



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
COMMONWEALTH KEYSTONE BUILDING
400 NORTH STREET, HARRISBURG, PA 17120

BUREAU OF
INVESTIGATION
&
ENFORCEMENT

January 15, 2020

Via Electronic Filing

Secretary Rosemary Chiavetta
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
I&E Reply Brief

Dear Secretary Chiavetta,

Enclosed please find the Bureau of Investigation and Enforcement's (I&E) **Reply Brief** in the above-captioned proceeding.

Copies are being served on active parties of record as evidenced in the attached Certificate of Service. Should you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink that reads "Erika L. McLain".

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ELM/ac
Enclosure

cc: Honorable Marta Guhl (*ALJ, PUC Philadelphia*)
Per Certificate of Service

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission

v.

Twin Lakes Utilities, Inc.

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Docket No. R-2019-3010958

**REPLY BRIEF
OF THE
BUREAU OF INVESTIGATION AND ENFORCEMENT**

Erika L. McLain
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PA Attorney ID No. 320526

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Dated: January 15, 2020

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I. Introduction

A. History of the Proceeding

The history of this proceeding was addressed in I&E's Main Brief and is incorporated by reference in this Reply Brief.¹ I&E would like to point out that Twin Lakes Utilities, Inc. ("Twin Lakes" or "Company") incorrectly asserts in its Main Brief that it filed the instant base rate case on July 19, 2019;² however, according to the Commission's public docket, Twin Lakes filed the instant base rate case on July 23, 2019. Pursuant to the established procedural schedule, I&E now files this timely Reply Brief in response to the Company's Main Brief.

B. Burden of Proof

I&E fully addressed the burden of proof in its Main Brief.³ I&E contends that with respect to both existing and proposed tariff rates and terms, the burden of proving the justness and reasonableness of those rates and terms is on the Company.

II. Summary of Argument

I&E maintains that Twin Lakes has failed to prove its requested \$211,793 revenue increase is warranted. As stated above, the Company has the burden of proof with respect to each of its ratemaking claims. The Company failed to satisfy this burden as it did not address many of I&E's recommended adjustments in its Main Brief. Moreover, the issues that Twin Lakes chose to address in Main Brief are not supported by Commission precedent or sound ratemaking principles. Accordingly, I&E continues to

¹ I&E M.B., pp. 1-2.

² Twin Lakes M.B., p. 1.

³ I&E M.B., pp. 2-3.

assert that Twin Lakes is only entitled to a \$51,098 revenue increase based upon its expense, rate base and rate of return adjustments.

Again, I&E would like to reiterate, that one major component to I&E's recommended revenue increase is the denial of Twin Lakes' return on equity due to it providing poor service to customers. If the ALJ and Commission find that Twin Lakes is providing adequate service and that a return on equity warranted, I&E's recommended revenue increase would be adjusted to \$111,777. However, the recommended 0.00% equity return is warranted given the Company's failure to provide safe and reliable service as mandated under the Public Utility Code.⁴ Specifically, the Company's system has one functional well (Well #2) and one non-functional well (Well #1). Well #1 is not operational because the Company has excessive UFW, averaging 80.5% for the years ending December 31, 2015, 2016, 2017, and 2018, which causes the wells to over-pump and "stresses the wells to the point where their operational viability is at risk."⁵ The over pumping caused Well #1 to collapse so it is no longer functioning, which has increased the stress on Well #2 as it is the only well that is currently able to serve customers. According to the Company, the continued over-pumping of Well #2 is placing that well at increased risk of collapse.⁶ This threat is of particular concern because Well #2 is currently operating with no backup. These service issues date back to when the Commission approved the sale of Twin Lakes to Middlesex in February 2009, and over the past decade have only continued to deteriorate. As will be discussed more fully

⁴ 66 Pa. C.S. § 1501.

⁵ Twin Lakes St. No. 3, p. 2.

⁶ Twin Lakes St. No. 3, p. 2.

below, the two prior rate cases included settlement terms that were designed to address and improve the distribution system; however, the Company failed to fulfill those terms putting reliable and adequate water service to Twin Lakes customers in jeopardy.

Additionally, while this base rate case was being litigated, the Pennsylvania Department of Environmental Protection issued a notice on November 13, 2019 detailing elevated levels of lead found in drinking water tap samples taken from the Twin Lakes' system. Accordingly, I&E maintains that the recommended 0.00% return on equity ("ROE") is warranted.

III. Rate Base

A. Plant in Service

As indicated in Main Brief, the Company used a historic test year ("HTY") ending March 31, 2019. The depreciated original cost claimed by Twin Lakes in this proceeding is \$1,443,561. Twin Lakes further claimed projected plant in service additions from April 1, 2019 to September 30, 2019 of \$37,500.⁷ This resulted in a total plant in service balance of \$1,481,060.⁸ I&E witness Sakaya accepted the Company's proposal to reflect the post-test year pro forma plant in service additions and accumulated depreciation from April 1, 2019 to September 30, 2019. Therefore, the total plant in service balance of \$1,481,060 less the accumulated depreciation balance of \$219,884 results in a total net plant of \$1,261,176.⁹ The Company has claimed an acquisition adjustment in the amount of \$54,406 and \$17,175 in cash working capital as additions to rate base. The only

⁷ I&E St. No. 3, p. 12.

⁸ *Id.*

⁹ I&E Ex. No. 3, Sch. 4, p. 2 line 3.

deduction to rate base claimed by the Company is \$25,047 in deferred income taxes. This results in a total rate base of \$1,307,710 which serves as the starting point for any further I&E adjustments to rate base.

B. Depreciation Reserve

I&E has not proposed a depreciation reserve adjustment to rate base and therefore has no reply.

C. Additions to Rate Base

1. Acquisition Adjustment

I&E continues to recommend its acquisition adjustment allowance of \$36,018 or a reduction of \$18,388 as argued in Main Brief.¹⁰ I&E's adjustment is based upon a 20-year amortization period and is consistent with the way the Commission generally treats acquisition adjustments.¹¹

Twin Lakes disagrees with I&E's acquisition adjustment recommendation. First, Twin Lakes argues that I&E witness Sakaya acknowledges the Company has never amortized the claimed acquisition adjustment.¹² This assertion is incorrect. As clearly stated in I&E's Main Brief, witness Sakaya explained in testimony that it appeared that Twin Lakes was properly amortizing the acquisition amount between the 2011 and 2015 rate cases because it claimed a positive acquisition adjustment of \$71,440 in 2011 and reduced the claim to \$54,406 in 2015.¹³ However, the Company no longer believes that it

¹⁰ I&E M.B., pp. 6-10.

¹¹ I&E M.B., pp. 8-9.

¹² Twin Lakes M.B., p. 7.

¹³ I&E St. No. 3-SR, p. 11; I&E M.B., p. 8.

is appropriate to amortize the acquisition adjustment as it continues to claim \$54,406 in the instant 2019 case despite the fact that four years have lapsed. I&E reasons that the Company understood, at least at one point, that there was supposed to be a certain amount of amortized over a certain period of time related to this positive acquisition adjustment.¹⁴ It is reasonable to reduce the acquisition adjustment over time similar to the way plant depreciates over time.¹⁵ Further, the Company has not provided any evidence as to why it should be allowed to earn a return on its overpayment for this system in perpetuity.¹⁶

Next, Twin Lakes asserts that I&E has failed to propose a corresponding adjustment to operations and maintenance expense to account for the annual amortization of the acquisition adjustment which doesn't adhere to the "matching principle."¹⁷ This argument is incorrect as I&E witness Sakaya in direct testimony stated that the acquisition adjustment results "in an annual amortization expense of \$3,572."¹⁸ This annual amortization expense is also properly reflected under operation and maintenance expense adjustments in I&E's recommendation tables in Appendix D of I&E's Main Brief.¹⁹

Lastly, Twin Lakes contends that I&E's acquisition adjustment constitutes impermissible retroactive ratemaking.²⁰ As I&E explained in Main Brief, the Company's

¹⁴ I&E M.B., p. 8.

¹⁵ I&E M.B., pp. 8-9.

¹⁶ I&E M.B., pp. 9-10.

¹⁷ Twin Lakes M.B., p. 7.

¹⁸ I&E St. No. 3, p. 19.

¹⁹ I&E Main Brief, Appendix D.

²⁰ Twin Lakes M.B., p. 7.

claim that I&E's recommendation constitutes retroactive ratemaking is without merit. First, the Company did recognize that an amortization was required as it was reflected in the interim between the 2011 and 2015 rate cases.²¹ Second, as I&E witness Sakaya explained, acquisition adjustments are similar to the way plant depreciates over time since the difference is the result of the level of net plant compared to the purchase price.²²

I&E's calculation of Twin Lakes' acquisition adjustment is consistent with sound ratemaking principles. Therefore, I&E continues to request the ALJ recommend and the Commission order Twin Lakes to reflect a reduction of \$18,388 to the Company's claim, resulting in a total positive acquisition adjustment allowance of \$36,018.

D. Deductions from Rate Base

1. Cash Working Capital

I&E continues to recommend an allowance of \$12,423, or a reduction of \$4,752, to the Company's cash working capital claim.²³ I&E's adjustment is based upon the disallowance of depreciation and bad debt expense from the calculation as both are non-cash items and thus properly excluded from the calculation of cash working capital.

Twin Lakes disagrees with I&E's recommendation and avers that depreciation and bad debt expenses should be included in the calculation for cash working capital as explained in *Accounting for Public Utilities*.²⁴ The Company further claims that OCA

²¹ I&E M.B., p. 9.

²² I&E M.B., p. 9.

²³ I&E M.B., pp. 10-13.

²⁴ Twin Lakes M.B., p. 7; Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities*, § 5.04, 5-23.

and I&E witnesses failed to provide sufficient justification for proposals that radically depart from basic public utility accounting concepts.²⁵

I&E maintains that it properly excluded depreciation and bad debt expense from cash working capital because these expenses do not require cash. The Company's assertion that including these items in the cash working capital calculation is "a long-held and widely accepted basic principle of public utility accounting"²⁶ is simply not true given that this Commission has long recognized that non-cash items such as depreciation and uncollectibles are not appropriate in the determination of cash working capital.²⁷ This approach of excluding non-cash items such as bad debt expense and depreciation from a cash working capital calculation was echoed in *A Guide to Utility Ratemaking*²⁸, recently reissued by the Commission. Accordingly, I&E's recommendation is consistent with longstanding Commission precedent and therefore should be adopted.

E. Conclusion

As explained in I&E's Main Brief and above, I&E continues to recommend a \$23,140 adjustment to the Company's rate base for a total of \$1,284,570.²⁹

²⁵ Twin Lakes M.B., p. 7.

²⁶ Twin Lakes M.B., p. 7.

²⁷ *Pa. PUC v. Phila. Suburban Water Co.*, 58 Pa. PUC 668, 674 (1984) ("we consider uncollectible accounts expense to be a non-cash expense and, as such; no return allowance will be granted"); *Pa. PUC v. Mechanicsburg Water Co.*, 80 Pa. PUC 212, 226 (1993) (the Commission adopted the OCA's adjustment to eliminate non-cash items, such as amortization and written-off uncollectibles from the cash working capital calculation); *Pa. PUC v. Dauphin Consol. Water Supply Co.*, 71 Pa. PUC 555, 563-564 (1989) (the Commission determined that non-cash items such as uncollectible expense do not require the utility to use cash funds and are already recovered as expenses.) *Pa. PUC v. Columbia Gas of Pa, Inc.*, 74 Pa. PUC 282, 300 (1990) ("any expense which does not require the utility to utilize cash funds does not require a CWC allowance").

²⁸ *A Guide to Utility Ratemaking*, James H. Cawley and Norman J. Kennard (2018 Edition), p. 123.

²⁹ I&E M.B., pp. 13-14.

IV. Revenues

Twin Lakes reported its revenues as of March 31, 2019, or the end of the historic test year, as \$133,514.³⁰ If granted the full increase, Twin Lakes would earn approximately \$211,793 in annual revenue as a result of this filing.³¹ As explained further below, I&E recommended that if less than the full increase is granted, rates should be scaled back proportionally.³² Apart from this recommendation, I&E made no further adjustments to revenues.

V. Expenses

A. Rate Case Expense

I&E recommended two adjustments to the Company's \$86,000 rate case expense claim. First, I&E recommended that the Company's request to amortize, rather than normalize the expense, be denied. Second, I&E recommended that the Company's 18-month period be rejected in favor of a 39-month normalization period to reflect Twin Lakes' historical filing frequency as stated in I&E's Main Brief.³³

With respect to the first issue, it appears that the Company now acknowledges that rate case expense should be normalized and is no longer requesting that it be amortized. I&E bases this assumption on the Company's Main Brief, where it repeatedly refers to "rate case expense normalization" and the "normalization period."³⁴ Normalization is the

³⁰ I&E St. No. 3, p. 25.

³¹ I&E St. No. 3, p. 26.

³² I&E St. No. 3, p. 26.

³³ I&E M.B., pp. 14-19.

³⁴ Twin Lakes M.B., pp. 8-9.

appropriate ratemaking treatment for rate case expense for the reasons explained fully in I&E's Main Brief. Therefore, given the Company's repeated reference to normalizing rate case expense in its Main Brief, it appears that this is no longer a point of dispute between I&E and the Company.³⁵

The second issue concerns the appropriate time period over which the expense should be normalized. Twin Lakes rejects I&E's recommended 39-month normalization period and, for the first time in its Main Brief, proposes that a two-year normalization period be adopted.³⁶ Twin Lakes' two-year normalization is a new position as its testimony consistently argued for a recovery period of 18-months. Given that the two-year period was not raised or supported by Twin Lakes' witnesses in testimony, its inclusion at this juncture is inappropriate.

Further, as with its claimed 18-month period, the Company's newly proposed two-year normalization period is unsupported by its historical filing frequency. Twin Lakes argues that it demonstrated a five-year timeline for future infrastructure improvements that will cause it to file for another rate increase well ahead of a five-year timeframe.³⁷ Despite the Company's intent to make future infrastructure improvements, as was articulated in I&E's Main Brief, it is the Commission's usual practice to set a normalization period based upon historic filing frequency.³⁸ Twin Lakes has not provided any evidence to suggest that the improvements listed in Twin Lakes' witness

³⁵ I&E M.B., pp. 15-16.

³⁶ Twin Lakes M.B., p. 9.

³⁷ Twin Lakes M.B., p. 9.

³⁸ I&E M.B., p. 16; *A Guide to Utility Ratemaking*, James H. Cawley and Norman J. Kennard (2018 Edition) p. 112.

Fullagar's direct testimony would trigger another rate case in order to complete these improvements. Even if that were true, however, as was stated above, the Commission looks to historic filing frequency to determine the proper normalization period and does not take speculative future filings into account. Here, I&E witness Zalesky correctly determined 39 months to be the Company's average filing frequency and used that as the basis for an appropriate rate case expense normalization period.

For these reasons, I&E recommends that Twin Lakes be permitted to normalize its \$86,000 rate case expense claim over 39-months, resulting in an allowance of \$26,462. This is a \$30,871 reduction to the Company's original claim based on its claimed 18-month period in testimony.

B. Maintenance Supplies

The Company claimed \$9,509 for maintenance supplies. In testimony and Main Brief, I&E recommended that this claim be reduced by \$5,010, resulting in a recommended maintenance supplies allowance of \$4,999. I&E's recommendation regarding maintenance supplies was not addressed in Twin Lakes' Main Brief. I&E continues to advocate for its adjustment to maintenance supplies as articulated in its Main Brief.³⁹

C. Purchased Power

The Company's purchased power claim was \$10,524. I&E recommended a purchased power allowance of \$7,520, which is a \$3,004 reduction to the Company's

³⁹ I&E M.B., pp. 19-20.

claim. As stated in I&E's Main Brief, I&E's purchased power and chemical expense adjustments consist of two components: price to compare and unaccounted for water.⁴⁰

Regarding the first adjustment, I&E determined that the Company paid more than PPL's current price to compare in virtually every month over a 39-month period, resulting in approximately \$3,000 additional generation and transmission charges.⁴¹ I&E concluded that ratepayers should not be required to pay for this imprudent expense. Twin Lakes did not dispute I&E's recommendation in its rebuttal testimony. Similarly, Twin Lakes did not respond to I&E's adjustment based on the price to compare in its Main Brief. Given that the Company has failed to support its purchased power claim, I&E requests its adjustment be accepted.

I&E's second purchased power adjustment is based on the Company's excessive unaccounted-for water, which averaged 80.5% from 2015-2018. Twin Lakes rejects this adjustment and argues that if the Commission were to adopt I&E and OCA's recommendations regarding purchased power and chemical costs for unaccounted for water it would increase operational risk to the detriment of Twin Lakes' customer base.⁴² The Company further asserts 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 and that reliable service cannot be maintained without adequate amounts of purchased power and chemicals.⁴³

⁴⁰ I&E M.B., pp. 20-29.

⁴¹ I&E M.B., pp. 20-21.

⁴² Twin Lakes, M.B., p. 14.

⁴³ Twin Lakes, M.B., p. 14.

These arguments fail to acknowledge the Commission's policy on unaccounted-for water, at 52 Pa. Code § 65.20(4), which determines levels of unaccounted-for water above 20% to be excessive.⁴⁴ As stated in I&E's Main Brief, it is important to keep unaccounted-for water to reasonable levels because it reduces the amount of water that ultimately needs to be pumped, treated, and sent to customers, while increasing the amounts available during peak demand and improving overall service quality.⁴⁵ The Company's current unaccounted-for water in 2018 was 81.3% and its three year average for the years ended December 31, 2015 through December 31, 2018 was 80.5%, well above the Commission's 20% threshold.⁴⁶ In order to recover costs for unaccounted-for water, the Commission has required water companies with levels in excess of the 20% benchmark to demonstrate by way of substantial evidence that their experience is both normal and reasonable by providing evidence (i.e., engineering, operations or historical testimony) to support the argument that these levels are reasonable.⁴⁷ Companies that are unable to support with substantial evidence that the excessive levels of unaccounted-for water they are experiencing are normal and reasonable have been subjected to a downward adjustment in operating and maintenance expenses.⁴⁸

The Company does not offer evidence to support that the level of unaccounted-for water in its system is reasonable nor does it offer any solution to reduce the unaccounted-

⁴⁴ 52 Pa. Code § 65.20(4).

⁴⁵ I&E M.B., pp. 22-23.

⁴⁶ I&E M.B., p. 23.

⁴⁷ I&E M.B., p. 26.

⁴⁸ I&E M.B., p. 26.

for water for which it knew was an issue as far back as 2011. In both the 2011 and 2015 rate cases, the Company entered into a Joint Settlement of its base rate case in which it agreed to certain measures that would help remedy the unaccounted-for water levels.⁴⁹ The Company failed to follow through on the system improvements spelled out in the both Settlements and remediation of the unaccounted-for water was not carried out as contemplated by the Settlements.

It is contrary to the public interest to continue passing the costs of treating and pumping excessive unaccounted-for water to Twin Lakes' customers. It is fundamental that imprudent and unreasonable expenses should be disallowed and, certainly, the Company's historic and current levels of unaccounted-for water is unreasonable. Twin Lakes argues that customers should pay 100% of the power and chemical expenses incurred to treat and pass the water through the system, but only 19.5% of the treated water actually makes it to those customers. Twin Lakes should have taken steps since the last base rate case where it was placed on notice to remediate this very issue, instead no major improvements have been undertaken since 2015 allowing the unaccounted-for water levels to worsen. For the reasons articulated in I&E's Main Brief and discussed above, I&E requests that the Commission adopt its adjustment to purchased power and chemical expense based upon price to compare and unaccounted-for water.

⁴⁹ I&E M.B., p. 24.

D. Bad Debt Expense

Twin Lakes claimed \$19,095 for bad debt expense. I&E put forth its recommendation regarding bad debt expense in its testimony and Main Brief, which was an allowance of \$3,062 based on the average percentage of net write-offs to gross revenues for three historic twelve-month periods.⁵⁰ Twin Lakes failed to address I&E's bad debt expense recommendation in its Main Brief. As Twin Lakes has failed to satisfy its burden of proof with respect to this claim I&E requests its \$16,033 adjustment to bad debt expense as articulated in its Main Brief be accepted.

VI. Taxes

As stated in Main Brief, I&E's recommendations regarding state and federal income taxes would only apply in the situation in which the Commission grants a return on equity to Twin Lakes.⁵¹

A. State Income Taxes

Twin Lakes did not address I&E's state income tax adjustment in its Main Brief, I&E continues to support its adjustment to state income taxes as was stated in Main Brief.

B. Federal Income Taxes

Twin Lakes did not address I&E's federal income tax adjustment in its Main Brief, I&E continues to support its adjustment to state income taxes as was stated in Main Brief.

⁵⁰ I&E M.B., pp. 29-31.

⁵¹ I&E M.B., p. 31.

VII. Rate of Return

A. Introduction

As stated in Main Brief, I&E looks to the legal standards in the seminal cases of *Bluefield*⁵² and *Hope*⁵³ to determine a fair and reasonable overall rate of return, which allows the utility the opportunity to recover those costs prudently incurred by all classes of capital used to finance the rate base during the prospective period in which its rates will be in effect.⁵⁴ The Company is claiming an overall rate of return of 9.00% including an 11.00% return on equity. I&E maintains that the Company's claimed 11.00% return on equity is unsupported given the Company is not providing safe and reliable service as mandated by the Public Utility Code therefore, I&E recommends that no equity return be awarded. Accordingly, I&E's recommended overall rate of return is 3.50% which includes 0.00% return on equity.⁵⁵ However, if the Commission disagrees with I&E's 0.00% return on equity recommendation, I&E recommends an overall rate of return of 8.12% which is based upon a traditional rate of return analysis that includes a 9.23% return on equity.⁵⁶

⁵² *Bluefield Water Works & Improvements Co. v. Public Service Comm. of West Virginia*, 292 U.S. 679, 692-93 (1923).

⁵³ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

⁵⁴ I&E M.B., pp. 35-36.

⁵⁵ I&E M.B., p. 37.

⁵⁶ I&E M.B., p. 37.

B. Proxy Group

I&E put forth its proxy group selection in Main Brief.⁵⁷ Twin Lakes did not utilize a proxy group in its rate of return analysis and failed to address I&E's proxy group in its Main Brief.

C. Capital Structure

As mentioned in Main Brief, I&E accepted the Company's capital structure of 50.00% long-term debt and 50.00% equity for the historic test year because it fell within the range of the capital structure ratios for I&E's proxy group.⁵⁸

D. Cost of Long-Term Debt

Although I&E accepted the Company's 7.00% debt cost rate in testimony and Main Brief, I&E also encouraged Twin Lakes to seek debt at a lower cost rate, including through channels available to its Parent, Middlesex Water.⁵⁹

E. Return on Common Equity

1. I&E's Primary Recommendation

The main area of disagreement is the appropriate cost of common equity. I&E continues to recommend a 0.00% return on equity for Twin Lakes.⁶⁰ This proceeding involves extraordinary circumstances in which the Company is not meeting its obligation to provide safe and reliable water service to its customers as required by the Code. I&E's

⁵⁷ I&E M.B., pp. 38-39.

⁵⁸ I&E M.B., p. 40.

⁵⁹ I&E M.B., p. 40.

⁶⁰ I&E M.B., pp. 41-59.

recommendation is just and reasonable when taking into consideration the quality of service and high rates Twin Lakes' customers are subjected to.

Twin Lakes argues against I&E's recommendation of 0.00% return on equity. First, Twin Lakes states that a 0.00% return on equity would place the Company at a significant disadvantage in the ability to raise capital thereby making it extraordinarily difficult, if not impossible, to finance critically needed improvements to maintain safe and reliable service.⁶¹ Twin Lakes believes that if the Commission were to grant I&E's position of 0.00% return on equity, it would cause regulatory uncertainty rendering it impossible for a water utility to plan for future investments in infrastructure.⁶² This argument fails because Twin Lakes has alternate sources of funding available to it. For example, it has recently applied to obtain such funding from PENNVEST and the Company's parent, Middlesex, can guarantee its debt repayments. As discussed in I&E's Main Brief, Twin Lakes knew of its obligation to make system repairs from its 2015 Settlement and waited to apply for a PENNVEST loan until 2019.⁶³ The Company did not address this issue meaning we are left without a reason for the delay. It is contrary to the public interest and the Public Utility Code to allow the Company to let the system fall into this state of disrepair and then award its requested 11.00% equity return.

Next, Twin Lakes claims that granting 0.00% return on equity would cause Twin Lakes and other water utilities in Pennsylvania to experience a credit downgrade.⁶⁴ Twin

⁶¹ Twin Lakes M.B., p. 13.

⁶² Twin Lakes M.B., p. 13.

⁶³ I&E M.B., p. 52.

⁶⁴ Twin Lakes M.B., p. 13.

Lakes goes further to state an unreasonably low return on equity will jeopardize Twin Lakes' ability to attract capital and dramatically impair the Company's ability to obtain a reasonable credit rating.⁶⁵ This argument is without merit as Twin Lakes has already stated that its credit rating is at a level which cannot attract capital as its Parent holds a \$1,000,000 Promissory Note as its lender of last resort.⁶⁶ A 0.00% return on equity for Twin Lakes would do little if anything to affect its already poor credit rating.

Lastly, Twin Lakes asserts that if the Commission were to deny Twin Lakes a return on equity, it would create regulatory uncertainty in the marketplace.⁶⁷ Regulatory uncertainty may result in a loss of investors for this Company and potentially seemingly unrelated companies as well.⁶⁸ However, as I&E has explained previously, this proceeding exhibits extraordinary circumstances that warrant a 0.00% return on equity. The Commission is obligated to ensure that public utilities are following the Code without regard to the potential affect it may or may not have on investors. Here, it is evident that Twin Lakes continues to disregard its responsibility to provide safe and reliable service to its customers by failing to make crucial improvements it was aware of since both of its last base rate cases in 2011 and 2015. It is a matter of public policy that the Commission determine that Twin Lakes is not fulfilling its statutory obligations and therefore not entitled to a return on equity.

⁶⁵ Twin Lakes M.B., p. 13.

⁶⁶ Twin Lakes St. No. 2, p. 6.

⁶⁷ Twin Lakes M.B., p. 13.

⁶⁸ Twin Lakes M.B., p. 13.

2. I&E's Alternative Recommendation

If the Commission disagrees with I&E's 0.00% equity recommendation, I&E also conducted a traditional rate of return analysis to address the Company's 11.00% equity claim.⁶⁹ Based on its DCF analysis, I&E recommends the following alternate rate of return for Twin Lakes:

| Type of Capital | Ratio | Cost Rate | Weighted Cost |
|-----------------|---------|-----------|---------------------|
| Long-Term Debt | 50.00% | 7.00% | 3.50% |
| Common Equity | 50.00% | 9.23% | 4.62% |
| Total | 100.00% | | 8.12% ⁷⁰ |

The Company's Main Brief addressed I&E's primary recommendation of 0.00% ROE but failed to address I&E's alternate recommendation of a 9.23% ROE. I&E's testimony and Main Brief fully explained its DCF analysis including the appropriate proxy group, the dividend yields used and the expected growth rates. The Company's Main Brief did not challenge any of this analysis. Unlike I&E's full ROE analysis, the Company's 11.00% recommendation was simply based on the small size of the Company and the authorized ROE range of 8.02-10.58% for a Pennsylvania water utility as published in the PAPUC Quarterly Earnings Summary Report for the year ended March 31, 2019. The Company's Main Brief failed to support why its 11.00% ROE claim is reasonable or explain why I&E's recommended 9.23% should be rejected. Therefore, even if the ALJ

⁶⁹ I&E M.B., pp. 59-63; I&E St. No. 2, pp. 31-38.

⁷⁰ I&E Exhibit No. 2, Schedule 1.

and Commission determine that an equity return is warranted, it is clear that the Company has failed to satisfy its burden to support its 11.00% ROE.

F. Overall Rate of Return

I&E maintains that Twin Lakes' claimed rate of return of 9.00% is wholly unsupported. The evidence overwhelmingly demonstrates that Twin Lakes has been and continues to provide poor service at unreasonably high rates, which does not warrant its claimed 11.00% ROE. I&E continues to recommend its 3.50% overall rate of return due to inadequate and unreasonable service. However, should the Commission determine that Twin Lakes is providing adequate and reasonable service, I&E's proposed overall rate of return of 8.12% should be adopted.

VIII. Other Issues

A. Quality of Service

1. Reliability

I&E addressed Twin Lakes' failure to provide reliable service to its customers in Main Brief. I&E remains concerned that customers are at risk of the Company not having the ability to provide water service. Twin Lakes has yet to offer any solution to ensure the customers receive water service. Further, in its Main Brief, Twin Lakes states that the entire system needs to be replaced as it is incapable of being pressurized to an acceptable level without an extraordinary amount of leakage.⁷¹

⁷¹ Twin Lakes M.B., p. 14.

The Company was placed on notice as to the reliability of service in both the 2011 and 2015 base rate cases.⁷² Both base rate cases ended with settlement agreements in which the Company agreed to address the reliability concerns of the system. The improvements listed in the settlements which the Company failed to undertake are crucial to mitigate the problems of unacceptably high levels of Twin Lakes' unaccounted-for water and the stress currently placed on Well #2, the Company's only functioning well. I&E believes it to be imperative that Twin Lakes take its obligation as a public utility to provide safe and reliable service to its customers seriously as it has disregarded its commitments to improve its system as agreed to in the past.

2. Exceedance of Lead Action Levels

Twin Lakes, in its Main Brief, notes its agreement to a 12-point program in which the Company will conduct various tests annually and report on its filings to address the exceedance of the lead action levels.⁷³ I&E supports the agreement as it addresses health and safety concerns and follows the Code's mandate that a public utility provide safe and reliable service to its customers.

B. Affordability of Rates

I&E argued that the Company's rates are unreasonably high given the level of service that customers receive.⁷⁴ In its rate filing, the Company is requesting to increase the average monthly bill from \$94.59/month to \$284.34/month.⁷⁵ Twin Lakes, in Main

⁷² I&E M.B., pp. 44-47.

⁷³ Twin Lakes M.B., p. 14.

⁷⁴ I&E M.B., pp. 53-56.

⁷⁵ I&E M.B., p. 53.

Brief, discussed the subjectivity of affordability.⁷⁶ First, this is not a theoretical issue given that several customers made it clear that their water bills were unaffordable when they testified at the two public input hearings held in the Company's service territory.⁷⁷ Second, I&E contends that Twin Lakes' rates are at an unreasonably high level based on objective information provided by the U.S. Environmental Protection Agency ("U.S. EPA"). The U.S. Environmental Protection Agency states that water/wastewater rates greater than 2% of median household income may be difficult for consumer affordability based on data across many federal and state programs.⁷⁸ I&E witness Henkel determined that the average Twin Lakes' water customer currently pays 1.79% of the median household income of Pike County, PA and that would climb to 4.70% if the Company's full increase is granted.⁷⁹

Twin Lakes asserts that the regulatory compact requires that the true cost of service be borne by the customers receiving the service regardless of the size of the customer base.⁸⁰ However, the regulatory compact does not demand this if the utility fails to provide safe, adequate and reliable service. The Code places the burden on the public utility to remedy any deficiencies in its system to ensure that its customers receive, "adequate, safe, and reasonable service."⁸¹ Section 523 of the Code requires the Commission to "consider...the efficiency, effectiveness and adequacy of service of each

⁷⁶ Twin Lakes M.B., p. 14.

⁷⁷ I&E M.B., 54.

⁷⁸ I&E M.B., p. 53.

⁷⁹ I&E M.B., p. 54.

⁸⁰ Twin Lakes M.B., p. 14.

⁸¹ 66 Pa. C.S. § 1501.

utility when determining just and reasonable rates...⁸² and, if the Commission finds that the utility has not provided adequate service, the Commission has the authority to disallow a rate increase in whole or in part under 66 Pa. C.S. § 526(a).⁸³ Therefore, in exchange for customers paying tariff rates for utility service (including the cost of plant in service and a rate of return), the regulated utility is obligated to provide safe, adequate and reasonable service. The Company has failed to satisfy its part of the bargain; therefore, the regulatory compact does not demand that Twin Lakes customers pay rates that are premised on receiving appropriate service when such service is not being provided.

Twin Lakes further states that it and its parent company, Middlesex Water Company, have gone above and beyond what should be reasonably expected of an investor in terms of its ongoing commitment to fund the capital and operating needs of a utility that has to remain viable on its own.⁸⁴ I&E believes the evidence has shown that neither has Twin Lakes nor Middlesex Water performed basic improvements to its system to improve quality and reliability as its unaccounted-for water is at an extreme level and it is functioning on one well that is stressed. It is also important to note that Middlesex Water Company was aware of size of the customer base and should have known the state of the system was poor prior to its acquisition.⁸⁵ This was discussed at length in I&E's Main Brief where Middlesex Water's due diligence was examined.⁸⁶

⁸² 66 Pa. C.S. § 523.

⁸³ I&E M.B., p. 42.

⁸⁴ Twin Lakes M.B., p. 15.

⁸⁵ I&E M.B., pp. 47-50.

⁸⁶ I&E M.B., pp. 47-50.

Twin Lakes' customers are clearly paying rates inconsistent with the level of service received by the Company. The Code places the burden on the public utility to remedy any deficiencies in its system to ensure that its customers receive, "adequate, safe, and reasonable service."⁸⁷ If the Commission finds that the Company has not provided adequate service, the Commission has the authority to disallow a rate increase under 66 Pa. C.S. § 526(a).⁸⁸

I&E maintains that Twin Lakes' customers are paying extraordinarily high rates for inadequate service.

IX. Rate Structure

In the event the Commission grants Twin Lakes less than its proposed rate increase, I&E recommended that rates be scaled back proportionally so that each rate receives the same percentage increase. In its Main Brief, Twin Lakes accepted I&E's recommendation.⁸⁹

X. Conclusion

Twin Lakes has failed to bear its burden of proof with respect to each and every element of its proposed \$211,793 rate increase. The Company's increase must be reduced to reflect the necessary and appropriate adjustments to ensure rates are just and reasonable. For the reasons stated herein and in its Main Brief, the Bureau of Investigation and Enforcement respectfully requests that Administrative Law Judge Guhl

⁸⁷ 66 Pa. C.S. § 1501.

⁸⁸ I&E M.B., p. 42.

⁸⁹ Twin Lakes Main Brief, p. 16.

and the Commission adopt its expense, rate base and rate of return recommendations in this proceeding, resulting in I&E's proposed increase of \$51,098.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Erika L. McLain", written over a horizontal line.

Erika L. McLain

Prosecutor

PA Attorney ID No. 320526

Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, Pennsylvania 17120

Dated: January 15, 2020

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Reply Brief** dated January 15, 2020, in the manner and upon the persons listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party):

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