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March 2, 2020

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 Exceptions 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 "Christine Maloni Hoover".

Christine Maloni Hoover
Senior Assistant Consumer Advocate
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Enclosures:

cc: The Honorable Marta Guhl, ALJ
Office of Special Assistants (e-mail only: ra-OSA@pa.gov)
Certificate of Service

*284197

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 document, the Office of Consumer Advocate's Exceptions, 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 2nd day of March 2020.

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Dated: March 2, 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. :

EXCEPTIONS
OF THE
OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

On February 19, 2020, the Public Utility Commission's (Commission) Office of Administrative Law Judge issued the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Marta Guhl regarding Twin Lakes Utilities, Inc.'s (Twin Lakes or the Company) proposed rate increase for water service. The ALJ recommended an increase of \$111,776 as a result of adjustments to the Company's rate base, operation and maintenance expenses, taxes, and rate of return.

The ALJ did not adopt the OCA's primary position that the Commission should reduce the return on equity from a market-based rate of 8.78% to 0% to reflect the inadequate service provided by Twin Lakes. The ALJ recognized the inadequate service but did not adopt a reasonable remedy for inadequate service or the unaffordability of the rates. The OCA files the exceptions as set forth below to address certain aspects of the R.D. Regarding revenue requirement, the ALJ did not adopt a number of the OCA's accounting adjustments, but in adopting I&E's revenue and expense adjustments that are similar to the OCA's adjustments, the ALJ has addressed the OCA's revenue and expense adjustments. The OCA is filing Exceptions regarding the acquisition adjustment, taxes, return on equity, adequacy of service, and affordability of rates.

The OCA submits that its Exceptions, if granted, will ensure that Twin Lakes' inadequate service is reflected in the approved revenue requirement in accordance with the Public Utility Code and respectfully requests that the Commission adopt the recommendations below. Therefore, pursuant to 52 Pa. Code § 5.533, the OCA files the following Exceptions for the Commission's consideration.

II. EXCEPTIONS

OCA Exception #1: The ALJ Erred by Allowing the Acquisition Adjustment Claim Because it Was Not Requested or Approved by the Commission in the First Base Rate Case Following Acquisition.
R.D. at 15-20; OCA M.B. at 7-8; OCA R.B. at 3-5.

The OCA argued for the disallowance of Twin Lakes' acquisition adjustment claim in this case because it was not properly requested, supported or approved by the Commission in the first base rate case following the acquisition as required by the Public Utility Code and the Commission's regulations. ALJ Guhl recommends that the Commission allow the claim in this case, subject to amortization of the acquisition adjustment beginning in 2011. For the reasons previously argued, the OCA submits that the Commission should disallow Twin Lakes' acquisition adjustment claim in its entirety.

ALJ Guhl states that none of the parties argue that the Company fails to meet the criteria under Section 1327.¹ R.D. at 19. The OCA submits that Twin Lakes bears the burden of proof to demonstrate that it meets the Section 1327 criteria, which it has not done at any point in this proceeding. Neither the OCA nor I&E are required to introduce evidence demonstrating that Twin Lakes fails to meet the requirements of Section 1327. ALJ Guhl further states that there is nothing in the statute or the regulation which prohibits the Commission from considering or approving an acquisition adjustment request after the first rate case following acquisition of a utility system. R.D. at 19-20. The OCA respectfully submits that the statutes and regulations do require acquisition adjustments to be requested by an eligible utility, supported, and considered by the Commission in the first base rate case following the acquisition at issue.

¹ 66 Pa. C.S. § 1327.

Section 1327 of the Code establishes nine criteria that must be met before a utility can claim an acquisition adjustment in rate base.² Additionally, the Commission’s Acquisition Policy Statement requires that after an acquisition is approved, an acquiring system may request the inclusion of the value of the used and useful assets of the acquired system in its rate base and that “[a] request *will* be considered during the acquiring utility’s *next* filed rate case proceeding” (emphasis added).³ Neither the statutes, regulations, nor the Commission’s Policy Statements state that an acquiring utility may request an acquisition adjustment in *any* rate case following acquisition; rather, the Commission deliberately expressed its intention to consider such a request in the acquiring utility’s *next* rate case. ALJ Guhl states that a utility is not prohibited from requesting an acquisition adjustment claim after the first rate case following acquisition of a utility system. R.D. at 19-20. The OCA submits, however, that this prohibition is found in the black letter of the Commission’s Policy Statement. By expressly requiring these requests to be made in the utility’s *next* rate case, the Commission indicates its intention *not* to consider such requests in subsequent rate cases.

Moreover, the Commission’s Policy Statement pertaining to water and wastewater utility acquisition incentives states *four* times that an acquisition adjustment request will be considered as part of the utility’s “next” rate case filing.⁴ The OCA submits that the Commission has

² Id.

³ 52 Pa. Code § 69.721.

⁴ “An acquiring utility that has met the criteria set forth in 66 Pa. C.S. § 1327(a) (1)-(9) for inclusion of a debit acquisition adjustment in its rate base, may elect to have this acquisition adjustment considered on a case-by-case basis as set forth in 66 Pa. C.S. § 1327(b), or as part of its **next rate case filing**.” 52 Pa. Code § 69.711(c)(1) (emphasis added) (subsection pertaining to procedure).

“The appropriate implementation procedure to qualify for the other acquisition incentives in subsection (b) would be to file the appropriate supporting documentation during the **next filed rate case**.” 52 Pa. Code § 69.711(c)(2) (emphasis added) (subsection pertaining to procedure).

deliberately and thoughtfully included the requirement that an acquisition adjustment claim be requested and considered in the rate case immediately following acquisition.

Further, requesting and considering acquisition adjustment claims in the first base rate case following acquisition is not only consistent with the Public Utility Code, the Commission's regulations and its Policy Statements, it also conserves judicial resources. When eligible utilities request acquisition adjustments in the first base rate case after acquisition, the information needed to support the criteria contained in Section 1327 is more readily available. Also, if the claim is granted, there would be no need to expend judicial resources litigating issues such as whether the acquisition adjustment has been amortized and if so, over what period, as was presented in this general base rate case.

Lastly, ALJ Guhl states that requiring the Commission to approve acquisition adjustment claims in the first rate case following an acquisition would tie the Commission's hands in the event of black box settlements. RD at 20. As the OCA argued in its Reply Brief (R.B.), the Commission has approved acquisition adjustment claims 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).⁵ As such, the OCA

“When an acquiring utility elects to have the acquisition adjustment to its rate base considered as part of its **next rate case filing**, the acquiring utility should file the following documentation....” 52 Pa. Code § 69.711(d) (emphasis added) (subsection pertaining to documentation needed to support inclusion of an acquisition adjustment).

“When the acquiring utility elects to request an acquisition adjustment during its **next rate filing**, it should submit a copy of its newly prepared original cost plant-in-service valuation of the acquired system....” 52 Pa. Code § 69.711(e) (emphasis added) (subsection pertaining to time to submit original cost valuation).

⁵ OCA R.B. at 3.

submits that the Commission is capable of approving acquisition adjustment claims where the parties agree to it in a settlement.

The OCA submits that it is neither reasonable nor appropriate for a utility to bring an acquisition adjustment claim eight years and three rate cases after it originally claimed the adjustment. Allowing such a claim contradicts the law and the Commission's express intent.

OCA Exception #2: The Federal Income Tax Claim Should Be Removed from the ALJ's Calculations to Reflect the Recommended Decision.
R.D. at 45-48; OCA M.B. at 19; OCA R.B. at 13.

The OCA recommended the disallowance of the federal income tax claim in its entirety, and ALJ Guhl also recommends disallowing this claim in whole. The OCA does not except to ALJ Guhl's recommendation regarding taxes; however, the OCA notes issues observed with Table I – Income Summary (Table I) provided by ALJ Guhl in this case. Table I has several embedded calculations, one of which is related to the federal income tax calculation. The federal income tax claim was initially eliminated as part of ALJ Guhl's adjustments, but taxes were then added back in to ALJ Guhl's calculation as a result of the expense adjustments made on Table II – Summary of Adjustments. These adjustments resulted in an overall positive increase in the federal income tax claim, and it is reflected on Table I in the column labeled "ALJ Adjustments" in the federal income tax row. These adjustments should be removed to reflect ALJ Guhl's recommendation excluding federal income taxes.

OCA Exception #3: The ALJ Erred By Adopting a 9.23% Return on Equity Because it Does Not Reflect Inadequate Service.
R.D. at 53-54, 73-75; OCA M.B. at 23-33, 43-45; OCA R.B. at 14-16, 22-23.

The ALJ rejected the OCA and I&E's primary positions that, due to inadequate service, a 0% return on equity should be used to calculate Twin Lakes' revenue requirement in this proceeding. R.D. at 53-53; OCA M.B. at 43-45; R.B. at 22-23. As discussed in the next Exception,

the ALJ agreed that Twin Lakes is not providing adequate service pursuant to Section 1501 of the Public Utility Code. R.D. at 82-83. The OCA recommended a 0% return on equity because Twin Lakes is not meeting its obligation to provide safe, adequate and reliable service pursuant to Section 1501 of the Public Utility Code. 66 Pa. C.S. § 1501. The OCA recommended a 0% return on equity as a reasonable way to reflect the inadequate service, pursuant to Section 523 of the Public Utility Code which permits the Commission to deny a rate increase in whole or in part. 66 Pa. C.S. § 523. The OCA excepts because the ALJ's return on equity recommendation of 9.23% does not reflect the inadequate service that the ALJ found in her review of the record. As discussed below, the return on equity should be set at 0%, rather than 9.23%, to adequately reflect the inadequate service found by ALJ Guhl.

The ALJ adopted the 9.23% return on equity reflected in I&E's secondary position. The ALJ stated that 9.23% was a "reduced rate of return" that reflects "all of the factors listed above, while also allowing the Company to recover some revenue." R.D. at 75. While it is accurate to state that 9.23% is a "reduced rate of return" as compared to the Company's request for an 11% return on equity, it is not accurate to conclude that 9.23% reflects any reduction for inadequate service. The 9.23% is a market-based return on equity based on the analysis presented by I&E witness Henkel.

The OCA's analysis of a market-based cost of equity calculation produced an ROE of 8.73% and an overall rate of return recommendation of 7.89%. OCA M.B. at 20-33; OCA R.B. at 14-17; OCA St. 2. Without considering quality of service, Mr. Rothschild's calculation is reasonable and supported by extensive analysis. Id. Similarly, it is the OCA's understanding that I&E's cost of capital calculation of 9.23% is the market-based recommendation and does not reflect any reduction for inadequate service. Rather, these two return on equity calculations are

the traditional analyses done by rate of return experts presenting testimony before the Commission. A review of the ALJ's discussion of the I&E and OCA testimony on cost of equity shows the ALJ's review of the standard cost of equity issues, such as proxy groups, growth rates, and dividend yields. R.D. at 55-58, 65-73. There is nothing in the market-based rate of return discussion that reflects any adjustment in the analyses for the quality of service provided by Twin Lakes. The reduction from 11% to 9.23%, as recommended by the ALJ, reflects only the fact that the Company's proposed 11% return on equity is overstated and not supported by a reasonable market-based analysis.⁶

In setting forth the recommendation, the ALJ recognizes that there are issues with reliability of service, the Company's failure to comply with the terms of prior settlement in the 2011 and 2015 rate cases, the Company's failure to gain access to financing, and the Company's delay in seeking a PENNVEST loan and grant. R.D. at 74. However, in making her recommendation, the ALJ then ties the inadequate service to the market-based return on equity (I&E's 9.23%) rather than 0% (or something less than the market-based return on equity) because it allows "the Company to recover some revenue." R.D. at 75.

The evidence shows that OCA's primary position, that there should be a 0% return on equity used to calculate the revenue requirement in this proceeding, allows the Company to recover additional revenue above its present revenues while at the same time reflecting the inadequate service received by Twin Lakes customers. Using a 0% return on equity, a 50% debt/50% equity capital structure and the Company's 7% debt cost rate, results in an overall cost of capital of 3.5%. OCA Table I, Sch. SLS-1C (attached to OCA's Main Brief). The resulting revenue requirement,

⁶ The analyses performed by OCA witness Rothschild and I&E witness Henkel clearly demonstrate that the cost of equity should be no higher than 9.23%.

using the 3.5% overall return results in additional revenues of \$98,688, or a 73.9% increase in revenues. Id. It is the OCA’s position that additional revenues of \$98,688 represent a reasonable “adjustment” or remedy for the inadequate service provided by Twin Lakes **and** recognizes the realities of the water system by providing substantial additional revenues for the Company.

OCA Exception #4: The ALJ Erred by Not Reflecting an Adequate Remedy for Inadequate Service.
R.D. at 77-83; OCA M.B. at 34-45; OCA R.B. at 17-23.

After reviewing the evidence, the ALJ found that Twin Lakes has failed to provide adequate and reasonable service in accordance with Section 1501 of the Public Utility Code. R.D. at 82-83. She found that Twin Lakes failed to take advantage of the rate increase related to the 2015 Settlement and did not replace Well No. 1, which meant that Phase 2 of the increase did not go into effect. R.D. at 82. In addition, the ALJ found that Twin Lakes did not replace the specific mains required to trigger Phase 3 rates of the 2015 Settlement. Id. The ALJ found that “Twin Lakes acknowledges that the system needs to be replaced but has failed to take any measure to improve the conditions.” Id. She also noted, “The Company should not be rewarded for its inaction in this case.” Id. at 82. She concluded that “Twin Lakes is not entitled to its full requested rate increase.” Id. at 83. The OCA agrees with the ALJ’s conclusion that the Company is not providing adequate service as required under Section 1501 of the Public Utility Code. See OCA M.B. at 34-43; OCA R.B. at 17-22. The OCA files this exception because the OCA submits that the ALJ’s revenue requirement based on a recommendation of a return on equity of 9.23%, does not represent a reasonable remedy for the inadequate service.

The Commission has the authority to deny a rate increase, in whole or in part, due to inadequate service. 66 Pa. C.S. § 526. Id. As discussed above, the OCA recommended that the return on equity be set at 0%, rather than 8.78%, which is the market-based cost of equity

calculated by Mr. Rothschild to reflect this inadequate service. As a result of the reduction in the cost of equity, the OCA's primary revenue requirement recommendation reflects additional annual revenues of \$98,688, or a 73.9% increase. Even the OCA's recommended revenue requirement, at 0% return on equity, represents an extremely large increase to the Twin Lakes' customers. The OCA submits, however, that its primary recommendation reflects a reasonable balancing of the evidence of inadequate service and is consistent with the Commission's authority under Section 526 of the Public Utility Code.

Given the ALJ's findings of inadequate service, the OCA submits that the appropriate remedy is to reduce the market-based return on equity to 0%, as recommended by OCA and I&E OCA St. 1; OCA St. 2; OCA M.B. at 43-44; OCA R.B. at 22-23. Given the evidence in this proceeding, it is not reasonable to find inadequate service and yet provide no reduction in the revenue requirement to reflect that evidence.

The OCA submits that the appropriate remedy for the finding of inadequate service is to set the return on equity to 0% and use the resulting overall rate of return of 3.5% to calculate the revenue requirement in this proceeding.

OCA Exception #5: The ALJ Erred by Not Reflecting an Adequate Remedy for the Affordability Issue Presented in This Proceeding.
R.D. at 83-87; OCA M.B. at 45-49; OCA R.B. at 23-25.

The ALJ recommended that "the Company be denied the full requested rate increase."

R.D. at 87. She stated:

Part of the reason for this is the concerns with affordability of rates for customers. Rate shock would be present not only at the Company's proposal but also with I&E and OCA's calculated revenue requirement. If rates are too high, then not only does that violate the basic principles of rate setting, it will result in customers not being able to afford water utility service.

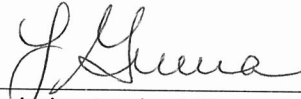
R.D. at 87. The ALJ concluded that the appropriate remedy was the adoption of I&E's market-based cost of equity and the resulting revenue requirement. Id. While the OCA agrees with the ALJ's analysis of the affordability issue, the OCA disagrees that, in this case, using the market-based cost of equity reflects a remedy for the affordability concerns. See OCA M.B. at 45-49; OCA R.B. at 23-25. In providing for an increase in revenues, using the market-based cost of equity, and not reflecting any reduction for inadequate service, the affordability concerns are still present, albeit not as great as under the Company's original proposal. The OCA submits that by using the 0% return on equity proposed by OCA and I&E reflects both the inadequate service and moves toward more affordable rates. In making that change, the affordability concerns would be better addressed, but clearly not fully addressed, due to large increase that would result even under those circumstances.

The OCA recommended in its Main Brief and its Reply Brief that the Commission initiate a 529 proceeding to permit an investigation into finding a capable public utility to acquire Twin Lakes. 66 Pa. C.S. § 529; OCA M.B. at 44; OCA R.B. at 23. This recommendation was not addressed by ALJ Guhl in the Recommended Decision. The OCA continues to maintain its recommendation that a 529 proceeding be initiated in this case.

III. CONCLUSION

Based on the foregoing and for the reasons articulated in the OCA's Main and Reply Briefs, the OCA respectfully requests that the Commission grant the OCA's Exceptions and adopt the OCA's positions as discussed above.

Respectfully submitted,



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