



COMMONWEALTH OF PENNSYLVANIA

July 25, 2019

E-FILED

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

Re: Joint Application of Aqua America, Inc., Aqua Pennsylvania, Inc., Aqua Pennsylvania Wastewater, Inc., Peoples Natural Gas Company LLC and Peoples Gas Company LLC for all of the Authority and the Necessary Certificates of Public Convenience to Approve a Change in Control of Peoples Natural Gas Company LLC and Peoples Gas Company LLC by Way of the Purchase of All of LDC Funding LLC's Membership Interests by Aqua America, Inc. / Docket Nos. A-2018-3006061, A-2018-3006062, A-2018-3006063

Dear Secretary Chiavetta:

Enclosed please find the Reply Brief, **Public Version**, on behalf of the Office of Small Business Advocate ("OSBA"), in the above-captioned proceeding.

Copies will be served on all known parties in this proceeding, as indicated on the attached Certificate of Service.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Erin K. Fure
Assistant Small Business Advocate
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Enclosures

cc: Robert D. Knecht
Brian Kalcic
Parties of Record

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Joint Application of Aqua America,	:	Docket No. A-2018-3006061
Inc., Aqua Pennsylvania, Inc., Aqua	:	Docket No. A-2018-3006062
Pennsylvania Wastewater, Inc., Peoples	:	Docket No. A-2018-3006063
Natural Gas Company LLC and	:	
Peoples Gas Company LLC for all of	:	
the Authority and the Necessary	:	
Certificates of Public Convenience to	:	
Approve a Change in Control of	:	
Peoples Natural Gas Company LLC	:	
and Peoples Gas Company LLC by	:	
Way of the Purchase of All of LDC	:	
Funding LLC's Membership Interests	:	
by Aqua America, Inc.	:	

**REPLY BRIEF – PUBLIC VERSION
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE**

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Date: July 25, 2019

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I. INTRODUCTION

On November 13, 2018, Peoples Natural Gas Company LLC (“Peoples Natural Gas”), and Peoples Gas Company LLC (“Peoples Gas”) (collectively, “Peoples”) together with Aqua America, Inc. (“Aqua America”), Aqua Pennsylvania, Inc. (“Aqua PA”), and Aqua Pennsylvania Wastewater, Inc. (“Aqua PA Wastewater”) (collectively, “Aqua”) filed the *Joint Application of Aqua America, Inc., Aqua Pennsylvania, Inc., Aqua Pennsylvania Wastewater, Inc., Peoples Natural Gas Company LLC and Peoples Gas Company LLC for all of the Authority and the Necessary Certificates of Public Convenience to Approve a Change in Control of Peoples Natural Gas Company LLC and Peoples Gas Company LLC by Way of the Purchase of All of LDC Funding LLC’s Membership Interests by Aqua America* (“*Joint Application*”) pursuant to Sections 1102(a)(3) and 2210(a)(1) of the Public Utility Code, 66 Pa. C.S. §§ 1102(a)(3) and 2210(a)(1).

The *Joint Application* proposed a plan of acquisition whereby Aqua America would purchase all the membership interests of LDC Funding LLC (“Funding”), the indirect parent company of Peoples, and thereby obtain control of Peoples (hereinafter the “Proposed Transaction”).¹ Funding is a wholly-owned direct subsidiary of LDC Parent LLC, which is indirectly owned by SteelRiver Infrastructure Fund North America LP (“SRIFNA”) and an affiliated fund, which are in turn managed by SteelRiver Infrastructure Associates LLC and its affiliated management entities (collectively, “SteelRiver”).

On December 7, 2018, the Office of Small Business Advocate (“OSBA”) filed a Notice of Appearance, Notice of Intervention and Protest in opposition to the *Joint Application* filed by Aqua and Peoples (collectively, the “Joint Applicants”).

¹ *Joint Application*, at 1-6, 11, ¶¶ 1-10, 29-30.

On June 11, 2019, an evidentiary hearing was held before Administrative Law Judge (“ALJ”) Mary D. Long. The direct and surrebuttal testimony of OSBA witness Mr. Robert D. Knecht were admitted into the record at the June 11, 2019 evidentiary hearing.

The Joint Applicants reached a settlement with certain parties in this case and filed a *Joint Petition for Approval of Non-Unanimous, Complete Settlement Among Most Parties* on June 26, 2019 (“*Non-Unanimous Settlement*”). Because it contains no affirmative public benefits, the OSBA is not a signatory to, and opposes, the *Non-Unanimous Settlement*, and recommends that it, as well as the proposed merger, be rejected in its entirety.

On July 10, 2019, the OSBA submitted its Main Brief. Also, on July 10, 2019, the Joint Applicants and the Commission’s Bureau of Investigation and Enforcement (“I&E”) submitted **Main Briefs**.

The OSBA submits this Reply Brief in accordance with the ALJ’s PreHearing Order which sets forth the litigation schedule for this proceeding.

II. SUMMARY OF REPLY ARGUMENT

The OSBA rejects the Joint Applicants' argument that Aqua America should be presumed technically, financially, and legally fit to own Peoples. There should be no such presumption afforded to Aqua America in these proceedings. The Proposed Transaction involves a water and wastewater company attempting to acquire a gas and natural gas utility. These services are so vastly different that applying a presumption of fitness would jeopardize public safety, particularly because there is no record evidence of Aqua America either having or being able to retain the competence and expertise to render natural gas service safely and consistently. As Aqua America has failed to demonstrate the required level of fitness, the Proposed Transaction should be rejected.

The *Joint Application*, as conditioned by the *Non-Unanimous Settlement*, should likewise be rejected because the Joint Applicants have not met their burden to demonstrate that the Proposed Transaction will result in any affirmative public benefits. The Joint Applicants have not set forth compelling arguments in their Main Brief to refute or negate the arguments raised by the OSBA in opposition to the Proposed Transaction. This Reply Brief addresses the arguments raised in the Joint Applicants' Main Brief, and demonstrates why each fails. The *Joint Application* and *Non-Unanimous Settlement* must be rejected by the ALJ and the Commission.

III. REPLY ARGUMENT

A. **Aqua America, Inc. Is Not Technically, Financially and Legally Fit to Own the Peoples Companies**

1. **Aqua America Should Not Be Presumed Technically, Financially and Legally Fit to Own the Peoples Companies**

In their Main Brief, the Joint Applicants argue that:

Aqua America is be presumed to be technically, legally and financially fit to assume control of the Peoples Companies by virtue of its long-standing existence and ownership of jurisdictional public service providers. . . . Significantly the Commission has previously applied this rebuttable presumption where the acquiring public utility provided a service of a different nature than that of the public utility it acquired.²

However, the authorities cited by the Joint Applicants support applying the presumption only when a utility is seeking merely to expand its certificated authority. In *South Hills Movers, Inc. v. Pennsylvania Public Utility Commission*, the Pennsylvania Commonwealth Court held “Once certified as a motor carrier, there is a continuing rebuttable presumption that the carrier is technically and financially fit.”³ Likewise the *Blue Bird Coach Lines* and *V.I.P. Travel Services, Inc.* cases involved motor carriers seeking to expand the common carrier services for which they were already certificated.⁴ That is not the case in this proceeding. Aqua America is not already certificated to own and operate a gas or natural gas utility.

The Joint Applicants additionally cited to *In re: Application of Pennsylvania Power & Light Company, PFG Gas, Inc., and North Penn Gas Company*, Docket Nos. A-120650F0006, A-122050F0003, 1998 Pa. PUC LEXIS 23 to argue that the presumption should be applied even

² Main Brief of the Joint Applicants (“JA MB”), at 9.

³ *South Hills Movers, Inc. v. Pa. Pub. Util. Comm’n*, 601 A.2d 1308, at 1310 (Pa. Cmwlth. 1992).

⁴ *Re Blue Bird Coach Lines, Inc.*, 1990 Pa. PUC LEXIS 50; *Re V.I.P. Travel Services, Inc.*, 56 PA PUC 625 (1982).

in cases where the acquiring utility provides a different service than the utility it seeks to acquire. At the time the *PPL/PFG/North Penn* case was decided, PPL owned Interstate Energy Company (“IEC”), a Pennsylvania public utility regulated by the Commission with oil and gas pipelines delivering gas to the Martins Creek and Lower Mount Bethel stations.⁵ Significantly, and in stark contrast to Aqua America, PPL actually owned a gas and oil pipeline utility in 1998 when it acquired PFG/North Penn. Aqua America does not currently own a gas utility, nor has it ever owned a gas utility. The Proposed Transaction is not comparable to the *PPL/PFG/North Penn* case because PPL had prior experience owning gas utilities; Aqua America has no experience whatsoever owning a gas company.

The Joint Applicants further argued that “no party has rebutted this presumption of fitness.”⁶ The record evidence demonstrates that this assertion is untrue. First, OSBA witness Mr. Knecht testified, as follows:

[E]stablishing a Commission policy that a Pennsylvania water utility is automatically fit to own and operate a Pennsylvania natural gas distribution utility merely on the basis of its status as a ‘jurisdictional public utility service provider’ would be unwise if not absurd....A demonstration of technical competence should surely remain a criterion for approving this type of transaction, even if the purchase is a Pennsylvania utility.⁷

Second, I&E also rebuts the presumption of fitness, both in its testimony and Main Brief:

In support of the Application, Aqua claims that it demonstrates its technical fitness with its experience in owning and operating public utility pipeline assets in conformance with the Code and Commission regulations. However, as expressed in I&E witness Orr's Direct Testimony, if Aqua is to acquire Peoples, Aqua must

⁵ PP&L Inc., Annual Report (Form 10-K) (March 3, 1998), available at: <https://www.sec.gov/Archives/edgar/data/317187/0000317187-98-000004.txt>

⁶ JA MB, at 11.

⁷ OSBA Statement No. 1, at 5-6.

adhere to safety provisions that do not exist for water and wastewater operators. Due to the potential volatile nature of natural gas as opposed to water, the safety requirement levels are elevated for natural gas operations. Additionally, Aqua will be required to follow regulations set forth by Pipeline and Hazardous Materials Safety Administration ("PHMSA"). Aqua, as water and wastewater utility, does not currently comply with PHMSA standards or the Code of Federal Regulations ("CFR") relating to the transportation of natural gas. If the Commission allows the acquisition to occur, Aqua would have to become acquainted with these additional obligations to safely provide service to its customers.⁸

As set forth in the OSBA's Main Brief, a water company must demonstrate technical competence to own a gas and natural gas company to ensure that the public is protected; Aqua America has no experience in owning or operating a gas or natural gas utility.⁹ Simply put, Aqua America has not made a demonstration of technical fitness to own Peoples. The Joint Applicants' argument must be rejected, and no presumption of fitness should apply to Aqua America in this case.

2. Aqua America Is Not Fit to Own the Peoples Companies

Applicants must demonstrate that Aqua is technically, legally and financially fit to operate Peoples. They fail on at least two counts. The OSBA rejects Aqua America's claim of technical fitness to own the Peoples Companies.¹⁰ Moreover, the OSBA demonstrated that, at the proposed purchase price, the Proposed Transaction will necessarily increase financial risk to ratepayers of both Aqua and Peoples.¹¹ Similarly, I&E argued that Aqua lacks both the

⁸ Main Brief of the Bureau of Investigation and Enforcement ("I&E MB"), at 9 (footnotes omitted, *citing* to I&E Statement No. 4 at 8).

⁹ Main Brief on Behalf of the Small Business Advocate ("OSBA MB"), at 8-9.

¹⁰ *See* OSBA MB, at 7-11.

¹¹ *Id.* at 12-15.

technical expertise to meet the safety requirements of a gas utility and the financial fitness to own, operate, and manage Peoples.¹² Failing to demonstrate at least two of the three requirements of fitness, Aqua America should not be permitted to acquire Peoples, and the Proposed Transaction, as conditioned by the *Non-Unanimous Settlement*, should be rejected in its entirety.

The Joint Applicants argue that Aqua America is technically fit because it is an experienced owner and manager of pipe-based utility assets and is a long-term investor in utility operations.¹³ Of course, the ALJ and the Commission are well aware that many public utilities use “pipe-based assets,” so it borders on the ridiculous that this would be sufficient basis to own a natural gas utility. Furthermore, as set forth in the OSBA’s Main Brief, owning and managing water and wastewater pipe varies dramatically from owning and managing natural gas pipe.¹⁴ Water, unlike natural gas, is not an explosive compound. Additionally, despite Aqua America’s witness Mr. Christopher Franklin stating that holding an asset for less than ten years is not long-term ownership, the longest commitment Aqua was willing to make in connection with owning Peoples in the *Non-Unanimous Settlement* is seven years.¹⁵

The Joint Applicants also observe that “highly-experienced teams will continue to lead the separate operations of Aqua PA and the Peoples Companies,” and that the water/wastewater and natural gas subsidiaries will have their own presidents who will report to Aqua America

¹² I&E MB, at 9-10.

¹³ JA MB, at 11.

¹⁴ See OSBA MB, at 9-10.

¹⁵ Transcript of Initial Evidentiary Hearing held June 11, 2019, at 76.

management.¹⁶ Ironically, this argument demonstrates Aqua America’s lack of technical fitness: Aqua America is only “technically fit” because Peoples is competent to operate itself. However, the burden in this proceeding is on Aqua America to prove that it would be technically fit to provide natural gas service. And Aqua America utterly failed to demonstrate that technical fitness.

Curiously, the Joint Applicants criticized the OSBA and I&E for failing to recognize that Peoples has a solid foundation of experienced supervisors, managers and leadership, and that operational personnel directly responsible for the day-to-day operations and service of Peoples will be unaffected by the Proposed Transaction.¹⁷ As set forth in the OSBA’s Main Brief, the OSBA argued that while Peoples currently has leadership experienced in operating a natural gas utility, Aqua America does not. *****BEGIN HIGHLY CONFIDENTIAL STATUTORY

ADVOCATES ONLY***** [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

¹⁶ JA MB, at 11.

¹⁷ *Id.* at 12.

CONFIDENTIAL STATUTORY ADVOCATES ONLY*****

B. The Proposed Transaction, as Conditioned by the Settlement, Will Not Result in any Substantial Affirmative Public Benefits

The Joint Applicants argued that the OSBA and I&E's concerns and perceived risks associated with the Proposed Transaction are speculative, unsupported or alleviated by commitments in the *Non-Unanimous Settlement*.¹⁹ This argument is without merit. As set forth in the Main Briefs of the OSBA and I&E, the concerns and risks associated with the Proposed Transaction are based on record evidence, and some of those concerns and risks are exacerbated by the commitments in the *Non-Unanimous Settlement*. Moreover, to the extent that the *Non-Unanimous Settlement* actually includes some provisions with modest public benefits, any such benefits are outweighed by the substantial harm associated with the Proposed Transaction.

1. The Purchase Price and Financing of the Proposed Transaction Is Harmful

The Joint Applicants claimed that one of the financial benefits of the Proposed Transaction is increased access to capital, which is "vital to accomplishing" many of the commitments made by the Joint Applicants in the *Joint Application* and *Non-Unanimous Settlement*, including accelerating the replacement of at-risk distribution pipe, and providing

¹⁸ *Joint Application*, at 23, ¶73.

¹⁹ JA MB, at 13.

benefits to low-income customers and gas producers from reconstruction of the Goodwin and Tombaugh Gathering Systems (“G/T Systems”).²⁰

As set forth in the OSBA’s Main Brief, the accelerated replacement of at-risk distribution pipe is not an affirmative public benefit to the Proposed Transaction.²¹ Peoples already has a Commission-approved Long Term Infrastructure Improvement Plan (“LTIIIP”) in place.²² Furthermore, Aqua America’s commitment in the *Non-Unanimous Settlement* is disingenuous: the commitment is simply to file a new LTIIIP in the near future. In so doing, Aqua America declines to commit any shareholder funds to replace that at-risk pipe, and proposes only to include an additional \$30 million annually in rate base if that “future” LTIIIP is approved.²³ Needless to say, ratepayers will surely be asked to provide both a return of and a return on that capital, both through the Distribution System Improvement Charge (“DSIC”) mechanism and future base rates proceedings.

Furthermore, as set forth in the OSBA’s Main Brief, the reconstruction of the G/T Systems as proposed in the *Non-Unanimous Settlement* places a significant burden on the ratepayers and is likewise not an affirmative public benefit.²⁴ In any event, the OSBA’s arguments as to why public ownership of Peoples is not an affirmative public benefit are laid out in its Main Brief.²⁵

²⁰ *Id.* at 14.

²¹ *See* OSBA MB, at 19-22.

²² I&E Statement No. 3 at 4-9.

²³ *Non-Unanimous Settlement*, at 13-14, ¶69. *See also*, Transcript of Initial Evidentiary Hearing, held June 11, 2019, at 175.

²⁴ OSBA MB, at 22-26. *See also*, Section III. B.5, *infra*.

²⁵ OSBA MB, at 16-18.

a. Purchase Price

In their Main Brief, the Joint Applicants argued, as follows:

[T]here is nothing surprising about payment of a purchase price in excess of book value for a utility with growing rate base and income potential...[T]he premium to book value being paid in the Proposed Transaction is consistent with other recent utility transactions.... The comparability of premiums paid in other transactions provides further support for the reasonableness of the purchase price.²⁶

The OSBA respectfully submits that the Joint Applicants' argument is belied by both the reaction of both the stock market and the credit rating agencies to the Proposed Transaction. The simple fact is that Aqua America proposes to give the SteelRiver entities some \$2 billion for a goodwill asset that will produce no revenues. This necessarily increases the financial riskiness of the combined entities, and the reactions of both the stock market and the credit rating agencies reflect that impact.

The Joint Applicants attempt to justify the exorbitant amount being paid in the Proposed Transaction based upon a Fairness Opinion authored by Moelis & Company LLC ("Moelis").²⁷ The record evidence demonstrates that Moelis is not an independent, unbiased entity, and therefore is not in a position to provide a Fairness Opinion. Specifically, as set forth in the OSBA's Main Brief, *****BEGIN CONFIDENTIAL***** [REDACTED]

²⁶ JA MB, at 14-15.

²⁷ *Id.* at 16.

²⁸ OSBA Statement No. 1-S, at 11.

[REDACTED]

[REDACTED]

*****END CONFIDENTIAL*****

b. Financing

The Joint Applicants argued that there is no evidence that the Proposed Transaction's financing will present any real risk of harm to customers.³¹ However, as set forth in the OSBA's Main Brief, both Standard & Poor's and Moody's explicitly recognized that the Proposed Transaction will increase the riskiness of Aqua America debt.³² Furthermore, lower credit

²⁹ Joint Applicants' Exhibit DJS-3R. [REDACTED]

³⁰ See JA MB, at 19.

³¹ *Id.* at 17.

³² OSBA MB, at 14.

ratings will serve to lower the value of the debt and lead to higher interest rates.³³ Simply put, contrary to the Joint Applicants' false arguments, the record evidence is unequivocal that the debt financing in the Proposed Transaction will increase the financial riskiness of Aqua America.

2. There Is No Obvious Public Benefit to Public Ownership

The OSBA addressed the issue of whether public ownership is a benefit to the Proposed Transaction in its Main Brief.³⁴ The OSBA respectfully submits that public ownership, by itself, does not rise to the level of an affirmative public benefit of the Proposed Transaction.

3. Retaining Existing Jobs Is Not An Affirmative Public Benefit And Expanded Job Opportunity Promises Made by the Joint Applicants Are Illusory

The Joint Applicants note that the Proposed Transaction does not contemplate or involve reductions in the workforces of either Aqua or Peoples, and that fact purportedly constitutes an affirmative public benefit.³⁵ As set forth in the OSBA's Main Brief, by definition, maintaining the status quo is not an affirmative public benefit.³⁶ To buttress its argument, the Joint Applicants compare the Proposed Transaction to an acquisition of Peoples by a hypothetical gas utility. In the Joint Applicants' scenario, this hypothetical gas utility is located outside of Pennsylvania, and that this hypothetical gas utility might eliminate jobs to achieve synergy savings, or it might even relocate jobs outside of Pennsylvania.³⁷ Of course, the ALJ and Commission will recall that Peoples was not publicly up for sale when Aqua approached Peoples

³³ *Id.*

³⁴ *Id.* at 16-18.

³⁵ JA MB, at 29.

³⁶ OSBA MB, at 12.

³⁷ JA MB, at 29.

with the Proposed Transaction.³⁸ In reality, the Joint Applicants cite to no record evidence indicating that this hypothetical alternative is anything but speculation. The simple fact is that if the Proposed Transaction is rejected, the status quo is maintained. If another actual suitor appears, the Commission will again evaluate whether there are affirmative public benefits associated with that proposed transaction.³⁹

The Joint Applicants additionally argue that the affirmative public benefits standard requires an applicant to demonstrate that the asserted benefits would not occur absent the Proposed Transaction.⁴⁰ The Joint Applicants then twist the affirmative public benefits standard by claiming that that the retention of workforce contemplated by the Proposed Transaction would not occur in a “typical” acquisition. This legal reasoning, which makes maintaining the status quo (which is akin to a “no harm” standard employed in other jurisdictions) into an affirmative public benefit, has been rejected by Pennsylvania Courts.⁴¹ Furthermore, as set forth in the OSBA’s Main Brief, the metric by which to evaluate whether a proposed merger will result in an affirmative public benefit must be comparison to the status quo (*i.e.* what would occur absent the Proposed Transaction). There is no record evidence (and certainly none produced by the Joint Applicants) that, absent the Proposed Transaction, the workforces currently in place would be reduced. Therefore, retention of the current workforce (the status quo) is not an affirmative public benefit.

³⁸ I&E Statement No. 1, at 11.

³⁹ OSBA Statement No. 1-S, at 3-4.

⁴⁰JA MB, at 30, *citing Popowsky v. Pa. P.U.C.*, 937 A.2d 1040, 1058 (Pa. 1972).

⁴¹ OSBA MB. at 3, 12. *See also, City of York et al., v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141; 295 A.2d 825, 828 (1972): the Proposed Transaction must “affirmatively promote the ‘service, accommodation, convenience, or safety of the public’ in some substantial way.”

In a similar vein, the Joint Applicants also argued that they have made commitments to retain certain jobs for the next five years and to only reduce staffing or relocate a call center upon Commission approval.⁴² Again, maintaining the status quo is not an affirmative public benefit.

Additionally, the Joint Applicants claimed that their commitment to accelerate the replacement of risky pipe will result in approximately 100 new jobs, inclusive of contracted labor and Peoples' employees, being added in Western Pennsylvania.⁴³ Of course, as set forth in the OSBA's Main Brief, the Joint Applicants have not undertaken a systematic evaluation of the limitations with respect to the availability of qualified workers to achieve accelerated replacement of risky pipe.⁴⁴ The Joint Applicants argued that Mr. Knecht "concedes that the Joint Applicants have based their understanding of labor availability upon conversations with local unions associated with necessary workforce."⁴⁵ The Joint Applicants failed to note that Mr. Knecht concluded that "such a cursory review of this issue is inadequate."⁴⁶ A more careful and thorough evaluation of the cost of creating an additional workforce, and whether such a workforce would actually be available, should have been undertaken before proposing such a commitment to accelerate pipe replacement in the *Non-Unanimous Settlement*. That Joint Applicants should offer to accelerate capital spending without any supporting analysis casts further doubt on Aqua America's fitness to own and operate a natural gas utility.

⁴² JA MB, at 31.

⁴³ *Id.* at 31-32.

⁴⁴ OSBA MB, at 19-20; *See also* OSBA Statement No. 1-S, at 15.

⁴⁵ JA MB, at 32.

⁴⁶ OSBA Statement No. 1-S, at 15.

Furthermore, as set forth in the OSBA's Main Brief, the Joint Applicants are highly incentivized to include every dollar of investment spending they can in their future LTIIIP, while ratepayers will shoulder the burden of that LTIIIP's cost.⁴⁷ Given that perspective, the Joint Applicants are not concerned with undertaking a systemic evaluation of workforce availability and/or cost for their LTIIIP.

The claim by the Joint Applicants that "I&E and OSBA witnesses prefer an acquisition of the Peoples Companies that produces synergy savings and lost jobs" is incomplete and misleading. First, the OSBA and I&E speak for themselves. Second, yes, if an acquiring entity can provide service of higher reliability, improved safety, and at lower cost than the status quo, the OSBA would perceive that to be a public benefit; however, that is not the case here. Third, and most importantly, the OSBA would "prefer acquisitions" where the acquiring utility is technically, financially and legally fit to provide the proposed service and where the acquisition affirmatively promotes the public in some substantial way. This type of "preferred acquisition" is legally required, and the Proposed Transaction meets none of those requirements.

4. The Proposed Transaction Promises to Accelerate Pipe Replacement to the Detriment of Ratepayers

I&E Witness Mr. Matthew Matse testified that Peoples' existing LTIIIP should be more levelized.⁴⁸ In response, the Joint Applicants proposed to increase DSIC eligible capital spending by \$30 million a year, to be paid by (of course) ratepayers.⁴⁹ In its Main Brief, the OSBA observed that Mr. Matse continued to testify that acceleration of LTIIIP spending would

⁴⁷ OSBA MB, at 21.

⁴⁸ I&E Statement No. 3, at 8-9.

⁴⁹ JA MB, at 33.

be “difficult if not impossible.”⁵⁰ Nevertheless, Aqua America, not being technically fit or competent in natural gas operations, and without having undertaken a systemic evaluation of the cost or feasibility of accelerating Peoples’ LTIIP, has promised to file for an acceleration of LTIIP spending in the *Non-Unanimous Settlement*.⁵¹

In an effort to mislead the Commission, the Joint Applicants partially quote OSBA witness Mr. Knecht’s testimony on cross-examination, but leave out a critical portion of his testimony.⁵² Specifically, during cross-examination, Mr. Knecht was questioned regarding accelerated elimination of at-risk pipeline:

Q. So accelerated elimination of at-risk pipeline reduces risk to greater numbers of customers?

A. Yes, and that’s true always. And if that’s the only criteria, then you’re in a situation where you’re trying to replace all of your at-risk pipe as fast as you possibly can, and that is not how natural gas utility replacement plans are developed.

As long as you can replace it and as long as you can get the work force in place to do it and as long as you can be technically competent about it, every additional bit of spending, as you say, is going to reduce the risk. You just can’t do it all at once, and you need a balanced plan.⁵³ [emphasis added]

The last minute inclusion of accelerated LTIIP spending in the *Non-Unanimous Settlement* is obviously not a balanced plan when it comes to pipe-replacement, since it was not accompanied by any analysis, and it remains subject to Commission review. Furthermore, as

⁵⁰ OSBA MB, at 20, *citing* I&E Statement No. 3, at 8-9.

⁵¹ OSBA MB, at 19-20; *Non-Unanimous Settlement* at 13-14, ¶69.

⁵² JA MB, at 34-35.

⁵³ Transcript of Initial Evidentiary Hearing held June 11, 2019, at 232.

Aqua America has not demonstrated that it is technically competent, it cannot be simply assumed that this acceleration of spending is reasonable.

The Joint Applicants argue that the OSBA advocates for a standard whereby a commitment in an application proceeding cannot be found to constitute an affirmative public benefit if the costs of implementation are recovered from ratepayers.⁵⁴ Once again, the OSBA can speak for itself, and the Joint Applicant's argument is nonsense. Nevertheless, the Joint Applicants use that standard to paint a dystopian future, whereby that ridiculous standard would "stymie the approval of beneficial public utility mergers and acquisitions in Pennsylvania."⁵⁵ In contrast, it is the OSBA's view that if a commitment to spend ratepayers' money constitutes an affirmative public benefit, there will never be a bar to any utility merger in the Commonwealth.

In fact, the OSBA adheres to the *City of York* standard, and argues for the rejection of a Proposed Transaction that would permit Aqua America to pay a \$2 billion premium to SteelRiver but force upon ratepayers an increase of \$30 million per year and at least \$79 million net cost to replace the G/T Systems. As much as the Joint Applicants try to obfuscate the record evidence, the bottom line is that ratepayers will be harmed by the Proposed Transaction and that there are no affirmative public benefits.

5. The Goodwin and Tombaugh Gathering Systems

As set forth in the OSBA's Main Brief, the reconstruction of the G/T Systems is not properly part of this proceeding.⁵⁶ Peoples already has a commitment regarding the G/T Systems as set forth in a 2013 settlement that was approved by Commission Order ("2013

⁵⁴ JA MB, at 35.

⁵⁵ *Id.*

⁵⁶ OSBA MB, at 25-26.

Peoples/Equitable Settlement”).⁵⁷ Peoples and its parent, SteelRiver, should be required by the Commission to satisfy the terms of that Commission Order, and to do so on an expedited basis.

The Joint Applicants claimed that it is the OSBA’s position that remediation of the G/T Systems is not an affirmative public benefit because it will be funded by ratepayers.⁵⁸ As the OSBA can speak for itself, it is the OSBA’s position that remediation of the G/T Systems as contemplated in the *Non-Unanimous Settlement* is an uneconomic project that will be funded almost entirely by ratepayers. In fact, the current CEO of Peoples, Mr. Morgan O’Brien, conceded in his rebuttal testimony that replacement of every mile of pipe on the G/T Systems would not be economic and “[i]n some cases, abandonment of the customer, and converting the customer to an alternative fuel source would be more economic and in the public interest.”⁵⁹ The *Non-Unanimous Settlement* contemplates replacement of the entire G/T system. After some five years of study, Peoples now estimates that the full replacement cost would be approximately \$120 million. The Joint Applicants’ analysis of this scenario, presented by Joint Applicant witness Mr. Joseph A. Gregorini, indicates that when this \$120 million is adjusted for the investment supported by revenues, the avoided propane conversion costs, and remaining Equitable funds, the negative impact on current ratepayers would be a present value of \$91.7 million.⁶⁰ The *Non-Unanimous Settlement* applies \$13 million in a near term one-time rate credit, leaving approximately \$79 million in net cost that must be paid by existing ratepayers. Moreover, unlike the ratepayer credit, the cost of the remediation is not capped at \$120 million,

⁵⁷ See Order entered on November 14, 2013, at Docket Nos. A-2013-2353647, A-2013-2353649, A-2013-2353651.

⁵⁸ JA MB, at 46.

⁵⁹ Joint Applicants Statement No. 3-R, at 8.

⁶⁰ *Non-Unanimous Settlement*, at 6-7, ¶¶29, 33. Joint Applicants Exhibit JAG-3R, Scenario 1.

and ratepayers are fully at risk for cost overruns. And that risk is significant. I&E presents credible evidence that, based on forecast costs for other mains replacement projects, the replacement costs will be in the \$184 to \$386 million range.⁶¹

The Joint Applicants argued that the *Non-Unanimous Settlement* proposal, whereby the costs to remediate the G/T Systems would be borne by ratepayers, is an essential aspect of the “regulatory compact” that forms the basis of public utility service and that the Joint Applicants would be entitled to a return of and on additional capital improvements to increase safety and reliability.⁶² The Joint Applicants’ cynical view of the “regulatory compact” entirely ignores the requirement that expenditures are to be reasonable and prudent. It is a curious fact of the Proposed Transaction that the Joint Applicants are willing to pay SteelRiver \$2 billion in *goodwill* – upon which they will earn no recovery – but are only willing to provide Peoples ratepayers with a one-time \$13 million rate credit, while requiring those same ratepayers to incur a net cost of at least \$79 million for the G/T Systems.

The OSBA observes that Aqua America’s desire to increase capital spending on G/T rate base is consistent with its position on increasing rate base through accelerated LTIIP spending. It would seem obvious that Aqua America is making every effort to increase its revenue-producing rate base, in order to offset the dilutive effect on earnings of the increase in non-revenue-producing goodwill.⁶³ Or, in short, Aqua America needs to get more rate base in place at Peoples upon which it can earn a return in order to reduce the financial impact of the \$2 billion

⁶¹ I&E MB, at 27.

⁶² JA MB, at 46.

⁶³ *See*, OSBA Statement 1-S, at 13,

goodwill asset. This effort would be understandable from a shareholder standpoint, except that it comes at the expense of ratepayers.

The Joint Applicants argued that the cost of the *Non-Unanimous Settlement* proposal to rehabilitate the G/T Systems would be modest.⁶⁴ The Joint Applicants estimate that the proposal would increase the “monthly bill of the average Peoples residential customer” by 1% or \$1 per month.⁶⁵ This estimate, however, depends on the accuracy of the \$120 million cost estimate to remediate the G/T Systems. If the cost of replacing the G/T Systems is higher than \$120 million, (for example, if the actual costs are closer to between \$184 million and \$368 million as estimated by I&E), there would be a much greater impact on residential (and all) ratepayers’ monthly bills.⁶⁶ The Joint Applicants *have not* provided an average cost for commercial and industrial customers. As stated above, the \$120 million cost in the *Non-Unanimous Settlement* is not capped.⁶⁷

The Joint Applicants also fail to highlight that the negative impact on ratepayers will extend for a time period of approximately sixty-seven years.⁶⁸ According to the Joint Applicants’ calculations, and again, assuming \$120 million is accurate, the maximum annual impact to ratepayers is \$10.2 million per year in Year 5, \$8.9 million in years 11 through 15, and \$8.7 million in years 16 through 20.⁶⁹ The OSBA respectfully submits that adding \$10 million per

⁶⁴ JA MB, at 37.

⁶⁵ *Id.*

⁶⁶ I&E Statement No. 2-SR, at 11.

⁶⁷ *Non-Unanimous Settlement*, at 6-7, ¶33.

⁶⁸ See Joint Applicants’ Exhibit JAG-2R. That exhibit shows a depreciation rate of 0.15 percent (\$1,905,293 for \$127,019,531 in capital), implying a recovery period of 66.7 years (1/.015).

⁶⁹ Joint Applicants’ Exhibit JAG-2R.

year to the rate increase addressed in the current Peoples' base rates case would represent a substantial rate impact.

In summary, the ratepayer impact of the *Non-Unanimous Settlement* under the Company's calculations is up to \$10 million per year, the negative impact will extend for more than 60 years, the capital costs could credibly be more than three times as high as those estimated by the Joint Applicants, and the ratepayers are fully responsible for all costs except for a one-time \$13 million credit. The OSBA respectfully disagrees with the Joint Applicants' attempt to portray this provision as having a *de minimis* impact on ratepayers.

In addition to the unfortunate direct ratepayer impacts of the *Non-Unanimous Settlement*, the precedent associated with accepting this settlement may prove even worse. Approving the Proposed Transaction would reward SteelRiver for doing nothing with natural gas gathering systems that it knew had serious problems. The 2013 Peoples/Equitable Settlement, which required Peoples to evaluate this problem, was signed in October 2013. No evaluation was forthcoming for more than five years, even though these systems were experiencing unaccounted-for gas rates in the 60 to 80 percent range.⁷⁰ And, even now, the economic assessment mandated by the 2013 Peoples/Equitable Settlement was only completed because the matter arose in this proceeding. As Mr. Knecht put it, this evaluation was undertaken at "a glacial pace."⁷¹

Under the Proposed Transaction, SteelRiver will earn a premium of \$2 billion on its book asset value, while having avoided addressing the G/T Systems as they committed to in the 2013 Peoples/Equitable Settlement. Under this precedent, Pennsylvania public utilities will know that

⁷⁰ I&E Statement No. 2, at 8.

⁷¹ OSBA Statement No. 1-S, at 17.

they do not need to address politically difficult problems, because the Commission will simply shift the cost responsibility to ratepayers. Instead of approving the Proposed Transaction, the Commission should require that Peoples meet its commitments under the 2013 Peoples/Equitable Settlement, and it should evaluate whether it should fine Peoples under Section 501 of the Pennsylvania Public Utility Code, 66 Pa. C.S. §501(a), for not addressing the issue, allowing the G/T Systems to get worse, and failing to meet its commitments in the 2013 Peoples/Equitable Settlement.

6. Other Conditions Proposed in the Settlement Do Not Provide Additional Affirmative Public Benefits to the Peoples Companies' Customers

The other conditions the Joint Applicants identify as benefitting Peoples' customers boil down to maintaining the status quo. The Joint Applicants argue the various commitments in the *Non-Unanimous Settlement* will “ensure that the Peoples Companies continue to provide safe and reliable service to their customers, at a level that meets or exceeds current performance.”⁷² Of course, the Joint Applicants concede that Peoples, under its current management, already provides safe and reliable service to their customers. There is no record evidence that Peoples' customer service performance would deteriorate absent the Proposed Transaction. As discussed above, there is record evidence that service performance may deteriorate *as a result of* the Proposed Transaction, because Aqua has not demonstrated that it is fit to operate a natural gas utility.

The Joint Applicants also argue that the contribution of additional funds to low-income programs will provide public benefits by assisting customers to maintain gas service, and that public benefits exist in the form of commitments to maintain and improve upon low-income

⁷² JA MB, at 47.

programs and services currently offered by Peoples.⁷³ However, as the OSBA pointed out in its Main Brief, targeting a specific class with benefits (specifically, residential low-income customers) while adversely affecting other (or in this case all) classes does not satisfy the *City of York* standard, as explained in the *Middletown Township* case.

7. Other Conditions Proposed in the Settlement Do Not Provide Additional Affirmative Public Benefits to Aqua PA's Customers

The Joint Applicants claimed that implementation of specific customer service metrics beyond current levels and installing Peoples' SAP would be affirmative public benefits.⁷⁴ As stated above, there is no demonstration that these benefits would not occur in the absence of the Proposed Transaction. It is in Aqua PA's interest, and in all utilities' interests, to continuously improve customer service and the improvement of Aqua PA's metrics is not dependent on the Proposed Transaction. In addition, as set forth in the OSBA's Main Brief, the implementation of SAP by Aqua America is not an affirmative public benefit because, according to Aqua, its current system does not currently need to be upgraded, the transition to a SAP system still needs to be evaluated, and it is likely that Aqua would eventually adopt a SAP system regardless of the Proposed Transaction.⁷⁵

The Joint Applicants argue that the *Non-Unanimous Settlement* contains conditions that benefit Aqua PA's low-income customers.⁷⁶ Again, as set forth in the OSBA's Main Brief,

⁷³ *Id.*

⁷⁴ *Id.* at 48-49.

⁷⁵ OSBA MB, at 26-27.

⁷⁶ JA MB, at 50.

targeting a specific class with benefits does not satisfy the *City of York* standard, as explained in the *Middletown Township* case.⁷⁷

8. Other Conditions Proposed in the Settlement Do Not Provide Additional Affirmative Public Benefits

The Joint Applicants identify a one-time \$10 million rate credit to Aqua and Peoples customers as an affirmative public benefit of the Proposed Transaction.⁷⁸ The Joint Applicants argue that the Proposed Transaction, as conditioned by the *Non-Unanimous Settlement*, provides for an immediate rate savings benefit of approximately \$23 million to existing customers, but fails to point out that \$13 million (of the \$23 million) rate credit is offered only to Peoples' customers, and it is only a small offset to the net cost impact of \$92 million.⁷⁹ When compared to the \$30 million per year increases in rate base which would result from the accelerated modified LTIIP spending, coupled with the (at least) \$92 million present value increase in rates (before the \$13 million credit) associated with the G/T Systems, and the implications of the increase in financial risk associated with the Proposed Transaction, the benefits of a one-time rate credit are overwhelmed by the negative effects. The Proposed Transaction will cost customers much more than they are currently paying and they will receive no affirmative benefits.

⁷⁷ See OSBA MB, at 4, 28.

⁷⁸ JA MB, at 51.

⁷⁹ See *Id.* at 52.

IV. CONCLUSION

For the reasons set forth in the OSBA's Main Brief, as well as the reasons set forth in this Reply Brief, the OSBA respectfully requests that the ALJ and the Commission reject the *Joint Application* and the *Non-Unanimous Settlement*.

Sincerely,



Erin K. Fure
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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Joint Application of Aqua America, Inc., Aqua Pennsylvania, Inc., Aqua Pennsylvania Wastewater, Inc., Peoples Natural Gas Company LLC and Peoples Gas Company LLC for all of the Authority and the Necessary Certificates of Public Convenience to Approve a Change in Control of Peoples Natural Gas Company LLC and Peoples Gas Company LLC by Way of the Purchase of All of LDC Funding LLC's Membership Interests by Aqua America, Inc.	:	Docket No. A-2018-3006061
	:	Docket No. A-2018-3006062
	:	Docket No. A-2018-3006063
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CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been served via email and/or First-Class mail (*unless other noted below*) upon the following persons, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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