]) but will not allow the Company to earn a profit" because the

Commission found in *McCloskey* that the Company is not providing adequate and reasonable water service. I&E Statement No. 3 (Water), Direct Testimony of Joseph Kubas, p. 5.

On page 50 of its Main Brief, the OCA contends that the Settlement actually provides for a rate of return on the water system. This is incorrect. I&E witness Zalesky updated his testimony on surrebuttal, indicating that I&E's primary litigation position had changed from his direct testimony. I&E's (modified) primary litigation position was that the Company should receive a rate increase of \$65,544. I&E Statement No. 1-SR (Water), Surrebuttal Testimony of John Zalesky, p. 2. The Settlement provides for a rate increase of \$65,557 for the water system. Settlement ¶ A.(1)(a).

With respect to the Company's wastewater system, the amount of the initial step increase is virtually identical to I&E's primary litigation position. I&E Statement No. 1-SR (Wastewater), Surrebuttal Testimony of John Zalesky p. 2. As I&E witness Kubas explained, I&E's primary litigation position was to "allow the Company to recover operating expenses and plant claimed in the base rate filing (subject to [certain ratemaking adjustments]) but will not allow the Company to earn a profit" because the Commission found in *McCloskey* that the Company is not providing adequate and reasonable wastewater service. I&E Statement No. 3 (Wastewater), Direct Testimony of Joseph Kubas p. 5.

On pages 49-50 of its Main Brief, the OCA contends that the Settlement provides for a rate of return for Hidden Valley's wastewater system in both the first step and the second step of the rate increase. This is untrue. In his surrebuttal testimony, I&E witness Zalesky stated that, upon further review, I&E had revised its litigation position. I&E's (modified) primary litigation position was that the Company should receive a rate increase of \$82,236. I&E Statement No. 1-SR

(Wastewater), Surrebuttal Testimony of John Zalesky, p. 2. The amount of the initial step of the wastewater increase in the Settlement is \$82,227. Settlement ¶ A.(1)(b).

The amount of the second step of the wastewater increase is very close to I&E's secondary litigation position. I&E's secondary litigation position, unlike its primary litigation position, allows the Company to obtain a return on equity. These rates are just and reasonable because Hidden Valley will not receive the second step of the wastewater rate increase until it demonstrates that its wastewater system is in compliance with the requirements of the *McCloskey* Decisions. Once Hidden Valley's wastewater system is in compliance with the *McCloskey* Decisions, Sections 523 and 526 of the Code provide no basis for denying the Company a return on equity. I&E's secondary litigation position was that the Company should be permitted to increase rates by \$145,807. I&E Statement No. 1-SR (Wastewater), Surrebuttal Testimony of John Zalesky p. 4. Under the Settlement, the first and second steps of the wastewater rate increase would result in a total increase of \$145,824. Settlement ¶ A(2).

Finally, considering that the second step of the increase in wastewater rates will occur when the wastewater system complies with the requirements of the *McCloskey* Decisions, it is worth noting that the OCA incorrectly states the deadline for Hidden Valley's wastewater system to do so. Ordering Paragraph 11 of the May 2018 Order requires Hidden Valley to comply with all recommendations from the engineer's report regarding the wastewater system by January 31, 2019. The OCA's Main Brief states that the deadline is April 30, 2019. OCA Main Brief p. 46. The difference is significant because the January 31, 2019 deadline will probably precede the entry of the Commission's final order in this case, whereas the April 30, 2019 date will probably follow the entry of the Commission's final order in this case. As argued in Hidden Valley's Main Brief, p. 25, Hidden Valley should not be denied a wastewater rate increase in this proceeding based on

quality of service, and then be permitted to file a new case seeking a wastewater rate increase in February 2019, after it has established compliance with all of the mandates of *McCloskey* for its wastewater system.

B. Factors and Standards for Determining Whether to Deny a Rate Increase, In Whole or In Part, Pursuant to Sections 523 and 526 of the Code

In its Main Brief, pp. 22-44, Hidden Valley argued that the revenue requirement agreed-to by the Company and I&E should not be reduced further, based on the quality of service. In the paragraphs that follow, Hidden Valley restates this discussion in a form similar to the approach the Commission uses when applying the Statement of Policy at 52 Pa. Code § 69.1201. In the process, Hidden Valley responds to the arguments in the Main Briefs of the OCA and the Foundation.

1. Seriousness of the service deficiency and the consequences for ratepayers

In deciding whether to deny rate relief, in whole or in part, the Commission has considered the seriousness of the service deficiency and its consequences for ratepayers. The Commission has made clear that a denial of rate relief, in whole or in part, is only warranted where the Commission finds *serious deficiencies* in the utility's service. For example, the Commission stated in *PG&W I* at *30, "Finally, we believe this Commission has the necessary authority, pursuant to its statutory authority to determine the justness and reasonableness of proposed rates, to refuse to consider a rate increase by a utility which has *seriously failed* to provide adequate service."

The Commission has also considered the consequences for customers of the deficient service. For example, *PG&W I* denied a rate increase, in whole, for a water system that had experienced a giardiasis outbreak. *PG&W I* at *8. *Clean Treatment* denied a rate increase, in whole, for a wastewater system that had experienced repeated sewage overflows and was subject

to a moratorium, such that some customers were being charged an availability fee when service was not, in fact, available. *Clean Treatment*, p. 2.

A denial of rate relief – particularly the “death penalty” of a complete denial of any rate relief – is an extreme remedy that should only be utilized in extreme cases. As Hidden Valley argued in its Main Brief, pp. 30-33, this factor supports approval of the Settlement, rather than a further reduction in the Company’s rate relief. The Settlement reduces the rate request for the water system by more than one-half. The Settlement also reduces the rate request for the wastewater system by more than one-half, until such time as the Company demonstrates that it has made the improvements mandated by the *McCloskey* Decisions. When the Company complies with those decisions, there is no basis for any reduction in rate relief, based on Sections 523 and 526 of the Code.

There is certainly no basis in the record for further reducing Hidden Valley’s wastewater rate relief below what was agreed-to in the Settlement, based on this factor. In *McCloskey*, the Commission found Hidden Valley was not providing reasonable and adequate wastewater service, but the deficiencies identified in that case do not rise to the level that would warrant a further reduction in the Company’s rate relief. Additionally, as noted in Hidden Valley’s Main Brief, there is extensive evidence in the record demonstrating that the wastewater system has been improved since the record closed in the *McCloskey* case. Hidden Valley’s Main Brief, pp. 30-33.

The OCA’s Main Brief, p. 41, states “The Company continues to improperly operate and equip its wastewater treatment and pumping facilities” but provides no citation to evidence in the record to support that statement. The OCA’s Main Brief refers to the engineer’s report that the company received in April 2018 regarding its wastewater system, but the OCA is well aware that this evidence is not the most recent evidence in the record regarding the condition of the

wastewater system. Glenn Fodor's rebuttal testimony was submitted on October 18, 2018 – some six months after the date of the engineer's report – and Mr. Fodor stated that two working pumps are currently installed in all stations and all high level alarms are currently in operating condition. HVUS Statement No. 4-R (Wastewater), Rebuttal Testimony of Glenn Fodor, p. 2. Additionally, Mr. Kettler testified at the hearing that many of the projects listed on the engineer's report had been completed by the date of the hearing. Tr. 237. Other projects are in progress, but had not been completed as of the date of the hearing. Tr. 237.

Additionally, as noted in Hidden Valley's Main Brief, pp. 31-32, the customer testimony at the public input hearings and the customer complaints reviewed by Mr. Fought barely mentioned the wastewater system. This evidence indicates that the wastewater system's service deficiencies have not had such a serious impact on ratepayers as to warrant a further reduction in rate relief. At least with respect to the wastewater system, therefore, the evidence of record demonstrates that this factor weighs in favor of approval of the Settlement.

2. Past efforts to improve service

In their Main Briefs, the OCA and the Foundation rely heavily on this factor. The Company agrees that its history of attempting to improve service is a relevant factor. This factor is similar to the consideration of a company's compliance history when considering whether to impose a civil penalty. 52 Pa. Code § 69.1201(c)(6).³ The Company, however, disagrees that this factor supports a further reduction in Hidden Valley's rate relief. The OCA and the Foundation mischaracterize certain facts to portray the Company as a repeat offender that must be severely

³ The Commission can take judicial notice of its own records. According to the Commission's website, the OCA's Petition for the Issuance of an Emergency Order, Docket No. P-2014-2424858, and the two complaint cases in *McCloskey*, are the only proceedings ever filed at the Commission against the Company since it received its certificate of public convenience in 2005.

punished. The record is much more complex. As a result, the Company submits that this factor weighs in favor of approving the Settlement, which provides for a partial reduction in rate relief.

The Company received its certificates of public convenience to operate a water system and a wastewater system in 2005. 2005 Application Proceeding. The Foundation's Main Brief claims that the Commission found the Company was providing unreasonable and inadequate service in violation of Section 1501 at that time. Foundation's Main Brief, pp. 1, 4 and 9. Similarly, the OCA's Main Brief claims that the Company has provided inadequate water and wastewater service since at least 2004. OCA's Main Brief, p. 18.

These allegations are unsupported by the record. The 2005 Application Proceeding recognized the need for improvements in the water system, but the Commission did not find the Company in violation of Section 1501 with respect to either the water or the wastewater system. In fact, the Commission never found the Company in violation of Section 1501 until the *McCloskey* Decisions.

In the 2005 Application Proceedings, the Commission approved a settlement agreement that, *inter alia*: resolved allegations that the company had been operating without certificates of public convenience; required the Company to undertake certain modifications and improvements to its water system; required the Company to conduct certain activities to improve water pressure and water quality; and established rates. 2005 Application Proceeding, Recommended Decision pp. 4-11. It is worth noting that the Settlement was a compromise of contested issues; the Company did not admit that it was providing service in violation of the Code prior to 2005, and the Commission made no finding that the Company had been operating illegally prior to 2005.

The Foundation's Main Brief, at pages 5, 6 and 10, claims that the Company ignored its obligations in the settlement agreement from the 2005 Application Proceeding and has taken no

steps to improve its water system. Again, the record does not support this allegation. To the contrary, the Findings of Fact from the September 2016 I.D. include the following:

14. HVUS has complied with some, but not all of the conditions of the 2005 settlement. Exhibit JMK-6.

15. Since 2005, the Company has made capital investments and improvements to maintain and improve its service. Exhibit JMK-5.

16. Respondent has undertaken various capital projects from 2009 to 2014, including the installation or replacement of pumps, valves, motors and water lines, in order to improve service. Exhibit JMK-5.

17. The costs associated with the capital projects undertaken by HVUS exceed \$100,000. Exhibits JMK-3, JMK-4 and JMK-5.

...

51. Subsequent to the 2005 Settlement, customers have experienced improvements in the quality of service provided by HVUS. Tr. 57, 1777, 190, 192, 203.

September 2016 I.D. pp. 8-12.⁴ In its January 2018 Order, the Commission specifically noted that the Administrative Law Judge's Initial Decision emphasized the Company's willingness to address the issues raised by the parties and to improve service to its customers. January 2018 Order p. 18, n.5. *See, e.g.*, September 2016 I.D. at 28 (noting that the Company had retained experts to address the water quality and billing issues and agreed to address the issues raised by the OCA in that proceeding).

As stated in Hidden Valley's Main Brief, pp. 9-10, the status reports filed in the *McCloskey* case demonstrate that the Company has continued to make improvements in the water and

⁴ At the hearing in the instant proceeding, Mr. Kettler testified that during the period immediately following the conclusion of the 2005 Application Proceeding, Hidden Valley invested \$300,000-\$400,000 in improvements to its water and wastewater system. Tr. 260-261.

wastewater systems since the close of the record in the *McCloskey* case. Some of these improvements were made even before the Commission entered its January 2018 Order. For example, Ordering Paragraph 5a. required the Company to replace 1,500 feet of 3-inch line to the Heights, which was completed in June 2016, and 1,000 feet of 2-inch line to Valley View, which was completed in November, 2016. Status Report filed September 17, 2018 in *McCloskey*.

The record in both the *McCloskey* case and this case demonstrates that the Company has continually made improvements in its system. Unfortunately, as the ALJ stated in *McCloskey*, “The design parameters of the system did not take into consideration the part-time usage of the community and the reduction of metered flows in the commercial meters over an extended period of time, which exist at Hidden Valley.” Finding of Fact 24. Over the years, the Company has tried several different techniques of overcoming this design flaw, including sequestration, flushing the mains, installing automatic operating blow-off valves, OCA Statement 3 (Water), Direct Testimony of Terry L. Fought, pp. 3-4, and the construction of loops to eliminate dead ends in the system. HVUS Statement No. 1-R (Water), Rebuttal Testimony of James M. Kettler, p. 17. These efforts clearly refute any argument that the Company’s service deficiencies were intentional (to use the terms of 52 Pa. Code § 69.1201(c)(3)) or that the Company lacks a propensity to operate safely and legally (to use the terms of 52 Pa. Code § 41.14).

As a result of the design flaw, addressing the issues with iron and manganese in the water will require the construction of a treatment plant or the construction of a pipeline to an alternative source of water. Either of those options will cost a substantial amount of money. HVUS Statement No. 1-R (Water), Rebuttal Testimony of James M. Kettler, HVUS Exhibit JMK-2 pp. 1-6. Unfortunately, the Company did not experience growth in its residential customer base, nor did the Company request a rate increase until this case. September 2016 I.D. p. 28. It is significant to

note, in this regard, that the 2005 Application Proceeding provided an opportunity for the Company to collect “annual revenues not in excess of \$182,500 for water operations and \$392,000 for wastewater operations, or \$575,000 in total annual revenues.” 2005 Application Proceeding, Recommended Decision, pp. 16-17. In 2017, the Company actually collected \$143,194 in water revenues, HVUS Statement No. 2 (Water), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 6, and \$290,724 in wastewater revenues, HVUS Statement No. 2 (Wastewater), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 6, for a total of \$433,918.

The Foundation suggests that the Company could have done more to improve the water and wastewater system, but for the distributions that the Company made to its owners over the years. There is no evidence, however, that the distributions to Mr. Kettler prevented the Company from making improvements. To the contrary, as Mr. Kubas stated at the hearing, paying Mr. Kettler and investing in capital improvements is not an either-or choice. Tr. 296-297. Hidden Valley made distributions to Mr. Kettler totaling \$857,849 during the period 2005-2017, HVUS Statement No. 1 (Water), Direct Testimony of James M. Kettler, p. 13. During that same period, as discussed above, the Company spent hundreds of thousands of dollars on capital improvements to improve service.

Hidden Valley submits that the mixed record on this factor supports approval of the Settlement, which proposes a reduction in the Company’s rate relief, rather than a complete denial of rate relief. As a result, the Administrative Law Judges should recommend approval of, and the Commission should approve, the Settlement.

3. Present efforts to improve service

In *Clean Treatment, supra*, the Commission denied a utility’s rate request, in its entirety, but allowed the Company to re-file for a rate increase, so long as the subsequent filing included a plan for bringing the system into compliance with the Code. The Commission stated: “We fully

realize that improvements to the Company's service and facilities will require a rate increase, but we have seen nothing in this filing that indicates that any improvements will be forthcoming." *Clean Treatment* p. 20. In the instant case, in contrast, the Company has a plan for improvements, which the Commission will enforce, and the Company is making a good faith effort to implement that plan. Hidden Valley's Main Brief, pp. 23-25.

The Main Briefs of the OCA and the Foundation primarily argue that present efforts do not matter.⁵ According to the OCA and the Foundation, only results matter, and the Company's efforts to improve the system have not yet fully rectified the deficiencies identified in *McCloskey*. See OCA Main Brief 21 and 24. They rely on language in *PG&W II*, pp. *13-14, to the effect that a utility must show actual results of service improvements, as opposed to plans for the future, in order to obtain rate relief.

That argument, however, overlooks the subsequent decision in *Clean Treatment*. It also overlooks several key facts that distinguish the instant case from *PG&W I and II*. *PG&W II* involved requests for reconsideration and clarification of the Commission's decision in *PG&W I*. Chairman Taliaferro explained that one reason for her vote to deny the company rate relief in *PG&W I* was that "the company is still earning in excess of \$10,000,000 in income available for a return on a ratemaking basis." *PG&W II*, 1986 Pa. PUC LEXIS 104 p. *23. In contrast, the Commission noted in *McCloskey* that Hidden Valley is financially challenged, in part, due to the

⁵ Nevertheless, the OCA contends that Hidden Valley will not comply with the *McCloskey* Decisions' mandate to test or replace customer water meters by April 30, 2019. OCA Main Brief p. 35. This allegation is based on the OCA's schedule for replacing/testing meters, not the Commission's or the Company's. The OCA posits that, if the Company tests/replaces the same number of meters every working day, the Company would need to test/replace three meters every day to comply with the Commission's Orders. OCA Statement 3 (Water), Direct Testimony of Terry L. Fought, p. 6. Based on that calculation, the OCA contends that the Company is behind schedule in its testing/replacing of water meters. There is nothing in the Commission's Orders, however, that requires the Company to test/replace the same number of meters every day. As a result, the Company has the managerial discretion to determine its own schedule. Moreover, at the hearing, Mr. Kettler noted that the winter is a better time to gain access to homes to perform the work, because Hidden Valley is a resort community. Tr. 240. As a result, the OCA's assertion that the Company will not timely complete the testing/replacing of water meters is unsupported.

fact that the Company had never raised rates since it received its certificate of public convenience in 2005. The Commission found the Company in violation of Section 1501 and ordered the Company to implement an improvement plan. It would offend basic notions of fairness for the Commission to order a financially challenged company to implement an extensive and costly improvement plan and then deny it the financial wherewithal to comply with that Order.

In some respects, this factor is similar to the factor in the Statement of Policy at 52 Pa. Code § 69.1201(c)(4), which provides that the Commission will consider:

(4) Whether the regulated entity made efforts to modify internal practices and procedures to address the conduct at issue and prevent similar conduct in the future. These modifications may include activities such as training and improving company techniques and supervision. The amount of time it took the utility to correct the conduct once it was discovered and the involvement of top-level management in correcting the conduct may be considered.

As argued in Hidden Valley's Main Brief, p. 25, the Company has modified its internal practices and procedures such that it is making a good faith effort to comply with *McCloskey* and improve service to customers. Consequently, this factor weighs in favor of approving the Settlement rather than further reducing the amount of the Company's rate relief.

4. Consequences of the Commission's Decision

The Main Briefs of the OCA and the Foundation focus exclusively on the past, retracing the history of the Company over the years. They take a punitive approach, arguing that the Company should be held "responsible" for its past conduct. Foundation's Main Brief, p. 2. The result is a combination of inconsistent positions. The OCA and the Foundation argue for a Conclusion of Law that the Company lacks financial fitness, while, at the same time, arguing that the Company should be denied a rate increase that would improve its financial fitness. OCA's Main Brief, Proposed Conclusion of Law 8; Foundation's Main Brief, Proposed Conclusion of Law #12.

The OCA and the Foundation never explain the obvious inconsistency in arguing for extensive improvements in service while simultaneously arguing that the Company should be denied the financial resources necessary to make those improvements. More importantly, the Main Briefs of the OCA and the Foundation fail to address the “what if” question: What happens if the Commission agrees with their position and denies the Company any rate relief whatsoever?

The Commission does not have the luxury of avoiding this question. In fact, the Commission has considered this question in such cases as *Pa. Pub. Util. Comm’n, et al. v. Delaware Sewer Company*, Docket No. R-2014-2452705 (Opinion and Order entered July 30, 2015) (“*Delaware Sewer*”); *Pa. Pub. Util. Comm’n v. Deer Haven, LLC d/b/a Deer Haven Sewer Company*, 2011 Pa. PUC LEXIS 1864 (Opinion and Order entered May 19, 2011) (“*Deer Haven*”); and *Lake Lotanka, supra*.

In its Main Brief, Hidden Valley argued that if the Commission denies the Company any rate relief, the Company will be destroyed and will be unable to improve service, as ordered in the *McCloskey* Decisions. Those results would adversely impact ratepayers⁶ and would not be in the public interest. Hidden Valley Main Brief, pp. 33-35. In contrast, if the Commission would approve the modest rate relief proposed in the Settlement, the Commission would enable the Company to pay its costs and comply with the *McCloskey* Decisions. Hidden Valley Main Brief, pp. 26-30 and 36-38. The combination of modest rate relief and an improvement plan appropriately balances the interests of the utility and ratepayers, and makes the Settlement a reasonable approach to resolving the instant Catch-22.

The Commission should not hide in an ivory tower, discussing the theory of “regulatory bargain” while ignoring the real-world consequences of its decision. Instead, it should approve

⁶ As noted on page 20 of Hidden Valley’s Main Brief, the interest of the Company and the ratepayers are aligned in this respect.

the Settlement, which proposes a reasonable approach to resolving the instant Catch-22 of a financially-challenged company that is trying to improve service, but needs money to accomplish that objective. This factor clearly supports approval of the Settlement, rather than a further reduction in the Company's rate relief.

5. Ability of the Company to Pay the Costs of Providing Service

In past cases, the Commission has recognized that a utility must provide service to customers, and must incur expenses to provide that service. It has therefore allowed utilities to increase rates to cover costs, even though the utility may be providing unreasonable and inadequate service. *Delaware Sewer Company, supra; Deer Haven, supra.*

The parties agree that the Company is not presently covering the costs of providing service to customers. Even the OCA's witnesses testified that the Company's net operating income is presently negative. According to the OCA's witnesses, net operating income for the wastewater system for 2017 was (\$47,098), OCA Statement 1S (Wastewater), Surrebuttal Testimony of Stacy L. Sherwood, Surrebuttal Schedule SLS-1, and net operating income for the water system for 2017 was (\$51,090). OCA Statement 1S (Water), Surrebuttal Testimony of Stacy L. Sherwood, Surrebuttal Schedule SLS-1. Under these circumstances, a complete denial of the Company's rate relief, would not allow the Company to cover the costs of providing service to customers.

As noted above, the Settlement provides for an increase in water rates that is virtually identical to I&E's primary litigation position, which was that the Company should be permitted to increase rates to cover costs, but not pay a return on equity. The Settlement also provides for an increase in wastewater rates in step 1 that is virtually identical to I&E's primary litigation position, which was that the Company should be permitted to increase rates to cover costs, but not pay a return on equity. Finally, the Settlement provides for an increase in wastewater rates in step 2 when the Company has demonstrated that its wastewater system is in compliance with the

mandates of the *McCloskey* Decisions. At that time, Sections 523 and 526 of the Code would not support a reduction in rate relief for wastewater service.

Hidden Valley respectfully submits that this factor strongly weighs in favor of approving the Settlement.

6. Constitutional Rights of the Utility

In its Main Brief, Hidden Valley argued that, if the Commission would deny *any* rate relief, the resulting rates would be so low as to violate the Company's constitutional rights. The Company has not raised rates in 13 years. As a result, the Company is losing money. In addition, the Commission has ordered the Company to implement an extensive and costly improvement plan. Denying the Company *any* rate relief, under these circumstances, would destroy the Company. Rates that are so low as to destroy the Company, by definition, are unconstitutional. Hidden Valley Main Brief, pp. 41-44.

In its Main Brief, the OCA discusses the theory of the regulatory bargain, but does not address the specific facts of this case. The OCA cites cases linking rates and quality of service, and concludes that "until the quality of service improve[s], it would be permissible for the effective rates to provide a return that might be considered confiscatory." OCA's Main Brief p. 22. The OCA, however, avoids any discussion of the numbers, and so never addresses the extent of the losses that would be incurred by the Company if it is denied any rate relief whatsoever.

In the seminal case of *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) ("*Bluefield*"), the United States Supreme Court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments

in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

Bluefield, 262 U.S. at 692-93.

In *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), the United States Supreme Court stated:

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

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

This is not a case in which investors are seeking an excessive rate of return. Rather, the Settlement simply proposes that the Company be able to recover its costs upon the entry of the Commission's Order. It is only after the Company's wastewater system complies with the mandates of *McCloskey* that the Company will receive a return on equity. If, in contrast, the Commission grants the relief requested by the OCA and the Foundation, investors will continue to *lose* money because the Company is not currently covering costs. As discussed above, in 2017, the Company lost \$156,781. Losses for 2018 will be even greater because of the costs of complying with the improvement plan mandated by the Commission in *McCloskey*. Consequently, a Commission decision to impose the "death penalty" of a complete denial of rate relief would violate the Fifth Amendment's prohibition against confiscation, U.S. Const. amend. V, the

Fourteenth Amendment's guarantee of due process, U.S. Const. amend. XIV, and the Excessive Fines clauses of the Pennsylvania and United States Constitutions.⁷

On the specific facts of this case, a complete denial of rate relief would produce a result that is constitutionally unacceptable. Consequently, this factor weighs in favor of approving the Settlement, rather than further reducing the Company's rate relief.

7. Need for Deterrence

As stated above, the OCA's Main Brief and the Foundation's Main Brief suggest that Hidden Valley is a repeat offender that should be severely punished. The Foundation, in particular, discusses the need to hold the Company "responsible." Foundation's Main Brief p. 2 The OCA argues that a reduction or denial of rate relief is not a sanction, but rather a "regulatory response that is grounded in the Public Utility Code and precedent based upon the utility's obligation to provide safe, adequate and reliable service in exchange for the collection of Commission-made rates." OCA's Main Brief p. 34.

Hidden Valley submits that, in deciding whether to deny rate relief, in whole or in part, pursuant to Sections 523 and 526 of the Code, the Commission should not be punitive. Rather, the Commission should consider the need to deter future bad conduct, much as the Commission considers the need for deterrence when considering whether to impose a civil penalty. 52 Pa. Code § 69.1201(c)(8).

In *McCloskey*, the Commission considered whether the need for deterrence weighed in favor of imposing a civil penalty on Hidden Valley. The Commission answered that question in the negative, in part, because the *McCloskey* Decisions included other enforcement mechanisms

⁷ The Excessive Fines Clauses, Article I, Section 13 of the Pennsylvania Constitution and the Eighth Amendment to the United States Constitution, U.S. Const. amend. VIII, prohibit penalties that are not reasonably proportionate to the violations.

(including the possible institution of a Section 529 proceeding). January 2018 Order, pp. 55-56. There is no evidence that suggests the need for deterrence has increased since that time. To the contrary, the evidence indicates that the Company has modified its internal practices and procedures such that it is making a good faith effort to comply with the Code, the Commission's orders and regulations. Consequently, Hidden Valley submits that this factor weighs in favor of approving the Settlement, rather than further reducing the Company's rate request.

8. Consistency with Prior Commission decisions

All parties to this proceeding agree that the Commission should consider past decisions in similar cases when deciding whether to reduce, in whole or in part, a utility's request for rate relief pursuant to Sections 523 and 526 of the Code. I&E, the Company, the OCA, and the Foundation all cite numerous decisions supporting their particular positions. They disagree, however, on the cases that are most similar.

As discussed above, this case is distinguishable from *PG&WI* and *II* because the Company is presently losing money and lacks the financial wherewithal to make the required improvements in service. This case is much more similar to cases such as *Delaware Sewer Company, supra*, and *Deer Haven, supra*, in that the Settlement provides for an increase in water rates, and an initial increase in wastewater rates, sufficient to allow the Company to cover the costs of providing service. This case is also similar to *Clean Treatment*, in that the Company has an improvement plan. This case is also similar to *Lake Latonka, supra*, in that the Settlement promotes the public policy of enabling the Company to comply with the law, rather than destroying the Company. Finally, this case is similar to the *Hope* decision in that the Settlement appropriately balances the interests of the utility and the ratepayers.

Consequently, Hidden Valley respectfully submits that this factor supports approval of the Settlement, rather than a further reduction in the Company's rate relief.

9. Other relevant factors

In deciding whether to reject a rate increase, in whole or in part, pursuant to Sections 523 and 526 of the Code, the Commission should consider other relevant factors, just as it considers other relevant factors in determining whether to impose a civil penalty on a utility. 52 Pa. Code § 69.1201(c)(10). This factor gives the Commission the flexibility to consider any facts or circumstances that may not have been considered under any of the preceding factors.

In its Main Brief, Hidden Valley argued that one other relevant factor that should be considered in this case is the Commission's policy of avoiding rate shock to customers by gradually increasing utility rates. Hidden Valley Main Brief, pp. 38-41. The customers of Hidden Valley understandably experienced rate shock when they received notice of the Company's first rate increase in thirteen years. That shock will not be reduced if the Company is prevented from increasing rates at all until it fully complies with the *McCloskey* Decisions. To the contrary, that shock will be multiplied several fold because the rate increase at that time will include the cost of complying with the *McCloskey* Decisions. The instant rate request does not include those costs. Hidden Valley Main Brief, pp. 39-40.

Hidden Valley respectfully submits that this factor weighs in favor of approving the modest rate relief proposed in the Settlement, rather than further reducing the Company's rate request.

C. On Balance, the Above Factors Support Approving the Settlement

Balancing the nine factors discussed above, which the Commission considers in determining whether to reduce a company's rate request, in part or in whole, pursuant to 66 Pa. C.S. §§ 523 and 526, leads to the conclusion that the Settlement should be approved. The Settlement already proposes a significant reduction in the Company's rate request, particularly its request for a water rate increase. A further reduction in rate relief is not warranted by the record.

D. Conclusion of Law Ostensibly Concerning Quality of Service

The Foundation and the OCA ask the ALJs and the Commission to reach the following conclusion of law: “HVUS has failed to maintain managerial, technical, and financial fitness as required by the Public Utility Code. 66 Pa. C.S. §§ 501(a), 1103, 1501.” OCA’s Main Brief, Proposed Conclusion of Law 8; Foundation’s Main Brief, Proposed Conclusion of Law 12. To the extent that the Company has failed to maintain financial fitness, this proposed Conclusion of Law would support Hidden Valley’s request for modest rate relief, rather than the position of the OCA and the Foundation.

To the extent that the OCA and the Foundation ask the ALJs and the Commission to reach a conclusion of law that the Company has failed to maintain managerial and technical fitness, Hidden Valley respectfully submits that the evidence in this rate case fails to support the requested conclusion of law. It should be noted, in this regard, that the ALJ in *McCloskey* found that the OCA failed to prove that the Company lacked the fitness to manage the utility in a manner that provides adequate service to customers. September 2016 I.D., pp. 28 and 35. The evidence introduced into the record in the instant case gives no basis for a contrary finding.

VI. INDEPENDENT AUDIT

In its Proposed Ordering Paragraph 3, the Foundation requests that the ALJs recommend that Hidden Valley “shall have an independent financial audit completed by an auditor *approved by the Commission and the parties to this proceeding* within 6 months after the entry of the Commission’s final order in this proceeding.” Foundation’s Main Brief, Appendix C. The Foundation, however, provides no argument as to why the Commission and the parties should have a role in the selection of the company’s auditor.

The Commission is not a super board of directors with the authority to micromanage the affairs of public utilities. *Bell Tel. Co. v. Driscoll*, 343 Pa. 109 (1941); *Metropolitan Edison Co. v. Pa. Pub. Util. Comm'n*, 437 A.2d 76 (Pa. Cmwlth. 1981). Consequently, the Commission should have no role in the Company's selection of its professional consultants. Additionally, the OCA and Mr. Kollar have been adverse to the Company in several fully-litigated cases. The working relationship between these parties at this time is not conducive to a cooperative venture. Additionally, as a CPA, Mr. Kollar may have a conflict of interest in the Company's selection of an auditor. As a result, the parties to this case should not have a role in the Company's selection of its auditor.

As stated in Hidden Valley's Main Brief, p. 45, the Company has no objection to a reporting requirement (*i.e.*, the Company should be required to report to the Commission and the parties that the audit has been completed), but the ALJs should not recommend, and the Commission should not approve, any intrusion by the parties or Commission staff into the Company's selection of its professional consultants.

The Company also believes that it should have twelve months, rather than six months, to complete the audit. Hidden Valley's Proposed Ordering Paragraph 12. The Settlement proposes that the Company file corrected annual reports within six months of the Commission's Final Order in this proceeding. By giving the Company twelve months to complete the audit, the Company would have the flexibility to complete the audit after filing the corrected annual reports, rather than performing both tasks at the same time.

VII. NON-UNANIMOUS SETTLEMENT PETITION AND JOINT STIPULATION

A brief discussion of the Non-Unanimous Settlement is necessary to respond to the remaining arguments in the Main Briefs of the OCA and the Foundation.

A. REVENUE REQUIREMENT

In its Main Brief, the Foundation argues that the Company is unable to prove that its rates are just and reasonable because the financial information used to calculate the rates is unreliable. Foundation's Main Brief p. 5. The support for the Foundation's argument is the allegation that the Company continues to file incorrect annual reports.

Hidden Valley notes that the settlement is a "black box" settlement. Nevertheless, as discussed above and in Hidden Valley's Main Brief, 46-49, there is substantial evidence in the record to support it. In addition, the reasonableness of the compromise reached in the Settlement is demonstrated by the fact that the total water and wastewater rate increase in the Settlement (\$211,381 after the second step of the wastewater rate increase) is lower than the Company's position, I&E's secondary litigation position, and the OCA's secondary litigation position. Hidden Valley's Main Brief, pp. 46-49.

The Foundation's reference to the Company's annual reports misses the mark because those reports are little-used in the rate-making process. The Company has supported its claims regarding operational revenue and operational expenses through invoices and other documentation provided to the parties during many rounds of discovery. If the Foundation had questions about these numbers, it had the opportunity to request supporting documentation. I&E and the OCA did so, and were able to determine an appropriate level of operating revenue and operating expense. The Foundation cannot now make a general assertion that all the data is unreliable and therefore the entire proposed rate increase should be denied.

The OCA's Main Brief, p. 49, argues that step 2 of the wastewater rate increase apparently uses a rate of return higher than that proposed by the OCA. The Settlement is a "black box"

settlement which does not include each and every adjustment made to produce the agreed-upon operating revenue amount.

We have historically permitted the use of “black box” settlements as a means of promoting settlement among the parties in contentious base rate proceedings. Settlement of rate cases saves a significant amount of time and expense for customers, companies and the Commission and often results in alternatives that may not have been realized during the litigation process. Determining a company’s revenue requirement is a calculation involving many complex and interrelated adjustments that affect expenses, depreciation, rate base, taxes and the company’s cost of capital. Reaching an agreement between various parties on each component of a rate increase can be difficult and impractical in many cases. For these reasons, we support the use of a “black box” settlement in this proceeding.

Pa. Pub. Util. Comm’n v. Peoples TWP, LLC, Docket No. R-2013-2355886 (Opinion and Order entered December 19, 2013), p. 27 (citation omitted).

Step 2 of the wastewater rate increase is just and reasonable and supported by substantial evidence. As noted previously, step 2 of the wastewater rate increase is virtually identical to the secondary litigation position of I&E. That position allowed the Company to earn a return on equity. I&E’s expert witness argued for a 9.13% return on equity using a hypothetical capital structure of 50% debt and 50% equity. I&E Statement No. 2 (Wastewater), Direct Testimony of Christopher M. Henkel, p. 5. The OCA’s expert witness recommended a return on equity of 8.18% using an actual capital structure, OCA Statement 2 (Water and Wastewater), Direct Testimony of Aaron Rothschild, pp. 2-3, but Hidden Valley argued for a return on equity of 10.25% using an actual capital structure. HVUS Statement No. 1 (Wastewater), Direct Testimony of Paul R. Herbert, Exhibit PRH-2 p. 2. Considering these various positions, the “black box” Settlement is just and reasonable and supported by substantial evidence.

Finally, as also noted previously, the OCA’s Main Brief, pp. 49-50, erroneously contends that the Settlement does not accurately reflect I&E’s primary litigation position on the water rates,

or I&E's primary or secondary litigation position on the wastewater rates. I&E modified its litigation position in surrebuttal testimony. I&E Statement No. 1-SR (Water), Surrebuttal Testimony of John Zalesky, p. 2; I&E Statement No. 1-SR (Wastewater), Surrebuttal Testimony of John Zalesky, p. 2. As modified, I&E's primary litigation position is virtually identical to the Settlement's water rates; I&E's primary litigation position is virtually identical to the Settlement's step 1 of the wastewater rate increase; and I&E's secondary litigation position is virtually identical to the Settlement's step 2 of the wastewater rate increase.

In short, the OCA's Main Brief and the Foundation's Main Brief fail to give any supportable reason for modifying the revenue requirement agreed-to in the Settlement. Consequently, the ALJs should recommend approval of, and the Commission should approve, this aspect of the Settlement.

B. RATE STRUCTURE

The OCA's Main Brief, p. 50, does not take a position on the rate structure proposed in the Settlement. The Foundation's Main Brief, p. 13, incorporates the OCA's Main Brief on this point.

For the reasons stated in Hidden Valley's Main Brief, p. 49, the Company respectfully submits that the ALJs should recommend approval of, and the Commission should approve, the rate structure contained in the Settlement.

C. ANNUAL REPORTS

In its Main Brief, the OCA supports the provisions of Paragraph C of the Settlement. Those provisions would require Hidden Valley to submit corrected annual reports for 2015-2018 that are prepared or reviewed by a rate consultant. In addition, those provisions would require Hidden Valley to have its future annual reports prepared or reviewed by a rate consultant until the earlier

of 2023, or the Company's next base rate case. The Foundation's Main Brief incorporates the arguments of the OCA on this issue. Foundation's Main Brief p. 13.

For the reasons stated in Hidden Valley's Main Brief, p. 50, the Company respectfully submits that the ALJs should recommend approval of, and the Commission should approve, this portion of the Settlement.

VIII. CONCLUSION

For the reasons set forth above, and in its Main Brief, Hidden Valley Utility Services, L.P., respectfully requests that the Administrative Law Judges recommend:

- (1) That the Joint Petition for Approval of Non-Unanimous Settlement be approved;
- (2) That, upon entry of a final Commission Order in this proceeding, Hidden Valley Utility Services, L.P. - Water, be authorized to file water tariffs, tariff supplements or tariff revisions containing rates, rules and regulations, consistent with the findings herein, to produce annual revenues not in excess of \$206,112 or an increase over present revenues of \$65,557.
- (3) That Hidden Valley Utility Services, L.P.'s water tariffs, tariff supplements and/or tariff revisions, described in the preceding paragraph, may be filed on at least one-day's notice.
- (4) That, upon entry of a final Commission Order in this proceeding, Hidden Valley Utility Services, L.P. - Wastewater, be authorized to file wastewater tariffs, tariff supplements or tariff revisions containing rates, rules and regulations, consistent with the findings herein, to produce annual revenues not in excess of \$375,866 or an increase over present revenues of \$82,227.
- (5) That Hidden Valley Utility Services, L.P.'s wastewater tariffs, tariff supplements and/or tariff revisions, described in the preceding paragraph, may be filed on at least one-day's notice.

(6) That, upon submission of Hidden Valley's report and verification from its engineer stating that all repairs, modifications and improvements to Hidden Valley's wastewater system have been completed, as required by Ordering Paragraphs 11 and 19 of the Commission's May 3, 2018 Order on Reconsideration in *McCloskey v. Hidden Valley Utility Services, L.P.*, Docket Nos. C-2014-2447138 and C-2014-2447169, Hidden Valley Utility Services, L.P., be authorized to file wastewater tariffs, tariff supplements or tariff revisions containing rates, rules and regulations, consistent with the findings herein, to produce annual revenues not in excess of \$439,462 or an increase over present revenues of \$145,824.

(7) That the wastewater tariffs, tariff supplements and/or tariff revisions described in the preceding paragraph may be filed on at least one-day's notice.

(8) That, within six months after the entry of the Commission's final order in this proceeding, Hidden Valley Utility Services, L.P. submit to the Commission corrected annual reports for the years 2015-2018. These annual reports will be prepared or reviewed by a rate consultant prior to submission to the Commission.

(9) That, during the period 2019-2023 or until its next rate case, whichever is earlier, Hidden Valley Utility Services, L.P. have its annual report prepared or reviewed by a rate consultant prior to submission to the Commission.

(10) That, within twelve months after the entry of the Commission's final order in this proceeding, Hidden Valley Utility Services, L.P. complete an independent financial audit. The Company shall file a notice at this docket number, and serve a copy of said notice on all parties to this proceeding, stating that the independent financial audit has been completed.

(11) That the following complaints against the water rate increase be dismissed:

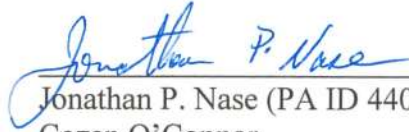
<u>Complainant(s)</u>	<u>Docket Number</u>
Office of Consumer Advocate	C-2018-3001841
Hidden Valley Foundation, Inc.	C-2018-3003528
Robert J. Kollar	C-2018-3003370
Gerry and Melissa Pindroh	C-2018-3001787
Debra J. Simpson	C-2018-3002198
Tom and Shelley Conroy	C-2018-3002468
John Cupps	C-2018-3002468
David Oster	C-2018-3002470
Toni Gorenc	C-2018-3002480
David Brodland	C-2018-3002485
Robert and Katherine Bair	C-2018-3002587
Jerome and Barbary Cypher	C-2018-3002671
Jon and Nina Lewis	C-2018-3002701
Celeste Emrick	C-2018-3003020

- (12) That the following complaints against the wastewater rate increase be dismissed:

<u>Complainant(s)</u>	<u>Docket Number</u>
Office of Consumer Advocate	C-2018-3001843
Hidden Valley Foundation, Inc.	C-2018-3003529
Robert J. Kollar	C-2018-3003372
Tom and Shelley Conroy	C-2018-3002200
John Cupps	C-2018-3002459
David Oster	C-2018-3002475
Toni Gorenc	C-2018-3002481
David Brodland	C-2018-3002487
Jerome and Barbara Cypher	C-2018-3002683
Jon and Nina Lewis	C-2018-3002698

(13) That upon filing of the notice described in paragraph 10 above, the proceedings at Docket Numbers R-2018-3001306 and R-2018-3001307 be marked closed.

Respectfully submitted,

A handwritten signature in blue ink that reads "Jonathan P. Nase". The signature is written in a cursive style and is positioned above a horizontal line.

Jonathan P. Nase (PA ID 44003)

Cozen O'Connor

17 North Second Street

Suite 1410

Harrisburg, PA 17101

Telephone: (717) 773-4191

E-mail: jnase@cozen.com

Counsel for *Hidden Valley Utility Services, L.P.*

Dated: December 21, 2018