BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2019-3008208
	:	
Wellsboro Electric Company	:	

EXCEPTIONS
OF WELLSBORO ELECTRIC COMPANY

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Dated: March 13, 2020

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I. INTRODUCTION

On July 1, 2019, Wellsboro Electric Company ("Wellsboro" or "Company") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") Supplement No. 125 to Tariff Electric-Pa. PUC No. 8 ("Original Supplement No. 125"), proposing an annual increase in revenues of $1,419,610. In support of this filing, Wellsboro submitted a Statement of Reasons, the supporting information required by 52 Pa. Code § 53.52(a), (b), and (c), and various other information. Wellsboro later filed replacement base rate schedules and tariff sheets reflecting an increase in distribution revenues of $999,999 on July 31, 2019, which the Commission acknowledged by Secretarial Letter dated August 8, 2019.[1]

The Office of Consumer Advocate ("OCA") filed a Formal Complaint against Wellsboro's rate increase on August 5, 2019. The Office of Small Business Advocate ("OSBA") and the Bureau of Investigation and Enforcement ("I&E"), thereafter, submitted Notices of Appearance in this proceeding. Pursuant to 52 Pa. Code § 5.61(d), Wellsboro elected not to file an Answer to OCA's Complaint.

On December 16, 2019, and December 17, 2019, Administrative Law Judges ("ALJs") Steven K. Haas and Benjamin Myers held an evidentiary hearing for the Citizens' Electric Company of Lewisburg, PA ("Citizens'"), Wellsboro, and Valley Energy, Inc. ("Valley") (collectively, "Companies") proceedings. During this hearing, the Companies and the advocates entered their prepared Testimony and Exhibits into the record. Company witnesses Howard S. Gorman, Dylan W. D'Ascendis, and Byron Farnsworth, Jr. presented Oral Rejoinder Testimony. I&E and OCA witnesses were also sworn in and submitted to cross-examination.

[1] In Rebuttal Testimony, Wellsboro subsequently revised its proposed revenue increase to support additional annual revenue of approximately $1.1 million but preserved the requested increase to base rate revenues of approximately $999,999. Wellsboro Main Brief, at 1.

On January 8, 2020, and January 22, 2020, OCA, OSBA, I&E, and Wellsboro submitted a Main Brief and Reply Brief, respectively. On February 28, 2020, ALJs Haas and Myers issued a Recommended Decision ("R.D.") in this proceeding.

For the reasons set forth below, Wellsboro hereby files these Exceptions to the ALJs' R.D.

II. EXCEPTIONS

A. Exception No. 1: The R.D. erred in rejecting the Company's 3% Fully Projected Future Test Year inflation adjustment as speculative. (R.D. at 21-23).

The R.D. fails to appropriately recognize the substantial evidence in support of the Company's 3% inflation adjustment, which meets the known and measurable standard as historically applied by the Commission. As described below, the Company provided evidence, including consistent historical expense increases, supporting its projection that total Operations and Maintenance ("O&M") expenses will increase by at least the 3% rate of inflation in the Fully Projected Future Test Year ("FPFTY"). As the Company has only proposed a conservative O&M inflation adjustment supported by historical experience, the Company submits that approval of the proposed 3% inflation adjustment is reasonable and consistent with the Commission's authority to approve FPFTY expenses. Alternatively, the Company submits that particularly strong evidence supporting a 3% FPFTY increase in salaries and benefits warrants approval of the 3% inflation adjustment for the accounts where labor is the primary expense.

1. The "known and measurable" standard does not preclude inflation adjustments.

The R.D. misapplies the known and measurable standard in its rejection of the Company's inflation adjustment. The R.D. asserts that inflation adjustments "are not actually known and measurable because they do not reflect the true cost of expenses [because] the adjustments are blanket adjustments which do not directly relate to the actual costs expected to be incurred." R.D.

at 22. This holding is inconsistent with Commission precedent. Even prior to the Pennsylvania Legislature's authorization of the FPFTY through Act 11 of 2012 ("Act 11"), the "known and measurable" standard was not universally applied to deny inflation adjustments – in fact, it had traditionally been applied in quite the opposite manner. In 1996, the Commonwealth Court of Pennsylvania stated: "PUC decisional law reflects its consistent acceptance of the application of an inflation factor to expenses which are not otherwise adjusted, and has not indicated that there are any inherent flaws in this adjustment procedure." *Nat'l Fuel Gas Distrib. Corp. v. Pa. Pub. Util. Comm'n*, 677 A.2d 861, 865 (Pa. Cmwlth. 1996). Consequently, there is nothing inherently inconsistent between the "known and measurable" standard and an inflation adjustment. The R.D.'s attempt to distinguish the Company's proposed inflation adjustment as a "blanket adjustment" does not invalidate the Company's method because the Company did not apply a blanket adjustment to all FPFTY costs. The Company applied an inflation adjustment solely to O&M expenses, which, as discussed below, is consistent with the Company's historical experience.

By way of contrast, the two cases cited by OCA that involve application by the Commission of the "known and measurable" standard to deny inflation adjustments involved far broader and more speculative adjustments. As stated in the Company's Main Brief, the Commission previously denied an inflation adjustment proposed by PECO Energy Company ("PECO") where PECO proposed to recover a true blanket 2% attrition adjustment to expenses, revenue, and rate base. *See* Wellsboro Main Brief at 39 *citing Pa. PUC v. Philadelphia Electric Company*, Docket No. R-822291 (Order Entered Nov. 22, 1983). The Company's adjustment applies only to expenses, and not to revenue or rate base. Wellsboro Main Brief at 31. Similarly, OCA's reliance on the Commission's decision in a 2007 Philadelphia Gas Works ("PGW") case as a rejection of an inflation factor misconstrues the Commission's decision in that case. *See* R.D. at

20. There, PGW proposed a 2% annual attrition adjustment to expenses as part of a broader proposal to set rates based on a five-year forecast. *See* Wellsboro Main Brief at 39; *see* also *Pa. PUC v. Philadelphia Gas Works*, Docket No. R-00061931 *et al.* (Order Entered Sept. 28, 2007) (PGW Order), at 14.[2] As clearly stated in the PGW Order, the Commission rejected the proposal based not on the inflation factor component, but rather the speculative nature of five-year projections. *See* PGW Order, at 17. Here, Wellsboro used the inflation adjustment solely for one year, the FPFTY. Therefore, the R.D. erred in concluding that OCA's cited cases support rejection of Wellsboro's proposal. *See* R.D. at 22. While the Commission has rejected certain inflation adjustments in the past, it has not categorically denied inflation adjustments as contrary to the known and measurable standard. In fact, the Commission has accepted inflation adjustments as consistent with the known and measurable standard. Wellsboro Main Brief at 38.

2. *The Company's claim is supported by the record and meets the "known and measurable" standard as historically applied by the Commission.*

The R.D. fails to recognize the substantial evidence in support of the Company's 3% inflation factor. The Company's inflation factor is supported with Company-specific historical experience, the 2020 budget increases, and other information, and meets the known and measurable standard as historically applied by the Commission.

First and foremost, the historical O&M expense increases demonstrate a consistent and verifiable trend of increased expenses. In fact, as seen in Schedule C1-1 (W), actual historic O&M expenses show an increase of over 18% from 2015 to 2018 (the last year full expense data is available) and 24% from 2012 to 2018. Wellsboro Main Brief at 36; *see also* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W) at 2. In other words, the Company's O&M expenses

[2] The Company's Main Brief incorrectly referenced a November 28, 2007, entry date for the PGW Order instead of the correct September 28, 2007, entry date.

have, on average, increased well above 3% each year between 2012 and 2018. As stated by Wellsboro CEO Craig Eccher:

> In that time period [2015 to 2018], our Operating & Maintenance Expenses increased by $262,806, from $749,987 in 2015 to $1,012,793 in 2018. Similarly, our Administrative & General Expenses increased by $52,048, from $991,061 in 2015 to $1,043,109 in 2018. Our Customer Account and Collection Expenses also rose by $103,324 from 2015 to 2018.

Wellsboro Main Brief at 36. It is clear that, historically, 3% is a reasonable and conservative projection of the Company's FPFTY increase in O&M costs. This approach parallels OCA witness Sherwood's statement that historical expense trends should be considered along with known and measurable increases when setting rates. OCA Statement No. 1-SR (REVISED) at 6.

Second, the Company's 2020 Budget indicates the proposed 3% expense adjustment represents a conservative estimate of the FPFTY costs. Mr. Farnsworth testified on Rebuttal that "On an overall basis, we expect expenses to increase by over 3% from 2019 to 2020, with significantly higher increases in some areas (e.g. health insurance costs) being offset by management's efforts to manage costs." Wellsboro Main Brief at 37. On Rejoinder, Wellsboro's Chief Operating Officer ("Mr. Farnsworth") confirmed that the Wellsboro 2020 Budget includes inflation. *Id.* at 37-38.

Third, the Company testified to vendor and labor expense increases justifying the 3% inflation adjustment for FPFTY expenses. Mr. Farnsworth testified on Rejoinder that the Company anticipated increases to salaries, benefits, and vendor costs. Mr. Farnsworth referenced two specific price increase notices, including a 2-5% increase from a major supplier that provides the Company with wires, pole construction materials, transformer connections, and other materials. *Id.* at 37. Even more notably, Mr. Gorman testified that the Premium Summary

provided by Highmark points to increases of as much as 9.79% for health care. *See* Tr. 78-79. Mr. Farnsworth testified on Rejoinder that labor costs were increasing as well. *See* Tr. 179.

Most of the evidence above, which had been summarized in the Company's Main Brief, was not addressed by the R.D. Instead, the R.D. rejected the Company's inflation adjustment for being a "blanket" adjustment unrelated to the actual costs to be incurred. R.D. at 22-23. However, as described above, the Company supported the proposed adjustment by presenting evidence of actual costs to be incurred. The Company has demonstrated that labor costs will rise by approximately 3%, and certain vendor and overhead costs such as health insurance will rise by much greater amounts. The Company has established, by a preponderance of the evidence, that its O&M expenses will increase by 3% from 2019 to 2020. This evidence is sufficient for Commission acceptance of the Company's proposed adjustment.

3. The R.D.'s decision, if adopted, would frustrate the purpose of Act 11 and the FPFTY.

The Company's approach to projecting 2020 costs aligns with the purpose of the FPFTY. The General Assembly enacted Act 11 to establish the FPFTY as a ratemaking tool to "reduce regulatory lag due to the use of rate case inputs that are outdated by the time new base rates become effective and, further, to provide more ratemaking flexibility for the timely recovery of prudently incurred infrastructure costs." *Implementation of Act 11 of 2012*, 2012 Pa. PUC LEXIS 1223 (2012), *4-5. While the R.D. correctly states that Act 11 did not abolish the "known and measurable" standard, it also does not preclude reliance on well-founded projections. R.D. at 21-22. To the contrary, Section 315 of the Public Utility Code explains that there will be "estimates" included with the Future Test Year ("FTY") and the FPFTY. 66 Pa. C.S. § 315 ("[T]he utility shall provide, as specified by the commission in its final order, appropriate data evidencing the accuracy of the *estimates* contained in the future test year or a fully projected future test year" (emphasis

added)). The R.D., by denying the Company's well-supported 3% increase for FPFTY O&M expenses, would erode the benefits of Act 11 and the FPFTY as an authorized ratemaking tool for the Company.

Contravening the clear purpose of Act 11, the R.D. relies on 2019 data for FPFTY expense allowances, despite substantial evidence that 2020 costs will increase at or above the 3% rate proposed by the Company. Where historical O&M expense confirm the Company experiences annual expense increases in excess of 3%, denying a modest 3% expense adjustment for the FPFTY directly conflicts with the forward-looking policy basis underlying Act 11 and the introduction of the FPFTY.

4. At minimum, the 3% inflation adjustment should be applied to expense categories consisting primarily of labor and benefits expense, as the record demonstrates the Company's employee labor and benefits expense will increase by 3%.

Although the Company maintains that the proposed 3% inflation adjustment should be granted in full, the R.D.'s rejection of the proposed inflation adjustment is particularly unjust as applied to the various expense accounts consisting primarily of labor and overhead expenses. As discussed above, the record shows that the Company will incur increased expenses from the FTY (2019) to the FPFTY (2020) for employee salary and benefits. These expense increases are not conditional – for every hour worked, the Company will experience higher employee labor and overhead costs.

As an alternative to applying the proposed 3% inflation adjustment to total O&M expense, the 3% inflation adjustment should be applied to the following expense accounts, which are comprised of a majority of labor and overhead expenses:

- Operations Supervision and Maintenance (Account No. 580). The R.D. recommended an allowance of $103,596 based on the Company's original expense claim of $106,704 minus

the 3% inflation factor that was included in the Company's claim. However, by removing the 3% inflation factor, the R.D. removed any labor-related expense adjustment for the FPFTY. Because this account is primarily comprised of labor and overhead expense, it is reasonable to apply the Company's proposed 3% adjustment to the final FTY expense approved for this account. *See* I&E Exhibit No. 1, Schedule 2.

- Miscellaneous Distribution Expense (Account No. 588). The R.D. recommended an allowance of $204,925 based on annualization of the 9-month, September 30, 2019, data (plus other adjustments described in Exception No. 5 below). However, this did not include a labor-related expense adjustment for the FPFTY. Because this account is primarily comprised of labor and overhead expense, it is reasonable to apply the Company's proposed 3% adjustment to the final FTY expense approved for this account. *See* I&E Exhibit No. 1, Schedule 5.
- Maintenance Supervision and Engineering (Account No. 590). The R.D. recommended an allowance of $63,373 based on the annualization of the 9-month, September 30, 2019, data. However, this did not include a labor-related expense adjustment for the FPFTY. Because this account is primarily comprised of labor and overhead expense, it is reasonable to apply the Company's proposed 3% adjustment to the final FTY expense approved for this account. *See* I&E Exhibit No. 1, Schedule 4.

As indicated above, to ignore these known and measurable increases for employee salary and benefits is inconsistent with the weight of the evidence and inconsistent with the forward-looking purpose of the FPFTY under Act 11. Even in denying the well-supported proposal to increase total O&M expense by 3% for the FPFTY, the R.D. maintains that FPFTY cost increases that are demonstrated and explained should be accepted. Accordingly, at minimum, the

Commission should apply the 3% expense adjustment to the FPFTY for the above-referenced accounts with predominant labor and overhead components.

B. Exception No. 2: The R.D. erred in denying the Company's proposal to increase its FPFTY O&M expense based on an annualization of 9-month FTY expense data. (R.D. at 27).

The Company proposed to project its FPFTY expenses by compiling all individual expense accounts based on annualized 9-month FTY actuals and applying a 3% inflation adjustment to derive total 2020 expenses. R.D. at 24. The R.D. rejected this approach, stating that the public utility must evaluate each individual cost claim under 66 Pa. C.S. §§ 1308(d), 315(a). *Id.* However, this assumes that the Company's approach does not adequately address individual accounts. In fact, Section 315(a) requires only that the public utility meets its burden of proof to show that the rate involved is just and reasonable. It does not prescribe the methods used to demonstrate the justness and reasonableness of a proposed rate, or how individual expenses may be justified.

Here, the Company's approach to projecting its costs is based on the most recent available data for each individual account. Wellsboro Main Brief at 32-33. This approach is consistent with the operations of a small public utility with limited staff. *See id.* at 34. As described by Witness Farnsworth, the Company's smaller size requires flexibility for labor assignments because "the Company shifts resources and priorities during the year as operational needs arise." *Id. citing* Wellsboro Statement No. 6-R, at 4.

In contrast, I&E and OCA's approach to reviewing Company expenses penalizes the Company for effectively managing its budget. Wellsboro Main Brief at 34. This selective approach focused on accounts where expenses ran below budget in the FTY without recognizing the commensurate increases in other accounts, despite the fact that movement between accounts is required for a small Company like Wellsboro to operate effectively. *Id.*

The R.D. erred by rejecting the Company's approach. R.D. at 24. Contrary to the R.D.'s conclusion, the Company's use of the most recent available data to develop its FPFTY projection is consistent with Section 315(a) because it reflects the actual FTY data for each expense account. For the reasons set forth above, the Commission should grant this Exception and approve the Company's proposed FTY expense based on the annualized 9-month FTY expense plus the 3% inflation adjustment.[3]

C. <u>Exception No. 3</u>: The R.D. erred in normalizing $60,000 of FPFTY Maintenance of Overhead Lines Expense as a "one time" expense rather than treating it as an ongoing annual expense. (R.D. at 27-28).

The Company's Account No. 593, Maintenance of Overhead Lines Expense includes labor, overhead, and other tree-trimming expenses. *See* I&E Exhibit No. 1, Schedule 8. The R.D. approved an allowance of $616,519.33 for Account No. 593. R.D. at 28. To calculate its allowance for Account No. 593, the R.D. started with the most recent FTY information available: actual expenses through November 30, 2019; plus $81,320 of projected expenses for December 2019, totaling $596,519.33; plus an adjustment for additional projected FPFTY expenses. *Id.* at 27.[4] The R.D. recognized that 2020 bids were higher than 2019 and concluded it would be appropriate to grant an adjustment for 2020 due to $60,000 in projected expense increases for the FPFTY. *Id.* at 27. However, the R.D. recommended that this $60,000 be normalized over three years, resulting in a $20,000 increase for the FPFTY. *Id.*

The Company does not dispute the R.D.'s calculation of $596,519.33 plus a FPFTY adjustment, but the Company excepts to the normalization of the FPFTY adjustment. As

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[3] In the event that the Commission denies this Exception, Exception Nos. 3-6 address individual expense accounts.

[4] This is a reduction from the Company's modified claim of $649,081. The Company made an original claim of $669,615 for Maintenance of Overhead Lines, but agreed with I&E's initial adjustment, removing $20,600 in duplicative expenses.

recognized by the R.D., the Company has demonstrated that the higher 2020 costs are related to: (1) the Emerald Ash Borer; and (2) increasing contractor costs. Wellsboro Main Brief at 41. Neither of these cost-drivers are non-recurring events. Rather, these expense increases reflect ongoing operating costs. *Id.*

The R.D. accepted OCA's proposal to normalize the costs based on OCA's opinion that this was essentially a "one time" expense rather than an ongoing annual expense. R.D. at 28. As a result, the ALJs recommended a $20,000 "normalized" allowance to spread the $60,000 over three years. R.D. at 28. Based on a misunderstanding of the Company's expense in OCA's testimony, the R.D. mistakenly concludes that additional tree trimming costs in 2020 are due to "accelerated efforts to address outages on the Middlebury circuit and the confirmation of the costs associated with the 115 KV transmission line associated with the Mid-Atlantic Interstate Transmission (MAIT) project." *Id.* at 27-28. In reality, Company Witness Farnsworth stated that the accelerated efforts regarding the Middlebury circuit outages required the Company to reorganize its schedule for normal tree-trimming costs in 2019. Wellsboro Statement No. 6-R at 8. The additional $60,000 of tree-trimming expense budgeted for 2020 is not impacted by these factors. *See id.*

The R.D. also incorrectly asserted that the Company failed to respond to OCA's erroneous proposal to normalize the $60,000 budget increase for the FPFTY. Witness Farnsworth addressed the OCA's proposal on Rejoinder by explaining that the Company's Account No. 593 expenses had been "misunderstood here in the past by one of the witnesses." Tr. at 176. Mr. Farnsworth then clarified that "as we got in the fourth quarter here we got tree trimming expenses that we're moving to incur through the end of the year which were part of our normal budget expense for 593." Tr. at 176. In other words, the Company incurred $65,000 of normal tree-trimming expenses in the 4th quarter of 2019 because it had prioritized other capital projects earlier in the FTY. Therefore,

neither the $65,000 expense incurred in the FTY nor the $60,000 of additional budgeted expense for the FPFTY represent non-recurring expenses.

The R.D. mistakenly attributed increased budget for 2020 to the Middlebury circuit and the MAIT project rather than the Company's ongoing efforts to combat the Emerald Ash Borer and increasing contractor costs. R.D. at 27-28; *but cf.* Wellsboro Main Brief at 41. These issues are not one-time costs; as a result, the $60,000 in additional FPFTY expense should be approved for recovery in the FPFTY, rather than being normalized across three years.

D. Exception No. 4: The R.D. erred in excluding the 3% FPFTY adjustment from Operations Supervision and Maintenance Expense. (R.D. at 29).

The Company's Account No. 580, Operations Supervision and Maintenance Expense includes employee salaries, wages, and overhead (employee benefits) expenses. *See* I&E Exhibit No. 1, Schedule 2. For Account No. 580, the R.D. approved the Company's claim for the FTY based on escalating costs related to tree trimming and operational activities. R.D. at 29. However, the R.D. reduced the Company's claim from $106,704 to $103,596 to remove the 3% inflation factor the Company had included in its initial claim. *Id.* As a result, the R.D. did not account for the increased expenses from the FTY to the FPFTY. As explained in Exception No. 1, the Company has budgeted for increased labor and healthcare costs. Because this account is comprised entirely of labor and overhead, a 3% adjustment should be added to the final amount approved by the R.D. *See* I&E Exhibit No. 1, Schedule 2.

E. Exception No. 5: The R.D. failed to appropriately apply the preponderance of evidence standard to Miscellaneous Distribution Expense. (R.D. at 31-32).

The Company's Account No. 588, Miscellaneous Distribution Expense includes employee salaries, wages, and overhead (employee benefits) expenses. *See* I&E Exhibit No. 1, Schedule 5. The R.D. approved an allowance of $204,925 for Miscellaneous Distribution Expense, a reduction from the Company's claim of $219,007. R.D. at 30. The Company presented evidence to show the

"other" subcategory would increase from the Historic Test Year ("HTY") to the FTY due to increased training for new employees. Despite this evidence, and despite an annualized FTY amount of $232,239, the ALJs accepted I&E's proposed adjustment to the "other" subcategory, resulting in a reduction to Account No. 588.[5] *Id.* In approving I&E's proposed downward adjustment, the R.D. erroneously concluded that the Company's claim of future retirements is speculative. *Id.*

In coming to this conclusion, the R.D. failed to recognize the preponderance of the evidence demonstrating that employee retirements will be a significant and ongoing issue for the Company. Wellsboro has testified that approximately 50% of its workforce has the potential of retiring within 10 years; however, the R.D. concluded this is a "speculative assumption" that "could result in over recovery if the employees that Wellsboro believes may retire do not in fact retire." R.D. at 32. In other words, the R.D. suggests there is no guarantee that the anticipated retirements will take place. The Company should not be held to a standard of guaranteeing that retirements will occur. Rather, the Company has a burden to show by a preponderance of the evidence that retirements will occur. The Company has demonstrated that eight employees – approximately half of its staff – are eligible to retire within the next 10 years. Wellsboro Main Brief at 45. Further, Wellsboro's COO testified that "several" employees, meaning at least 3, are "going to be retired . . . in the next five years." This is a large number of anticipated retirements for Wellsboro's small workforce, and it is sufficient to demonstrate that the overlap expenses removed from the Company's claim by I&E are not one-time expenses and will continue on a recurring basis as the Company trains new employees to replace the outgoing retirees. Wellsboro Main Brief at 45. The Company must continue training

[5] The R.D. also added $14,934 to account for a disability-related employee absence that had reduced the 2019 expense.

for existing employees to use new systems and tools while meeting customer expectations efficiently and effectively in a technology-driven world where data is requested on-demand. *See id.*

Additionally, as discussed above, the R.D. did not apply an FPFTY adjustment to its $204,925 allowance. As explained in Exception No. 1, the Company has budgeted for increased labor and healthcare costs. Because this account consists primarily of labor and overhead expense, it is reasonable to apply the Company's proposed 3% adjustment to the expense approved for this account. *See* I&E Exhibit No. 1, Schedule 5.

F. <u>Exception No. 6</u>: The R.D. erred in finding that the Company did not justify the full expense claim for Maintenance Supervision and Engineering Expense. (R.D. at 34).

The Company's Account No. 590, Miscellaneous Distribution Expense includes employee salaries, wages, and overhead (employee benefits) expenses. I&E Exhibit No. 1, Schedule 4. The R.D. approved an adjustment to the Company's $80,232 claim, resulting in an allowance of $63,373 for Maintenance Supervision and Engineering. The R.D. approved the adjustment based on a 9-month annualization of the FTY expense. However, the R.D. erred in finding that the Company had not justified its full expense claim.

As explained by the Company, Account No. 590 was under budget by $14,957. The Company explained on the record that this was directly connected to an employee spending more time on an Account No. 588 task, which resulted in Account No. 588 coming in over budget by $13,232.

The R.D. erroneously concludes that Wellsboro has provided no justification for its original claim for Account No. 590. However, the Company provided testimony showing that, absent the shift of cost for the employee working on the Account No. 588 project, Wellsboro's projection would be very accurate. In other words, the Company's projections align closely with the annualized amount plus the employee's cost that was shifted to Account No. 588.

As discussed above, the R.D. did not apply an FPFTY adjustment to its allowance, which was based on the annualization of the 9-month, September 30, 2019 data for Account No. 590. As explained in Exception No. 1, labor expenses are increasing, and health care expenses are increasing over 9%. Because this account consists entirely of labor and overhead expense, it is reasonable to apply the Company's proposed 3% adjustment to the final FTY expense approved for this account. *See* I&E Exhibit No. 1, Schedule 4.

G. <u>Exception No. 7</u>: The R.D. erred in declining to consider multiple methods to establish the ROE where data shows DCF results to be unreliable based on a market-to-book analysis. (R.D. at 54).

The R.D. recommended a 9.74% Return on Equity ("ROE") for the Company, modified to 9.31% to account for Wellsboro's reduced revenue request of $999,999 (due to filing limitations). R.D. at 76. To arrive at its recommendation, the R.D. averaged the mean and median proxy group ROE from the Company's Discounted Cash Flow ("DCF") analysis and set the base ROE at one standard deviation above that average (9.49%). *Id.* The R.D. additionally approved a 0.25% performance adjustment to arrive at the recommended 9.74% ROE. *Id.* at 81. Then, to account for Wellsboro's Exhibit (HSG-1R), which allowed for only a 7.14% rate of return on rate base to limit the revenue increase to $999,999, the R.D. adjusted the ROE to 9.31%. *Id.*

By developing a recommended ROE based solely on the Company's DCF analysis, the R.D. erred in declining to consider multiple methods to determine the appropriate ROE for the Company. The record in this case presents credible evidence demonstrating that primary reliance on the DCF method in the current market environment will understate the appropriate ROE. The Commission should consider this evidence and incorporate the multiple models presented by Company witness Mr. Dylan D'Ascendis in determining the appropriate ROE for the Company.

The R.D. reviews prior Commission decisions and concludes that the Commission has historically relied on the DCF as the preferred method for determining an appropriate ROE, with

the Capital Asset Pricing Model ("CAPM") method serving as a check. R.D. at 54. However, although the ALJ quoted select material from the Commission's decision in *Pa. Pub. Util. Comm'n v. UGI Utilities, Inc. – Electric Division* ("UGI Order"), the R.D. omits language from the UGI Order demonstrating that the Commission will consider other methods where appropriate. As noted in the Company's Main Brief, the Commission clarified this point as follows:

> Initially, we note that UGI has presented a valid argument that sole reliance on one methodology without checking the validity of the results of that methodology with other cost of equity analyses does not always lend itself to responsible ratemaking. As such, where evidence based on other cost of equity methods indicates that the DCF-only results may understate the utility's current cost of equity capital, we will consider those other methods, to some degree, in evaluating the appropriate range of reasonableness for our equity return determination.

Wellsboro Main Brief, at 68-69 *citing* UGI Order at 104-105. The Company submits that the Commission's comments in the UGI Order clarify that the DCF is the preferred method, but other methods will be considered where reliance on the DCF would lead to unreasonable results.

The record in this proceeding presents evidence that relying on DCF results will understate the appropriate rate of return for the Company. Mr. D'Ascendis analyzed the market-to-book ratios of the combined I&E and OCA electric utility proxy groups and observed that the market-to-book value for the combined proxy group has significantly exceeded the 1.65 ten-year average, with particularly high market-to-book ratios since 2018. Wellsboro Main Brief at 69. The below table presents the results of Mr. D'Ascendis' analysis:

Main Brief Table 6

M/B Ratios of the Combined Electric Utility Proxy Group Compared with

Ten-Year Average

Wellsboro Main Brief at 69. As explained by Mr. D'Ascendis, the DCF model assumes a market-to-book ratio of 1.0, which means that the model will overstate or understate the required ROE if the actual market-to-book value of the proxy group deviates from 1.0. *See id.* This is due to incongruent methods by which investors and regulators assess value; investors evaluate returns based on market value, while regulators authorize returns based on book value. *Id.* This effect is mitigated when the market-to-book ratio is at or close to 1.0. *Id.* Thus, in the current environment where the market-to-book ratio more than doubles 1.0, and even significantly exceeds the ten-year average of 1.65, the DCF model will understate the appropriate return for the Company.

In addition to presenting this analysis, Mr. D'Ascendis also provided extensive supporting evidence corroborating his findings. Mr. D'Ascendis reviewed financial literature concluding that "application of the standard DCF model to utility stocks understates the investor's expected return when the market to-book (M/B) ratio of a given stock exceeds unity." Wellsboro Main Brief, at

70. He further demonstrated the unreasonable results of the I&E and OCA ROE recommendations by applying the I&E and OCA cost rates to book value instead of market value, which reduced the I&E and OCA growth rates from 4.69% and 5.15% at market value, to just 0.23% and 0.81% at book value. *Id.* Finally, to further illustrate the impropriety of using a DCF model where the market-to-book ratio exceeds unity (1.0), Mr. D'Ascendis applied the I&E and OCA DCF models to the book value capital structure of the respective proxy group. *Id.* This adjustment corrects the apples-to-oranges result of the R.D., which relies on a DCF model with a market value capital structure to develop an ROE that will ultimately be applied to book value. Correcting this imbalance by running the I&E and OCA DCF models with a book value capital structure increases the respective ROEs by over 100 basis points (8.10% to 9.19% for the I&E DCF ROE and 8.38% to 9.45% for the OCA DCF ROE). *Id.*

While the R.D. partially addresses the shortcomings of the I&E and OCA ROE recommendations by establishing the recommended ROE at the high end of a standard deviation range based on the average of Wellsboro's mean and median constant growth DCF results, the R.D. justified this recommendation as reflecting a size adjustment, rather than reflecting an adjustment due to understated DCF results. R.D. at 76. As detailed above, Mr. D'Ascendis established the inaccuracy of the DCF model in the current market environment where the market-to-book ratio far exceeds unity (1.0). While the R.D. does apply the CAPM model as a check on the DCF, it declines to consider the full multiple model analysis proposed by the Company, despite the Commission's indication in the UGI Order that consideration of other models is appropriate in circumstances where the results of such models show the DCF results may be understated. R.D. at 52; *but cf.* Wellsboro Main Brief at 68-69. The result of this omission is that the R.D. applies a size adjustment to a base ROE of 8.27, where the appropriate result would be to apply the size

adjustment to the base ROE of 9.05, as justified by the multiple model approach proposed by Mr. D'Ascendis. *See* R.D. at 76; *but see* R.D. at 52-53.

Consistent with the above analysis of the market-to-book ratio, each of the alternative analyses developed by Mr. D'Ascendis show an ROE higher than the DCF method. R.D. at 52. These results reinforce the necessity to view DCF results with skepticism when running the model in an environment where market values far exceed book value. Although the Commission has used the standard deviation range around the DCF results in determining the quarterly Distribution System Improvement Charge ("DSIC") ROEs, it is more precise to examine and consider multiple models. In this environment, the Commission should carefully consider the alternative models proposed by Mr. D'Ascendis, as detailed in the Company's Main Brief. Wellsboro Main Brief at 60-67.

The Company recognizes that this Exception may not impact the overall result as the R.D. awarded the maximum 7.14% overall return proposed by the Company. However, to account for any potential modifications to the R.D. and ensure the record reflects the appropriate analysis, the Company requests that the Commission grant this Exception and develop an unadjusted ROE recommendation based on the multiple models proposed by Mr. D'Ascendis.

H. Exception No. 8: The R.D. erred in failing to apply the Company's 100 basis point adjustment for size risk to the ROE. (R.D. at 76).

As explained previously, the R.D. developed a recommended ROE for the Company using the high end of a standard deviation range based on the average of Wellsboro's mean and median constant growth DCF results. R.D. at 76. The R.D. set the ROE at the high end of the standard deviation range in recognition of the evidence affirming that Wellsboro faces size risk. *Id.* While the Company appreciates the R.D.'s acknowledgement of size risk, the Company submits that the methodology developed by the R.D. could result in an ROE that is commensurate with the ROEs

established for much larger Electric Distribution Companies ("EDCs"), but not truly reflective of the Company's size risk. To accurately account for the Company's size risk, the Commission should approve the Company's proposed size adjustment, subject to the maximum proposed ROE of 10.30%.

The R.D. reasonably finds that an ROE based on the average mean and median DCF results on the record would produce an unreasonable result for the Company. However, the R.D. erred in attributing its use of the standard deviation method solely to the Company's size. As discussed in the Company's brief, the Commission applies the standard deviation method (setting an ROE within a standard deviation range of median or mean DCF results) in developing the ROE for purposes of calculating electric utility DSICs. Wellsboro Main Brief at 79. As the DSIC is applicable primarily to large EDCs, this suggests that the process of setting an ROE within a standard deviation of the mean or median DCF results does not reflect size risk. Accordingly, to ensure the authorized ROE reflects the Company's risk, the Commission should apply a size adjustment to the result of the standard deviation method approved by the R.D. To the extent this result would exceed the Company's proposed ROE, the Company submits that the authorized ROE should be capped at the proposed 10.30%.

The Commission should also consider the conservative nature of the proposed 100 basis point size adjustment in comparison to the size adjustment supported by the Mr. D'Ascendis' analysis of the Company's size risk relative to the proxy group companies. As detailed in the Company's Main Brief, Mr. D'Ascendis conducted a market capitalization analysis showing Wellsboro has a market capitalization of $26.840 million compared to an average company market capitalization of $16.7 billion for the companies in Mr. D'Ascendis' electric utility proxy group ("Electric Utility Proxy Group"). Wellsboro Main Brief at 90-91. After determining the market

capitalization of the Company and the Electric Utility Proxy Group companies, Mr. D'Ascendis relied on published data ranking publicly listed companies into size deciles grouped by ranges of minimum and maximum market capitalizations. *Id.* The $16.7 billion market capitalization of the Electric Utility Proxy Group companies ranks in the 2nd decile while the Company's $26.8 million market civilization ranks in the 10th decile. *Id.* The size decile rankings translate to a size premium spread of 4.70% between the Company and the Electric Utility Proxy Group Companies. *Id.*

The calculated 4.70% or 470 basis point size premium spread between the Company and the Electric Utility Proxy Group companies corroborates the reasonableness of Mr. D'Ascendis' proposed 100 basis point size adjustment. Accordingly, the Commission should apply the 100 basis point size adjustment to any ROE that it would otherwise award to a larger EDC. Since the ROE method applied in the DSIC Quarterly Reports indicates the standard deviation method is generally deployed to calculate an appropriate ROE for larger utilities, the R.D. use of that method does not obviate the necessity to apply a further adjustment to account for size risk. Therefore, while the Company concurs in the R.D.'s finding that Wellsboro faces size risk, it respectfully requests that the Commission grant this Exception and apply the 100 basis point size adjustment to the ROE resulting from the R.D.'s standard deviation method, subject to a cap at the 10.30% maximum proposed ROE.

The Company recognizes that granting this Exception may not impact the overall result as the R.D. awarded the maximum 7.14% overall return proposed by the Company. However, to account for any potential modifications to the R.D. and ensure the record reflects the appropriate analysis, the Company requests that the Commission grant this Exception as set forth above.

I. Exception No. 9: The R.D. erred in approving a revenue allocation that fails to adequately move all customers towards cost-of-service. (R.D. at 105).

The R.D. erred in rejecting the Company's proposed revenue allocation, including a rate decrease for rate schedule POL customers. The R.D. correctly rejected the arguments from I&E, OCA, and OSBA suggesting the general proposition of rate decreases for any class should be rejected where other classes will experience rate increases. R.D. at 103. While agreeing with the Company on the general principle that rates may decrease where justified by cost-of-service and other ratemaking factors, the R.D. denied the proposed rate decrease to rate schedule POL on the grounds that two other rate schedules, CS and MSL, would receive rate increases resulting in relative rates of return above 1.0 at proposed rates. *Id.* at 104. This result fails to sufficiently move rate schedule POL towards cost-of-service and should be denied.

As set forth in the Company's Main Brief, the Company's proposed revenue allocation moves all classes closer to cost-of-service and avoids extreme rate impacts. Wellsboro Main Brief at 100-101 *citing Lloyd v. Pa. PUC,* 904 A.2d 1010, 1015 (Pa. Cmwlth. 2006). The R.D. rejects this approach primarily on the grounds that it would impose rate increases on rate schedules CS and MSL and result in relative rates of return above 1.0. R.D. at 104. However, the R.D. overlooks that the relative rates of return for rate schedules CS and MSL, 1.62 and 2.08 under the Company's proposed revenue allocation, represent significant progress from the respective 4.17 and 7.09 relative rates of return under present rates. *Id.* at 102. Under the Company's proposed revenue allocation, rate schedules CS and MSL receive rate increases of 10.7% and 1.2%, well below the system average increase of 19.5%. *Id.* at 95. While the R.D. is correct that other factors can justify deviating from the cost-of-service study results, these circumstances do not justify further adjustments. With a relative rate of return of 12.42 under present rates, rate schedule POL should receive as much rate relief as reasonably possible. *See id.* at 100. The Company's proposal brings

Rate POL as close to cost-of-service as possible without subjecting other rate schedules to rate shock. Accordingly, the Company's proposed revenue allocation should be approved.

J. <u>Exception No. 10</u>: The R.D. erred in denying the Company's proposal to recover minimum demand costs through the fixed monthly charge. (R.D. at 123).

The R.D. erred in rejecting the Company's proposal to increase the fixed monthly charges for Residential and Commercial customers to include a small portion of demand charges equal to minimum demand. As set forth in the R.D., the Company recognizes that the Commission, with limited exceptions, has allowed for recovery only of direct customer costs through fixed monthly charges. However, consistent with the Commission's adoption of its Statement of Policy on alternative ratemaking ("Final Policy Statement"), the Company proposed to include minimum demand costs in the proposed fixed monthly charges for Residential and Commercial customers in order to reflect the Company's fixed costs more closely. R.D. at 106; *see also* 52 Pa. Code §§ 69.3301-3302. The R.D. adopted arguments from I&E and OCA and denied the Company's proposal as contrary to established ratemaking principles and the Final Policy Statement. R.D. at 123. The Company submits that the R.D.'s analysis misstates both the Commission's discretion to approve exceptions to its traditional ratemaking policies and the flexibility afforded by the Final Policy Statement. The Company's proposal reflects a careful balancing of policy objectives, including cost-of-service principles and energy efficiency, and should be approved by the Commission.

As summarized in the R.D., Wellsboro proposed to increase the fixed monthly charge for rate schedules RS (Residential Service), RSAW (Residential Service All Electric), NRS (Non-Residential Service), and NRH (Non-Residential Service Space Heating), from $11.92 to $13.40, with $1.48 of the increase attributable to a shift of minimum demand costs into the fixed monthly charge. R.D. at 107. The minimum demand costs that the Company proposes to include equal the

monthly cost of 0.09 kW of demand, which is met or exceeded by 96.9% of the Company's Residential customers. *See id.* at 107-08. Similarly, the Company proposed to increase the customer charge for rate schedules CS (Commercial Service) from $32.03 to $35.00. R.D. at 109. The Company additionally proposed to increase the fixed monthly charge for rate schedules CSH (Commercial Service Space Heaters) from $45.81 to $58.00. *Id.* at 109. As described in the Company's Main Brief, the demand costs shifted to rate schedules CS and CSH are significantly below the costs of the minimum demand requirements for each rate schedule. *See* Wellsboro Main Brief at 108.

The R.D. argues that Wellsboro's proposal should be denied as contrary to cost-of-service principles and devoid of customer protections. R.D. at 124. This finding is in error. The Company acknowledges that its proposal to recover minimum demand costs through the fixed monthly charge expands the costs generally recovered through such charges. However, the Company reasonably relied on the Commission's authority to deviate from the traditional ratemaking guidelines. Specifically, the Company's Reply Brief referenced a 2004 decision where the Commission determined that indirect costs such as "employee benefits, local taxes and other general and administrative costs... are costs which may be considered for inclusion in the customer charge, but *such claims are subject to scrutiny on a case-by-case basis*." Wellsboro Reply Brief at 43 *citing Pa. PUC v. Aqua Pennsylvania Inc.*, 2004 Pa. PUC LEXIS 39 (Order entered Aug. 5, 2004) (Emphasis added). Here, the Company provided a reasonable basis for its proposed fixed monthly charge by demonstrating that the demand costs to be collected through the fixed monthly charge represent the minimum demand costs incurred by the vast majority of residential customers (approximately 97%). R.D. at 107-108. These are not variable costs that could be eliminated or reduced by customer behavior. *Id.* The R.D. overlooks the Company's intentional

design in shifting only the minimum demand costs as a customer protection to ensure that only those demand costs that are not variable are shifted to the fixed monthly charge. The remaining demand costs would continue to be recovered through the company's variable (volumetric) rates. *Id.*

The R.D.'s rejection of the Company's proposed fixed monthly charge as a violation of cost-of-service principles ignores the fact that recovery of demand charges through volumetric per-kWh rates is also inconsistent with a strict application of cost-of-service principles. *See* Wellsboro Reply Brief at 44-45. I&E acknowledged that the Company's existing rate structure omits a Residential demand charge and thus recognized that "the energy charge does not perfectly reflect demand-related costs imposed on the system." R.D. at 119. I&E appears to oppose recovery of the demand costs through the fixed monthly charge because the physical infrastructure necessary to support the Company's demand is not correlated or "fixed" to the number of customers. R.D. at 119-20. This is a distortion of the Company's reference to fixed costs, as the Company uses the term in reference to the cost of each customer's fixed demand, not the total cost of the Company's existing demand-related infrastructure. *See* Wellsboro Main Brief at 103 (stating that the proposal to recover demand costs through the fixed monthly charge is "based on demand levels that the vast majority of the accounts experience each month."). While a demand charge could be developed to recover these minimum demand costs, the Company believes its proposal reasonably reflects the fixed nature of the minimum demand costs while preserving a familiar and simplified rate structure for the Residential customers. *See* Wellsboro Main Brief at 107.

While the Company believes its proposed fixed monthly charge is reasonable under the Commission's traditional process, the recent enactment of Act 58 further supports approval of the Company's proposed customer charge. The R.D. takes a misguided approach in finding that the

Company's proposal is not an alternative ratemaking proposal under the Final Policy Statement because it allegedly fails to promote efficient use of energy sources or reflect cost-of-service principles. R.D. at 125. The above discussion addresses the cost-of-service argument. With regard to the Final Policy Statement, the R.D. adopts an overly narrow view of the policy initiatives underlying alternative ratemaking. The R.D. finds that the Company's proposal "fails to promote efficient use of energy sources as its inclusion of demand charges in the fixed customer charge prevents customers from seeing price signals that would otherwise encourage conservation and the efficient use of electricity."[6] *Id.* This conclusion arises from a misperception that alternative ratemaking mechanisms are intended to unilaterally promote energy efficiency. The plain language of the Commission's Final Policy Statement and Section 1330 of the Public Utility Code demonstrates otherwise.

The R.D. oversimplifies the purpose of the alternative ratemaking mechanisms under the Commission's Policy Statement in finding that alternative ratemaking mechanisms must directly promote efficient use of energy sources. *See* R.D. at 125. The Final Policy Statement identifies several policy objectives of alternative ratemaking proposals, including "the objectives of 66 Pa.C.S. § 1330 (relating to alternative ratemaking for utilities)." Section 1330 of the Public Utility Code provides as follows:

> It is the policy of the Commonwealth that utility ratemaking should encourage and sustain investment through appropriate cost-recovery mechanisms to enhance the safety, security, reliability or availability of utility infrastructure and be consistent with the efficient consumption of utility service.

66 Pa. C.S. § 1330. Importantly, Section 1330 of the Public Utility Code clarifies that a policy objective of alternative ratemaking is to sustain investment in utility infrastructure. *Id.; see also*

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[6] The R.D.'s approach would suggest that implementing hourly-priced default service for Residential customers is necessary to promote energy efficiency by sending market price signals.

Wellsboro Main Brief at 109 (stating that "[b]y aligning rates with costs, the Company's proposal supports the Company's ongoing efforts to invest in reliability projects."). The R.D. concurs that the Company's proposal "promotes revenue stability and provides some insulation for reduction in usage that may be caused by efficiency efforts," but the R.D. never recognizes that the true purpose of the Company's proposal is not to directly promote energy efficiency, but to develop a cost recovery mechanism that ensures that continued support of energy efficiency will not compromise the Company's ability to recover its fixed minimum demand costs. R.D. at 124. Accordingly, the Company's proposal indirectly supports energy efficiency by removing disincentives existing in the current rate structure.

The R.D.'s finding that the Company's proposal prevents customers from seeing price signals that would otherwise encourage conservation is inconceivable. R.D. at 125. As detailed above, the Company has only proposed to shift minimum demand costs to the fixed monthly charge. The R.D. at no point explains how shifting minimum demand costs to the fixed monthly charge would distort price signals to customers as the proposal ensures that demand costs above the minimum baseline would continue to be recovered through variable per-kWh rates. The Commission should also consider that the vast majority of price signals encouraging conservation come from the generation component of a customer's bill, which would remain unchanged by the proposal to shift the minimum demand costs for the distribution system to the fixed customer charge. Wellsboro Reply Brief at 44 n. 17. Accordingly, the R.D.'s suggestion that shifting minimum demand costs to the fixed monthly charge would discourage customers from purchasing energy efficient equipment should be rejected. *See* R.D. at 125. The Company's proposal preserves appropriate price signals supporting conservation by limiting the demand costs recovered through the fixed charge to the costs of customers' minimum demand. The Company

manages a fixed set of assets that have been built over the years to support the existing customer base with safe and reliable service. As weather conditions vary year-to-year due to shifting customer usage patterns and efficiency gains (LEDs, appliances, etc.), the same set of assets will need to be maintained and upgraded to provide safe and reliable service to customers with ever-changing needs. *See* Wellsboro Statement No. 6-R at 9.

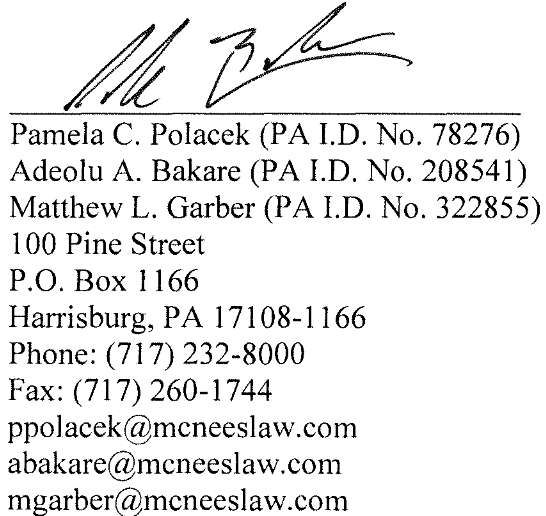
For the above reasons, the Commission should grant this Exception and approve the Company's proposed fixed monthly charges, including the proposal to assign minimum demand costs for recovery through fixed Residential and Commercial monthly charges.

III. CONCLUSION

WHEREFORE, Wellsboro Electric Company respectfully requests that the Pennsylvania Public Utility Commission grant these Exceptions, approve the Company's recommendations therein, and otherwise adopt the Recommended Decision.

Respectfully submitted,

McNEES WALLACE & NURICK LLC



By ______________________

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Dated: March 13, 2020