

COMMONWEALTH OF PENNSYLVANIA




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

Re: Pennsylvania Public Utility Commission
v.
Twin Lakes Utilities, Inc.
Docket No. R-2019-3010958

Dear Secretary Chiavetta:

Attached for electronic filing please find the Office of Consumer Advocate's Reply Brief in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

A handwritten signature in blue ink that reads "Christ Maloni Hoover".

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Enclosure:

cc: The Honorable Marta Guhl, ALJ
Certificate of Service

*282591

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission :
v. : Docket No. R-2019-3010958
Twin Lakes Utilities, Inc. :

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

Dated this 15th day of January 2020.

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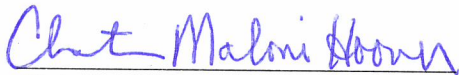
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Dated: January 15, 2020
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :
 :
 v. : Docket No. R-2019-3010958
 :
 Twin Lakes Utilities, Inc. :

REPLY BRIEF
OF THE
OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this Reply Brief in response to the Main Brief (MB) of Twin Lakes Utilities, Inc. (Twin Lakes or the Company). The OCA's Main Brief contained a comprehensive discussion of the evidence and its position on all issues; thus, the OCA will respond only to those matters raised by Twin Lakes that require further clarification. In doing so, the OCA does not waive its position on contested issues not repeated in this Reply Brief. Accordingly, the OCA incorporates its Main Brief arguments and analyses herein by reference.

Contrary to Public Utility Commission (PUC or Commission) regulations, Twin Lakes did not address several adjustments the OCA made in its testimony. See 52 Pa. Code § 5.501(a)(3). The OCA submits that the Company should not be permitted to raise these issues for the first time in its Reply Brief because that would deny the OCA the opportunity to respond to Twin Lakes' legal argument regarding those issues.

For the reasons stated in its Main Brief and restated below, the OCA respectfully requests the Commission adopt its recommendations and approve an increase of no more than \$98,688¹ in annual revenues rather than the increase of \$211,793 in revenues the Company has requested.

¹ The OCA stated its recommended revenue increase incorrectly in the Conclusion paragraph of its Main Brief. OCA MB at 51. It is stated correctly here as \$98,688. Table I; OCA St. 1, Sch. SLS-1C.

II. SUMMARY OF ARGUMENT

Twin Lakes has not met its burden of proving that the Commission should approve its request. Additionally, Twin Lakes has failed to show that it is providing adequate, efficient, safe and reasonable service to its customers as required by Section 1501 of the Public Utility Code. The OCA has shown that the Company experiences unreasonably high unaccounted for water, has issued numerous boil water advisories without adequate communication to consumers regarding when those advisories would be lifted, and has provided water that exceeded the lead action level.

The Company's claims for the acquisitions adjustment, cash working capital, management fee, legal expense, purchase power and chemical expenses, bad debt expense and rate case expense are not consistent with ratemaking principles. The OCA's adjustments to these claims are reasonable and appropriate and should be adopted. The Company's recommended 11.0% return on equity and overall rate of return of 9.0% are not consistent with Commission precedent and should not be adopted. The OCA has demonstrated with Commission approved methods that the Company's cost of equity should be adjusted to 8.78% and its overall market-based rate of return should be 7.89%.

Due to evidence of excessive levels of unaccounted for water, an inoperable well, an active well that is in risk of collapse, customer service issues, and a notice issued that the Company has exceeded the lead action level, the OCA submits that the Company has not established that it is providing safe, adequate, and reliable service as required under the Public Utility Code. The OCA submits that the appropriate remedy is that the return on equity be set at zero. This results in a recommended additional annual revenue requirement of no more than \$98,688. The OCA also maintains its request that the Commission initiate a Section 529 proceeding.

III. RATE BASE

A. Plant in Service

The OCA did not propose any adjustments to plant in service.

B. Depreciation Reserve

The OCA did not propose any adjustments to depreciation reserve.

C. Additions to Rate Base

Twin Lakes claimed an acquisition adjustment of \$54,406. Twin Lakes Exh. MLT-5. The OCA submits that the acquisition adjustment was not approved by the Commission in Twin Lakes' 2011 rate case (its first rate case following acquisition) and should not be included in rate base at this time or at any time in the future. OCA MB at 7-8; OCA St. 1 at 4; OCA St. 1 SR at 3. In its Main Brief, Twin Lakes presents two arguments to support its claim that are without merit. Twin Lakes MB at 5-7. For the reasons discussed below, Twin Lakes' acquisition adjustment should be denied.

Twin Lakes argues that there is no requirement that its claim for an acquisition adjustment be approved by the Commission and that the lack of approval was a "direct result" of the settlements in the Company's prior two rate filings. Twin Lakes MB at 6. Twin Lakes' argument is without merit. The Commission can approve an acquisition adjustment as part of a settlement where the acquisition adjustment is agreed to by the signatory parties. See e.g., Pa. P.U.C. v. Aqua Pennsylvania, Docket No. R-2018-3003558, R-2018-3003561 Order at 18, 58 (May 9, 2019) (Commission approved acquisition adjustments as specifically set forth in a settlement petition). Twin Lakes' argument should be denied.

Twin Lakes also argues that there is nothing in the Acquisition Policy Statement that prohibits a utility from requesting an acquisition adjustment in any future case. Twin Lakes MB at 6. In fact, the plain language of the Policy Statement, which Twin Lakes quotes on page 6 of

its Main Brief, states that a request for the inclusion of the acquisition premium will occur during the “utility’s **next** filed rate case proceeding.” 52 Pa. Code § 69.721. This language clearly states that the claim is in the next filed rate case proceeding, and not 10 years and two cases after an acquisition. There is no basis to ignore the plain language of the policy statement. Having a claim for an acquisition premium made in the next case following acquisition is reasonable and appropriate because it would be based on evidence that is from the time of the acquisition or the years leading up to the acquisition. See 66 Pa. C.S. § 1327(a)(1)-(3). In addition, after an acquisition is approved, the acquisition premium is added to rate base, and the amount is amortized as an addition to expense over a reasonable time period along with the reductions to rate base. 66 Pa. C.S. § 1327(a)(9). It is not reasonable to expect that this process would be delayed for more than ten years and three rate cases.²

Acquisition adjustments are an exception to the use of depreciated original cost used to develop rate base. For water and wastewater acquisitions, a positive acquisition adjustment, when the purchase price exceeds the depreciated original cost, is permitted only when the criteria in Section 1327 are met. 66 Pa. C.S. § 1327. Whether an acquisition adjustment meets the statutory criteria should be determined in the first base rate case following proposed acquisition. See 52 Pa. Code § 69.721 (“After the approval of an acquisition . . . an acquiring utility may request the inclusion of the value of the used and useful assets of the acquired system in its rate base. A request will be considered during the acquiring utility’s next filed rate case proceeding.”). An acquisition adjustment should thus not be included as part of a utility’s claimed rate base unless

² The impact of delaying the determination of an acquisition premium and the time over which it will be amortized was calculated by Ms. Sherwood when she explained that if the acquisition premium had been approved in the 2011 rate case, the premium would have been amortized in part by now. OCA MB at 8, footnote 4; OCA St. 1 at 4. Specifically, Ms. Sherwood noted that the typical period of time to amortize an acquisition adjustment is twenty years, and the proposed acquisition occurred on November 3, 2009. OCA St. 1 at 4. The proposed acquisition adjustment in this case should thus have been amortized over the last ten years. If amortized correctly, the proposed acquisition adjustment should be \$9,840 in this proceeding. OCA St. 1 at 4.

the acquisition adjustment is approved by the Commission in the base rate proceeding immediately following the approved acquisition.

Twin Lakes also argues that it did not “by statute or regulation forswear from seeking an acquisition adjustment for all time to come.” Twin Lakes MB at 6. Twin Lakes made the request for the acquisition adjustment in its first case following acquisition and should have had it addressed in that case. It is not reasonable to permit Twin Lakes to claim the acquisition premium in each case and continue to postpone addressing the claim.³

D. Deductions from Rate Base

The Company proposed a cash working capital amount of \$17,175. OCA St. 1 at 9. As explained in the OCA’s Main Brief, Ms. Sherwood used the same one-eighth method to calculate her cash working capital adjustment based on her proposed level of operation and maintenance expenses (O&M), excluding bad debt expense, depreciation expense, and taxes. OCA MB at 9-10; OCA St. 1 at 9; Sch. SLS-9. Ms. Sherwood adjusted cash working capital to \$11,885, or an adjustment of \$4,879. Table II; Sch. SLS-9.

In its Main Brief, Twin Lakes argues that the OCA’s calculation is a radical departure from basic public utility accounting concepts. Twin Lake MB at 7. Ms. Sherwood explained why she excluded those two expense items:

CWC allows for the company to earn a return on the capital that is required to fund the day-to-day operating costs in advance of receiving revenues. Both bad debt expense and depreciation expense are considered non-cash items, and therefore, should not be included in the calculation of CWC.

OCA MB at 9; OCA St. 1SR at 4. Ms. Sherwood’s approach is supported by the recently reissued *A Guide to Utility Ratemaking*, James H. Cawley and Norman J. Kennard, *A Guide to Utility*

³ Ms. Sherwood noted that the acquisition premium claimed in this case is higher it was in the 2011 case. OCA M.B. at 8; OCA St. 1 at 4.

Ratemaking, 2018 Edition, prepared for the Pennsylvania Public Utilities Commission, © 1983, http://www.puc.pa.gov/General/publications_reports/pdf/Ratemaking_Guide2018.pdf

(Guide). OCA MB at 9. Ms. Sherwood explained that her approach is consistent with the description of the one-eighth method provided in the Guide:

The *Guide* defines this CWC calculation as the average net lag (45 days) “multiplied by the total operating and maintenance expense, less purchased gas, water, or electric (depending on utility filing type); non-cash items such as depreciation and uncollectibles; and taxes, since the taxes are collected prior to payments being made.”

OCA MB at 9-10; OCA St. 1SR at 4 citing Guide at 123. The OCA’s calculation, using the one-eighth method, as shown on Schedule SLS-10 C, is consistent with the Guide and reasonable for ratemaking purposes. The same calculation for the one-eighth method should be adopted once the final level of operation and maintenance expense is known. OCA MB at 10.

IV. REVENUES

In its Main Brief, Twin Lakes correctly notes that the OCA did not recommend any adjustments to present revenues. Twin Lakes MB at 8. However, Twin Lakes incorrectly states that means that the OCA agrees with its proposed revenue requirement. See id. The OCA introduced evidence that the appropriate revenue requirement that should be adopted by the Commission in this proceeding is no more than \$98,688. OCA MB, Tables I and II; OCA St. 1, OCA St. 2.

V. EXPENSES

The OCA recommended adjustments to the following expenses: management fees, legal expense, maintenance supplies expense, purchased power and chemical expenses, bad debt expense, and rate case expense. See OCA MB at 12-18. In its Main Brief, the Company addressed only purchased power and chemical expense (Twin Lakes MB at 14) and rate case expense (Twin Lakes MB at 8-9).

A. Management Fee

Twin Lakes claimed \$1,824 in management fees in this case. OCA MB at 12; OCA St. 1, Sch. SLS-4; Table II. The OCA adjusted the management fees because the Company included the acquisition adjustment claim in calculating subsidiary net assets which is one of three factors for allocating management fees. OCA MB at 12; OCA St. 1, Sch. SLS-4; Table II. Due to the OCA's recommendation to remove the acquisition adjustment, the factor calculated from the Company's subsidiary net assets needs to be adjusted. OCA MB at 12; OCA St. 1, Sch. SLS-4; Table II. Twin Lakes did not provide any discussion or legal argument in its Main Brief regarding the OCA's adjustment. The OCA submits that Twin Lakes should not be permitted to raise arguments on this issue in its Reply Brief.

B. Legal Expense

Twin Lakes claimed \$1,001 in legal expense in this case. OCA MB at 12; OCA St. 1 at 5, Sch. SLS-5; Table II. The OCA adjusted the legal expense because the majority of the increase in the test year is related to outside counsel expenses not experienced in the prior 12-month periods ended 2017 and 2018 and do not appear to be re-occurring. OCA MB at 12-13; OCA St. 1 at 5, Sch. SLS-5; Table II. Twin Lakes did not provide any discussion or legal argument in its Main Brief regarding the OCA's adjustment. The OCA submits that Twin Lakes should not be permitted to raise arguments on this issue in its Reply Brief.

C. Maintenance Supplies Expense

Twin Lakes claimed \$9,509 in maintenance supplies expense in this case. OCA MB at 13; OCA St. 1, Sch. SLS-6; Table II. The OCA adjusted the maintenance supplies expense because the Company claims that the expense is related to two main breaks which were not experienced during the 12-month period ended March 31, 2018. OCA MB at 13; OCA St. 1 at 6, Sch. SLS-6; Table II. Twin Lakes did not provide any discussion or legal argument in its Main Brief regarding the OCA's adjustment. The OCA submits that Twin Lakes should not be permitted to raise arguments on this issue in its Reply Brief.

D. Purchased Power and Chemical Expense

The OCA recommended an adjustment to purchased power expense of \$6,335 and chemical expense of \$1,808 due to the unreasonably high unaccounted for water. OCA St. 1; Table II; Sch. SLS-7. OCA witness Mr. Fought stated that the Company's unaccounted for water was 81.5% in 2018. OCA St. 3 at 7; Exh. TLF-3. OCA witness Ms. Sherwood stated that ratepayers should not be required to pay for treatment of water loss 61.5% above levels the Commission deems excessive. OCA St. 1; Table II; Sch. SLS-7.

Twin Lakes stated that adopting the OCA's recommendations increases operational risk to the detriment of Twin Lakes' customer base. Twin Lakes MB at 14. It further stated that:

[t]he UFW rate continues to increase in spite of the Company's replacement and repair work. This is a clear indication that the entire system needs to be replaced. Further, Mr. Fullagar states that the entire system is in need of replacement given that the system is incapable of being pressurized to an acceptable level without an extraordinary amount of leakage. Twin Lakes St. No. RKF-2R.

The Company stated that reliable service cannot be maintained without appropriate amounts of purchased power and chemicals. Twin Lakes MB at 14.

The Company's operation and maintenance of its facilities are not considered efficient as required by Section 1501 of the Public Utility Code. OCA St. 1 SR at 8. The Commission deems

levels of unaccounted for water exceeding 20% to be excessive. 52 Pa. Code. § 65.20 (4). The Company's unaccounted for water has fluctuated between 78% and 86.7% between 2011 and 2018. OCA St. 3, Exh. TLF-3. As the Company stated, these levels will not improve in spite of continued replacement and repairs, and the whole system is in need of replacement. Twin Lakes St. No. RKF-2R at 3. The OCA submits that ratepayers should not be required to pay for treatment of water with such excessive levels of unaccounted for water, especially where the Company anticipates a replacement of the entire distribution system in the near future. OCA St. 1 at 7; OCA St. 1SR at 8.

E. Bad Debt Expense

Twin Lakes claimed \$19,095 in bad debt expense in this case. OCA MB at 15; OCA St. 1 at 7-8, Sch. SLS-8; Table II. The OCA adjusted the bad debt expense because the Company's bad debt expense was \$2,400 in 2017 and 2018, much lower than in the test year. OCA MB at 15; OCA St. 1 at 7-8, Sch. SLS-8; Table II. Since the Company's bad debt expense was consistent in 2017 and 2018 and increased by \$11,712 in the test year, the OCA recommended that the amount should be \$4,061, or the normalized bad debt expense for 2017 through 2019. OCA MB at 15; OCA St. 1 at 7-8, Sch. SLS-8; Table II. Twin Lakes did not provide any discussion or legal argument in its Main Brief regarding the OCA's adjustment. The OCA submits that Twin Lakes should not be permitted to raise arguments on this issue in its Reply Brief.

F. Rate Case Expense

The OCA recommended a 48.5-month normalization period for rate case expense based upon the Company's historical filing frequency which is consistent with the Commission's approach to this issue. OCA MB at 17-18; OCA St. 1 at 8-9; OCA St. 1SR at 7. Twin Lakes witness Ms. Tilley initially proposed that rate case expense be amortized over 18 months. Twin Lakes St. No. 2 at 3-4. In rebuttal, the Company stated that the rate case normalization time period

should match the period of time that the rates are expected to be in effect. Twin Lakes St. No. 2 at 3-4. It then stated that if historical filing frequency is considered, the 19 months between the acquisition of Twin Lakes and its first base rate proceeding should be included, which would reduce the normalization period from 48.5 months to 38.7 months. Twin Lakes St. No. MLT-2R at 4. In its Main Brief, the Company then stated that Ms. Tilley's 2-year rate case expense normalization period should be adopted. Twin Lakes MB at 9. In support of its argument, the Company stated the following:

Twin Lake's [sic] maintains its intention to file its next water rate case in two years, if not sooner, and the normalization period for the rate case expense should remain at two (2) years so that the cost of this case will be recovered before the next rate increase.

Twin Lakes MB at 8. The Company further argued that:

Twin Lakes has adequately presented, in this case, a five-year time line for future infrastructure improvements that will cause it to file for another rate increase well ahead of a five-year timeframe. The Commission should therefore adopt Twin Lake's [sic] recommendation for normalization of rate case expense.

Twin Lakes MB at 9.

The Company's request for rate case normalization is unclear. Initially, Twin Lakes witness Ms. Tilley requested an 18-month amortization of the expense. Twin Lakes St. No. 2 at 3-4. Then, in surrebuttal, Ms. Tilley stated that if historical filing frequency is considered, the time period should be reduced to 38.7 months instead of the 48.5 months OCA witness Ms. Sherwood recommended, or the 49 months I&E witness Mr. Zalesky recommended. Twin Lakes St. No. 2 at 3-4. Now, in its Main Brief, the Company states that the Commission should accept Ms. Tilley's recommendation of a two-year (24 month) normalization for rate case expense, when she actually recommended an 18-month amortization. Twin Lakes MB at 9. As explained below, all of the

Company's positions are unsupported by legal precedent and the evidence in this case and its arguments in support of its positions are unpersuasive.

The Commission has consistently held that rate case expenses are normal operating expenses and should be normalized, not amortized, based upon the historical filing frequency of the utility's rate filings. Popowsky v. Pa. P.U.C., 674 A.2d 1149, 1154 (Pa. Cmwlth. 1996) (Popowsky); Pa. P.U.C. v. Columbia Water Co., 2009 Pa. PUC LEXIS 1423 (2009); Pa. P.U.C. v. Lancaster Sewer, 2005 Pa. PUC LEXIS 44 (2005); Pa. P.U.C. v. National Fuel Gas Distribution Corp., 84 Pa. PUC 134, 175 (1995); Pa. P.U.C. v. Roaring Creek Water Co., 73 Pa. PUC 373, 400 (1990); Pa. P.U.C. v. West Penn Power Co., 119 PUR4th 110, 149 (Pa. PUC 1990); Pa. P.U.C. v. City of Dubois, Docket No. R-2016-2554150, Order (March 28, 2017) (City of Dubois) (Petition for Reconsideration denied on this issue). In Popowsky, the Commonwealth Court considered the "time period in between rate filings" in determining the frequency of the utility's rate filings. Popowsky, 674 A.2d at 1154; OCA St. 1SR at 6. Moreover, the normalization period is determined by examining the utility's actual historical rate filings, not upon the utility's intentions. Id. at 1154. Twin Lakes states that it "maintains its intention" to file its next rate case in two years. Twin Lakes MB at 8. Consistent with Commission precedent, this intention should not be considered in determining the normalization period.

The Company's initial request for an 18-month amortization should be rejected because rate case expense should be normalized as a standard operating expense. The 19-month time between the acquisition of Twin Lake and its first rate case should not be considered because it is not a time between rate filings. Additionally, the Company's intention to file in the next two years is irrelevant. Therefore, the OCA submits that a 48.5-month normalization period should be used which represents the average of the time between rate filings.

VI. TAXES

Twin Lakes claimed \$19,119 in federal income taxes and \$10,105 in state income taxes. OCA MB at 19; OCA St. 1 at 10. Ms. Sherwood adjusted the federal income tax claim to reflect the level of rate base and expenses that she recommended in her testimony and used the 21% tax rate as claimed by the Company. Id. Her federal tax adjustment reduces the Company's claim by \$9,943. Table II; Exh. SLS-10 C. She also adjusted the state income taxes to reflect the Company's \$72,087 carry-forward net operating loss that will be applied to future state income taxes. Id. Ms. Sherwood noted that net operating losses generated from 1998 onward can be carried forward for up to 20 years and concluded that it is unlikely that any state income taxes will be paid by the Company and should not be collected from ratepayers. OCA MB at 19; OCA St. 1 at 10. Table II; Exh. SLS-10 C.

Twin Lakes did not provide any discussion or legal argument in its Main Brief regarding the OCA's adjustment. The OCA submits that Twin Lakes should not be permitted to raise arguments on this issue in its Reply Brief.

VII. RATE OF RETURN

The OCA recommended a cost of equity of 8.78%, a cost of debt of 7.0%, a capital structure of 50% debt and 50% equity and overall rate of return of 7.89%. OCA MB at 33; OCA St. 2 at 3. Twin Lakes witness Ms. Tilley recommended a cost of equity of 11.0%, a cost of debt of 7.0%, a capital structure of 50% debt and 50% equity and an overall rate of return of 9.0%. Twin Lakes MB at 10-12; Twin Lakes St. No. 2 at 6.

In support of its 11.0% cost of equity recommendation, the Company stated that:

Twin Lakes has a Five-Year Master Plan which includes \$4.8 million of capital improvements that will need to take place in the near term. Twin Lakes needs to make these critically-needed improvements to upgrade the water system all to help ensure safe and reliable service to the Company's customers. Twin Lakes needs to attract capital to make these vital improvements...Twin Lakes' rate of return should reflect the use of a capital structure that results in its debt and equity ratios being comparable to those of similar water utilities...Twin Lakes should be awarded an appropriate return on equity to attract equity capital.

Twin Lakes MB at 11-12. It further stated that:

Ms. Tilley noted that given the extremely small size of Twin Lakes, coupled with the most recently published authorized ROE ranging between 8.02-10.58% for a Pennsylvania water utility, a recommendation of a [sic] 11.00% ROE is a fair and reasonable expected return.

Twin Lakes MB at 11. The Company's arguments are not supported by the record in this case, as discussed below. OCA MB at 20; OCA St. 2 at 2-7.

As the OCA stated in its Main Brief, the Commission has defined an appropriate rate of return as follows:

the amount of money a utility earns, over and above operating expenses, depreciation expense and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the 'return' are interest on long-term debt, dividends on preferred stock, and earnings on common stock equity. In other words, the return is the money earned from operations which is available for distribution among the capital. In the case of common stockholders, part of their share may be retained as surplus.

Pa. P.U.C. v. Emporium Water Co., 95 Pa. PUC at 196, 208 PUR4th 502, 507 (2001) (EWC 2001) (quoting Public Utility Economics, Garfield and Lovejoy, 116 (1964)). Further, “[t]he return authorized must not be confiscatory, and must be based upon the evidence presented.” Pa. P.U.C. v. Philadelphia Suburban Water Co., 71 Pa. PUC 593, 623 (1989) (PSWC 1989) (citing Pittsburgh v. Pa. P.U.C., 165 Pa. Super. 519, 69 A.2d 844 (1949) (Pittsburgh)). The Court noted that “[t]he rate-making process under the Act, *i.e.*, the fixing of ‘just and reasonable’ rates, involves a balancing of the investor and consumer interests . . . and does not insure that the business shall produce revenues.” Id. More recently, the Court stated that the consumers are obliged to rely upon regulatory commissions to protect them from excessive rates and charges. See Permian Basin Area Rate Cases, 390 U.S. 747, 794-95 (1968) (Permian) (citing Atlantic Refining Co. v. Public Service Comm’n, 360 U.S. 378, 388 (1959)).

In reviewing a utility’s rate increase request, the Pennsylvania Public Utility Commission must consider the efficiency, effectiveness, and adequacy of service provided by the utility. 66 Pa. C.S. § 523(a). The Commission has recognized the connection between rates and service, stating:

It is our opinion that in exchange for the utility’s provision of safe, adequate, and reasonable service, the ratepayers are obligated to pay rates which cover the cost of service which includes reasonable operation and maintenance expenses, depreciation, taxes and a fair rate of return to the utility’s investors. Thus, as the OCA contends, a quid pro quo relationship exists between the utility and its ratepayers.

Pa. P.U.C. v. Pennsylvania Gas and Water Co., 61 Pa. PUC 409, 415-16 (1986).

The OCA does not oppose the Company’s capital structure recommendation of 50% equity and 50% debt, and does not oppose the 7.0% cost of debt recommendation based upon the Company’s difficulty accessing capital with any financial institution as a stand-alone entity. OCA St. 2 at 5. However, the OCA maintains its 8.78% cost of equity calculation, instead of the 11.0%

recommended by Twin Lakes witness Ms. Tilley, based on Mr. Rothschild's calculations under the DCF model, including a Constant Growth and a Non-Constant Growth method applied to the Water Proxy Group using data available through August 31, 2019. OCA MB at 24; OCA St. 2 at 2.

The Commission has relied upon the DCF approach for many years. OCA MB at 24; see, e.g., City of Dubois; Pa. P.U.C. v. UGI Utilities, Docket No. R-2017-2640058, Order (October 25, 2018); Pa. P.U.C. v. City of Lancaster – Bureau of Water, 2011 Pa. PUC LEXIS 1685 (2011); Pa. P.U.C. v. Emporium Water Co., 2008 Pa. PUC LEXIS 2076 (2006); EWC 2001, 95 Pa. PUC at 201, 208 PUR4th at 512; Pa. P.U.C. v. York Water Co., 75 Pa. PUC 134, 156-69 (1991); PSWC 1989 at 631-32; Pa. P.U.C. v. Pennsylvania-American Water Co., 71 Pa. PUC 210, 279-82 (1989); Pa. P.U.C. v. The Peoples Natural Gas Co., 69 Pa. PUC 1, 167-68 (1989); Pa. P.U.C. v. Pennsylvania Power, 67 Pa. PUC 91, 164, 93 PUR4th 189, 266 (1988) (Penn Power 1988); Pa. P.U.C. v. National Fuel Gas Distribution Corp., 67 Pa. PUC 264, 332 (1988).

The Company's rate of return should not be calculated based upon expenses it expects to incur five years later. OCA witness Aaron Rothschild properly determined a market-based return on equity based upon the commonly accepted DCF approach utilizing actual and historical data provided by the Company. The OCA calculated a recommendation which includes an overall rate of return of 7.89%, consisting of a 7.0% cost of debt and an 8.78% cost of equity. OCA MB at 20. As discussed in VII.A.4 below, the fair rate of return, to reflect the inadequacy of service provided by Twin Lakes, sets the equity return at zero and results in an overall rate of return of 3.50%. Sch. SLS-1 C. As such, the OCA's recommended zero return on equity to reflect inadequate service should be adopted.

VIII. OTHER ISSUES

A. Quality of Service

1. Legal Standard

In its Main Brief, Twin Lakes did not address its obligations under Section 1501 of the Public Utility Code, 66 Pa. C.S. § 1501, or the Commission's authority to deny a rate increase, in whole or in part, under Section 526 of the Public Utility Code. 66 Pa. C.S. § 526. The OCA provided a thorough review of the case law under these sections of the Public Utility Code in its Main Brief. OCA MB at 34-35.

2. Background

In its Main Brief, Twin Lakes addresses the purchased power and chemical expense adjustments related to the high levels of UFW that are present in its system. Twin Lakes MB at 14. The OCA's expense adjustments are discussed above in Section V.D. The OCA addressed why the UFW in the Twin Lakes distribution system is one of multiple indicators of inadequate service that result in a conclusion that Twin Lakes is not providing safe, adequate, and reliable service under Section 1501 of the Public Utility Code. OCA MB at 35-43. In addition to UFW above 80%, Twin Lakes has no back up water supply (and its primary well is in danger of being overpumped), and it has exceeded the lead action level in its 2019 monitoring, which requires it to do additional monitoring and possibly a corrosion control study that may lead to the addition of corrosion control. Id. Twin Lakes acknowledged in its 2019 Application to Abandon that it cannot make the necessary improvements at a reasonable cost to its 114 customers.

3. The Evidence Establishes That Twin Lakes Is Not Providing Safe, Adequate, and Reliable Service.

In its Main Brief, Twin Lakes acknowledges that the entire distribution system needs to be replaced. Twin Lakes MB at 14. It acknowledges the stipulation entered into by the parties regarding the exceedance of the lead action level and the additional steps it has agreed to in this proceeding. Id. Regarding boil water advisories, Twin Lakes repeats its testimony about why it issues boil water advisories, but does not address OCA's recommendation that it needs to adequately inform its customers that a boil water advisory has been lifted. Id. It did not address the water supply issues, or its failure to address some of the issues raised by its customers at the public input hearing. See OCA MB at 40-43. As discussed below, Twin Lakes appears to minimize the depth and breadth of the service quality and reliability problems that are present every day for its customers. Twin Lakes has had ten years, multiple rate increases, and many opportunities to do what is necessary to improve the service provided to its customers and has failed to do so. Twin Lakes has presented no feasible plans to address the replacement of its well, replacement of the distribution system, and modifications to its practices and has failed to show how these improvements can be made and keep rates in an affordable range.

a. Unaccounted For Water

Twin Lakes repeats its position that it must keep unaccounted for water at high levels (more than 80%) or else risk breaks in the distribution system. Twin Lakes MB at 14. It does not discuss the detrimental impact that has on its source of supply. It does admit that the entire distribution system must be replaced. Id. Its defense of its extremely high UFW is an admission that its system is not acceptable from a cost or operations perspective.

b. Reliability of the Source of Supply

Twin Lakes did not address the problems with its current and only source of supply, Well # 2. Nor did it address its failure to replace Well # 1, as it agreed to do in the 2015 rate case settlement. The OCA addressed the issues and concerns with the source of supply and how these problems are related to the high level of UFW discussed above. OCA MB at 40-42.

c. Exceedance of Lead Action Level

In its Main Brief, Twin Lakes states that it has agreed with the parties to a 12-point program related to the lead levels and other water quality parameter. Twin Lakes MB at 14. The OCA agrees that the Stipulation addresses a number of important issues related to the exceedance of the lead action level. OCA MB at 42. The Stipulation does not address the additional costs and the additional burdens for the customer presented by Twin Lakes' exceedance of the lead action level.

d. Public Input Testimony

In its Main Brief, Twin Lakes argues that the public input testimony was minimal, stating that “[a] total of only thirteen people⁴ testified in both sessions combined.” Twin Lakes MB at 16. Additionally, the Company stated that “...only one witness (Ms. Helen Miller) testif[ied] that any further rate increases would be a financial hardship.” Twin Lakes MB at 15. The Company also stated that “[t]he participation level and comments at the Public Input Sessions are further proof that Twin Lakes is providing its customers with safe and reliable service....” Twin Lakes MB at 17.

To accurately present the evidence presented at the public input hearings, the OCA provides this summary of the public input testimony. Contrary to Twin Lakes' characterization, it is clear that customers are concerned about the overall affordability and the level of rates that they

⁴ Three people testified on the record at the 1 p.m. hearing and eight people testified on the record at the 6 p.m. hearing. Tr. 32; Tr. 58.

currently pay and might pay as a result of the rate increase request. All but two witnesses who testified expressed concerns with the affordability of the proposed rate increase. Greg Nieczaj, Twin Lakes customer and father to a four-month-old, referred to the proposed rates as potentially “devastating” to him and his young family. Tr. 101. It is clear that customers are concerned about the frequent boil water advisories and not knowing whether a boil water advisory has been lifted. In addition, customer service issues were raised yet were not responded to by Twin Lakes. Gerasimos Xenatos testified that customer service discriminated against him because of the way he spoke English, telling him to go back where he came from and then hung up on him. Tr. 90-92. Finally, it should be noted that the public input hearing was held before customers received the notice of the exceedance of the lead action level. The evidence from the public input hearings shows that Twin Lakes’ customers have consistent concerns regarding affordability of their rates and quality of service.

Summary of Public Input Hearing testimony

1. Frank Perez testified that he does not believe the Company’s request of an increase of 162% is just or reasonable and that it would be an extreme hardship to the residents of Sagamore Estates. Tr. 44-47.
2. Virginia Pfeiffer testified that she feels that the proposed increase is not just and reasonable and that she is worried about her neighbors’ ability to pay. Tr. 47-50.
3. Phillip Adams testified that he opposes the rate increase proposed by Twin Lakes because it is neither reasonable or [sic] just, and he believes it is unaffordable for many families. Tr. 52-54.
4. Donna Hersca testified that she believes the rate increase is unjust and unreasonable based upon average national and statewide water bill data that she presented into the record. Ms. Hersca pays \$110 a month for her two-family household. Ms. Hersca testified that “[m]y husband and I, we’re currently struggling to pay our current unjust and unreasonable [sic] high water bill. If an increase were to be approved, we anticipate that we would simply not be able to afford it.” Tr. 71-82.

5. Helen Miller testified that “[m]y feeling is that this price is a hardship as it is, and it will be an increased hardship when the rates go up or if they go up substantially or any amount.” Tr. 83. Ms. Miller is a senior citizen living alone, employed full-time, and stated that she pays \$129 a month. Ms. Miller testified that Twin Lakes is a not a high-income area, and expressed concerns with other families’ ability to pay. Ms. Miller testified that “...as a senior citizen and a person on her own, this is a hardship...” Tr. 83-84.
6. Jeffrey Shatt testified to the water being out a lot in the summer of 2019, and to boil water advisories being issued by the Company. Tr. 86. He stated that “[t]he company’s communication as to when those water boil advisories ended was barely existent. I had to call them to find out every time, and every time I got a different answer.” Tr. 86. He testified that he did not have water service for three days at one point. Tr. 87.
7. Gerasimos Xenatos testified that he was without water for three of the hottest days in the summer of 2019. Tr. 90. Mr. Xenatos testified that it was not related to a boil water advisory, but the water was shut off because of a pump problem. Tr. 92. Mr. Xenatos also stated that he experienced service interruptions without notice and did not have past due bills. Tr. 93. He stated that customer service discriminated against him for the way he spoke English and told him to go wherever he came from and that he was hung up on. Tr. 90-92.
8. Stacy DeFrancesco testified that she and her husband own a home in the community and rent it out and if the rates go up so high that they cannot rent the house, they will be forced to foreclose on their home. Tr. 94-96.
9. Grezegorz (Greg) Nieczaj testified that he has a 4-month-old son and wife and would not be able to afford their bill if the increase became effective. Mr. Nieczaj testified that it would be “devastating” for him if it were to go into effect. Tr. 99-101.
10. Jeremy Monz testified that he is paying \$170 per month for three-person household. Mr. Monz stated that he has been struggling and does not think he can handle another rate increase. Tr. 104. He also testified to water meter installation issues underneath his home. Tr. 103-105.
11. Tami DeFrancesco testified that the increase is unjust and would be a hardship for many people and might cause them to have to leave their homes. Ms. DeFrancesco testified that the house is a five-person household (her daughter, her daughter’s husband and their three kids), and the bill is \$350 quarterly. Tr. 105-107.

The OCA submits that the customers' testimony at the public input hearings supports the OCA's concerns and recommendations regarding the lack of safe, adequate, and reliable service and the affordability of the proposed rates. Therefore, Twin Lakes' arguments should be rejected.

4. The Appropriate Remedy for the Inadequate Service Is The Reduction of the Cost of Equity.

The OCA recommended a zero return on equity to recognize the inadequate service provide by Twin Lakes. OCA MB at 43-45; OCA St. 1SR at 2. This recommendation is consistent with the Commission's obligation to review the efficiency and effectiveness of management as part of any rate proceeding, 66 Pa. C.S. § 523, and with the Commission's authority to deny in part or in its entirety, any proposed rate increase when there is inadequate service. 66 Pa. C.S. § 526.

In its Main Brief, Twin Lakes argues that the recommended 0% return on equity is "entirely unreasonable and inappropriate given the physical condition of the system and the continued extraordinary efforts by Twin Lakes to work toward ensuring safe and reliable service for its customers." Twin Lakes MB at 12. The OCA submits that these arguments are without merit and should be rejected. First, the zero return on equity recommendation comes after two cases and additional revenues that have been agreed to and approved by the Commission to address part of the service issues. OCA MB at 34-45. For the most part, with the exception of the lead action level exceedance, these quality of service issues have been present during the last ten years and are not new, yet the customers have paid higher rates, over the last ten years, without any improvement. Id. The record is clear that the entire distribution system needs to be replaced, and Well # 1 (currently not used) needs to be replaced, after which Well #2 will need to be rehabilitated or possibly replaced. Id. In addition, due to the lead action level exceedance, Twin Lakes may need to develop a corrosion control study that may lead to the addition of corrosion control in the

future. Finally, Twin Lakes has not adequately addressed the customer service concerns raised by its customers. The appropriate remedy is the zero return on equity proposed by the OCA.

Twin Lakes argues that the OCA and I&E recommendations for a zero return on equity (to recognize Twin Lakes' ongoing, longstanding inadequate service), will cause Twin Lakes and other water utilities in Pennsylvania to experience a credit downgrade. Twin Lakes MB at 13. Twin Lakes cites to **no** record evidence to support this sweeping statement. Moreover, Twin Lakes has stated that, despite substantial rate increases resulting from its 2011 and 2015 rate cases, it is currently unable to secure financing as a stand-alone entity. Twin Lakes St. No. 2 at 5. The OCA submits that Twin Lakes' argument should be denied.

In addition to the zero return on equity to recognize Twin Lakes' inadequate service, the OCA submits that the Commission should initiate an Section 529 investigation, 66 Pa. C.S. § 529, so that a record may be developed regarding the most reasonable way to proceed to ensure that he Twin Lakes customers receive adequate service at just and reasonable rates. OCA MB at 44-45. Twin Lakes did not address this recommendation in its Main Brief.

B. Affordability of Rates

The OCA presented the testimony of Ms. Sherwood regarding the affordability of rates for the Twin Lakes customers. OCA MB at 45-49; OCA St. 1 at 10-15. Ms. Sherwood found that the rates proposed by Twin Lakes, or even under the OCA's two scenarios (adjusted revenue requirement or zero return on equity), the customers will experience rate shock that violates the ratemaking principle of gradualism. Moreover, the resulting level of rates may not be affordable for some customers. In its Main Brief, Twin Lakes does not dispute Ms. Sherwood's calculations of the impact on Twin Lakes customers, but rather attacks Ms. Sherwood's qualifications. Twin Lakes MB at 14-15. Twin Lakes also argues that affordability "is not contemplated in the

regulatory compact.” Id. at 15. As discussed below, Twin Lakes’ arguments are without merit and should be denied.

Ms. Sherwood has more than ten years of experience in the public utility regulatory area. See OCA St. 1, App. A. During that time, she has worked at a regulatory commission and in the private sector addressing many aspects of utility regulation. Id. In addition, she worked as the lead analyst for the EmPOWER Maryland limited income programs implemented by the Maryland Department of Housing. Id. Ms. Sherwood is qualified to address the level of rates proposed in this case, the median household income statistics from Pike County as well as the indicators used by the United States Environmental Protection Agency (EPA) and the Pennsylvania Infrastructure Investment Authority (Pennvest). Based on her experience, she is qualified to address the issue of affordability presented in this proceeding and Twin Lakes’ argument should be disregarded.

Regarding Twin Lakes’ argument that affordability is not part of the regulatory compact, it is clear that just and reasonable rates is part of the regulatory compact. 66 Pa. C.S. § 1301. Moreover, in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) (Hope), the Court noted that “[t]he ratemaking process under the Act, *i.e.*, the fixing of ‘just and reasonable’ rates, involves a balancing of the investor and consumer interests . . . and does not insure that the business shall produce revenues.” More recently, the Court stated that the consumers are obliged to rely upon regulatory commissions to protect them from excessive rates and charges. See Permian 390 U.S. at 794-95. Regarding affordability specifically, rates are required to be just and reasonable under Section 1301 of the Public Utility Code. 66 Pa. C.S. § 1301.

As Ms. Sherwood explained, in setting rates, there is the principle of gradualism and avoiding rate shock. OCA MB at 45-49; OCA St. 1 at 10-15. Twin Lakes’ proposed rates will

result in rate shock and even under the revenue requirement proposals calculated by OCA, there will be rate shock. There is clearly a zone of reasonableness for rates and Commission determinations within that zone are consistent with the Commission's obligations and responsibilities. Rates that are set at a level below or above that zone of reasonableness are not considered to be just and reasonable. Further, to the extent that the rates are so high that customers cannot pay those rates, then there is an issue regarding the long-term viability of the utility and the service it provides. The answer to that dilemma is not to increase rates even higher, but rather to find a solution that results in ratepayers receiving adequate service and, in return, paying just and reasonable rates.

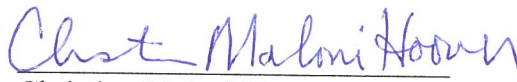
IX. RATE STRUCTURE

The OCA did not propose any adjustments to rate structure.

X. CONCLUSION

WHEREFORE, for the reasons stated here and in the Office of Consumer Advocate's Main Brief, Twin Lakes' proposed increase should be denied due to the inadequate service it provides to its customers. The OCA submits that the Commission should grant additional annual revenues of no more than \$98,688.

Respectfully Submitted,



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Dated: January 15, 2020
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