



COMMONWEALTH OF PENNSYLVANIA  
PENNSYLVANIA PUBLIC UTILITY COMMISSION  
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE  
REFER TO OUR FILE

March 4, 2010

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
P.O. Box 3265  
Harrisburg, PA 17105-3265

Re: Pennsylvania Public Utility Commission v. Newtown Artesian Water  
Company

Docket No. R-2009-2117550

Dear Secretary McNulty:

Enclosed please find an original and nine (9) copies of the Office of Trial Staff's  
(OTS) **Reply Exceptions** in the above-captioned proceeding.

Copies are being served on all active parties of record.

Sincerely,

Adeolu A. Bakare  
Prosecutor  
Office of Trial Staff  
PA Attorney I.D. #208541

Enclosure  
AAB/edc

cc: Parties of record  
Chairman Cawley  
Vice Chairman Christy  
Commissioner Gardner  
Commissioner Powelson  
Chief Counsel Pankiw  
Director Davis

SECRETARY'S BUREAU  
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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

<b>Pennsylvania Public Utility Commission</b>	:	
	:	
v.	:	<b>Docket Nos. R-2009-2117550</b>
	:	<b>C-2009-2122003</b>
<b>Newtown Artesian Water Company</b>	:	

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**REPLY EXCEPTIONS  
OF THE  
OFFICE OF TRIAL STAFF**

---

Adeolu A. Bakare  
Prosecutor  
PA Attorney I.D. #208541

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Dated: March 4, 2010

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**TABLE OF CONTENTS**

I. INTRODUCTION ..... 1

II. EXCEPTIONS ..... 2

    OTS Reply Exception No. 1: NAWC erroneously argues that a capped PWAC would not provide an opportunity to earn a just and reasonable return ..... 2

        A. NAWC is not deprived of an opportunity to earn a just and reasonable return under the traditional ratemaking process ... 3

        B. NAWC has an opportunity to earn a just and reasonable return under the proposed capped PWAC... ..... 6

    OTS Reply Exception No. 2: OTS replies to the NAWC Exceptions claiming that the ALJ’s recommendation to cap the proposed PWAC fails to comply with the statutory requirements of Section 1307 and decisional precedents ..... 10

    OTS Exception No. 3: OTS replies to the NAWC Exception rejecting the Recommended Decision’s provision of one-directional interest on overcollections ..... 14

III. CONCLUSION..... 15

**TABLE OF CITATIONS**

**Cases**

*Pennsylvania Indus. Energy Coalition v. Pennsylvania Public Utility Commission*,  
653 A.2d 1336, 1349 (1995) ..... 7

**Statutes**

66 Pa. C.S. § 1301 ..... 11

66 Pa. C.S. § 1307 ..... 1, 9, 10, 13

66 Pa. C.S. § 1307(a)..... 11

66 Pa. C.S. § 1308 ..... 12

**Regulations**

52 Pa. Code § 53.54 ..... 12

52 Pa. Code § 53.54(c)..... 12

**Other Authorities**

*Rate Case Handbook, A Guide to Utility Ratemaking Before the Pennsylvania  
Public Utility Commission*, by James H. Cawley and Norman James Kennard  
(1983) ..... 8

## I. INTRODUCTION

The Office of Trial Staff (“OTS”) respectfully submits these instant Reply Exceptions pursuant to the procedural schedule established by Administrative Law Judge Ky Van Nguyen (“ALJ”) in this fully litigated proceeding. Newtown Artesian Water Company (“NAWC” or “Company”) initiated the case on July 1, 2009, by filing Supplement No. 68 to Tariff Water – Pa. P.U.C. No. 9, with an effective date of August 31, 2009.<sup>1</sup> The tariff supplement proposes to implement a purchased water adjustment clause (“PWAC”) pursuant to Section 1307 of the Public Utility Code, 66 Pa. C.S. § 1307.<sup>2</sup>

The procedural history provided in the OTS Exceptions, filed in this proceeding on February 22, 2010, is hereby incorporated by reference.

These OTS Reply Exceptions respond to issues raised in the NAWC Exceptions also filed on February 22, 2010. The arguments presented in NAWC’s Exceptions are unsupported by record evidence or otherwise against the public interest. OTS therefore respectfully requests that the Commission to deny NAWC’s Exceptions.

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1 NAWC initially filed Supplement No. 67 to Tariff Water – Pa. P.U.C. No. 9 on July 1, 2009 and subsequently received notice from Commission staff that the filing should have been filed as Supplement No. 68. Pursuant to Commission staff directive, NAWC filed Supplement No. 68 on July 16, 2009. For briefing purposes, Supplement No. 68 is referred to as if filed on July 1, 2009.

2 NAWC Exhibit No. 1, Supporting Information, p. 3.

## II. EXCEPTIONS

### OTS REPLY EXCEPTION NO. 1

**NAWC erroneously argues that a capped PWAC would not provide an opportunity to earn a just and reasonable return.**

NAWC Exceptions, No. 1B, p. 7-8.  
Recommended Decision, pp. 13, 19.  
OTS Reply Brief, pp. 13-14.  
OTS Main Brief, pp. 16-21.

In excepting to the ALJ's proposal to cap NAWC's PWAC at 3% of the revenues billed to customers, NAWC argues that the capped PWAC would not permit the Company to immediately recover the full amount of a purchased water increase and therefore fails to provide an opportunity to earn a just and reasonable return. As demonstrated in the OTS Main Brief, Reply Brief, and Exceptions, NAWC has an opportunity to earn a fair return on its just and reasonable expenses under the existing regulatory scheme. NAWC's proposed PWAC would permit the Company to recover expenses already recoverable through base rates or purchased water pass-through filings through an automatic adjustment clause. Implementation of an automatic adjustment clause to recover costs typically requested in a base rate case actually increases the likelihood that the Company will recover unjust and unreasonable expenses. The 3% cap recommended by the ALJ would serve to partially mitigate such an occurrence.

Conversely, the Company's asserts that the proposed 3% cap would hinder the PWAC and make it impossible for the Company to earn a just and reasonable

return. This argument is borne from a limited and self-serving definition of “just and reasonable.” OTS opines that an uncapped PWAC threatens unjust and unreasonable rates, while both the traditional ratemaking process and the capped PWAC provide important safeguards insuring that the rates recovered by NAWC are just and reasonable.

**A. NAWC is not deprived of an opportunity to earn a just and reasonable return under the traditional ratemaking process**

NAWC’s Reply Exceptions put the proverbial “cart before the horse” by arguing that a capped PWAC will not provide a just and reasonable return when the Company has failed to show that it is deprived of an opportunity to earn a just and reasonable return under the traditional ratemaking process. The NAWC Main Brief claims that the Company is denied an opportunity to earn a just and reasonable return because its average earned return of common equity is less than the allowed returns on common equity granted to certain other jurisdictional water utilities. NAWC MB, p. 32; OTS Exceptions, pp. 11-12. The Company also claims that the risks associated with purchased water are not considered in base rates. NAWC RB, p. 12; OTS MB, p. 19. As demonstrated below, these claims are not supported by record evidence.

The Company has not carried its burden of proof in showing that it does not currently earn a just and reasonable rate of return. NAWC argues that its 6.9% average return on common equity for the five years ended in 2008 pales in comparison to the allowed returns on common equity granted to certain other

jurisdictional utilities. NAWC MB, p. 12. However, as described in the OTS Main Brief and acknowledged by a Company Expert Witness at the evidentiary hearing, the *average* rate of return, which reflects the rate actually earned by a utility, is not commensurate to the *allowed* rate of return, which represents the maximum profit margin that the Commission permits a utility to earn. OTS Exceptions, p. 12; Tr. 39-37.

Similarly, the OTS Main Brief exposed procedural and substantive errors in the Company's claim that increased purchased water expenses are not considered in base rate cases. Procedurally, this claim must fail because the Company's recent base rate filings culminated in settlements where the parties agreed upon on a final revenue requirement, without rejecting or adopting specific line items such as increased purchased water expenses. OTS MB, pp. 18-19. Substantively, the claim must also fail as NAWC cannot show that the other parties to the 2008 Settlement did not consider the increased purchased water costs in agreeing to grant the Company an additional \$420,000 in annual revenues. OTS MB, p. 20. Additionally, NAWC's purchased water costs have not increased since the 2008 Settlement.<sup>3</sup> RD, p. 6. Therefore, NAWC is not presently deprived on an opportunity to earn a just and reasonable return.

Even in the event of a subsequent increase in purchased water rates, NAWC

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3 In the Recommended Decision, ALJ Nguyen found that "BCWSA intends to hold the current rate until 2012." RD, p. 6.

can accelerate recovery of such costs within the traditional ratemaking process. The OTS Reply Brief and the OTS Exceptions discussed the availability of purchased water pass-through filings.<sup>4</sup> OTS RB. 8-9; OTS Exceptions, 8-10. By filing a purchased water pass-through, NAWC can petition to Commission to quickly grant a one-time rate increase to recover increased purchased water costs. This process strikes an important balance as the Commission has demonstrated its willingness to recognize the financial pressures that can follow substantial increases in purchased water rates.<sup>5</sup> However, unlike a PWAC, the purchased water pass-through filings do not provide any authority to adjust future rates without a submitting another comprehensive rate filing to the Commission. OTS Exceptions, p. 9. In this proceeding, the Company has failed to address or explain its failure to file a purchased water pass-through despite protesting the financial impact of prior increased purchased water rates. This silence on the matter cannot masquerade the fact that NAWC already reserves the option to file a purchased water pass-through in between base rate cases and therefore is not denied an opportunity to earn a just and reasonable return.

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4 The OTS Reply Brief clarified the difference between a PWAC and a purchased water pass-through filing following NAWC's efforts to associate its proposed PWAC with Commission precedents favoring purchased water pass-through filings. *See* OTS RB, p. 8.

5 As discussed in the OTS Exceptions, the Commission permitted United Water Bethel, Inc. to recover increased purchased water expenses through a purchased water pass-through. OTS Exceptions, p. 8.

**B. NAWC has an opportunity to earn a just and reasonable return under the proposed capped PWAC**

In arguing that NAWC must receive immediate dollar-for-dollar recovery of any and all increased purchased water expenses in order to realize an opportunity to earn a just and reasonable return, the Company erroneously equates an opportunity with a guarantee. According to NAWC, a PWAC only provides an opportunity to recover a just and reasonable return when it renders the Company “able to recover purchased water increases on an immediate, dollar-for-dollar basis without the need for expensive Section 1308 general rate proceedings either to recover the balance of a large BCWSA increase or to “zero out” the charge after frequent smaller BCWSA increases. NAWC Exceptions, p. 8. Essentially, NAWC argues that the proposed capped PWAC would eliminate the Company’s opportunity to earn a just and reasonable return because it fails to entirely foreclose the need to claim any increased purchased water expenses in a base rate case. OTS, however, avers that NAWC’s proposed PWAC ignores the Commission’s well established policy against using automatic adjustment clauses to erode the general base ratemaking process and encourages recovery of unjust and

unreasonable rates.<sup>6</sup> Rather than eliminate NAWC's opportunity to earn a just and reasonable return, OTS submits that the 3% cap proposed by the ALJ protects the ratepayers from unjust and unreasonable rates by reserving large increased purchased water expense for base rate case review.

The Company incorrectly argues that its proposed PWAC is not unfair to ratepayers because the clause provides nothing more than dollar-for-dollar recovery of an increased expense. NAWC Exceptions, p. 8 n.25. This position ignores the reality that analysis of just and reasonable rates in a base rate case generally requires a comprehensive review of the Company's total operational expenses before a determination can be made as to whether the costs to be recovered from ratepayers are just and reasonable.<sup>7</sup> While the Commission has approved automatic adjustment clauses permitting dollar-for-dollar recovery of certain expenses, it grants such relief only under limited circumstances and usually under statutory authority.

For example, the Commission, under explicit statutory authority from the legislature, permits the recovery of fuel costs through an automatic adjustment

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<sup>6</sup> See *Pennsylvania Indus. Energy Coalition v. Pennsylvania Public Utility Commission*, 653 A.2d 1336, 1349 (1995). "We agree that Section 1307 should have limited application and the PUC should not use it to disassemble the traditional rate-making process, the General Assembly did not limit the allowance of automatic adjustment to only fuel costs and taxes which are generally beyond the control of the utility. Instead, the General Assembly specifically allowed the recovery of fuel costs and also allowed the PUC or the utilities to initiate the automatic adjustment of costs within specific procedures." OTS notes the General Assembly has not provided specific procedures for the initiation of an automatic adjustment clause to recover increased purchased water costs. To the extent that the Commission resolves to grant NAWC's PWAC, OTS submits that it reserves the authority to implement specific procedures governing the clause including a cap in the manner provided for in the Recommended Decision.

<sup>7</sup> See OTS Exceptions, p. 7 n.7; see also OTS MB, p. 18.

clause because such costs are highly volatile.<sup>8</sup> The volatility of NAWC's purchased water costs does not approximate that of purchased gas costs which are extremely volatile and can fluctuate upwards or downwards tremendously over very short time periods.<sup>9</sup> Contrarily, NAWC experiences increased purchased water expenses every two years at the most and the record does not reflect a single occurrence of decreased purchased water expenses. OTS Main Brief, p. 18, OTS Reply Brief, p. 11. BCWSA does not anticipate increasing the rates established in 2008 until at least 2012. RD, p. 6. This record demonstrates that the BCWSA purchased water rate increases do not occur frequently enough to eliminate the Company's opportunity to earn a just and reasonable return, particularly when considering the aforementioned availability of purchased water pass-through filings. Therefore NAWC's increased purchased water expenses should not be exempted from the traditional ratemaking process and recovered on a dollar-for-dollar basis.

Although OTS maintains that no PWAC is necessary to preserve NAWC's opportunity to earn a just and reasonable return, the capped PWAC proposed by the ALJ at least serves to mitigate the potentially unjust and unreasonable rates that would result from adoption of the Company's proposed PWAC. The OTS Reply

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8 Rate Case Handbook, p. B2. "Generally automatic adjustment clauses are utilized to recover fuel costs which continue to spiral upwards." *Id.*

9 See Rate Case Handbook, p. B2 (noting that "between January and December 1974, fuel costs around the country increased 80%."); see also OTS RB, p. 15 citing PUC Purchased Gas Cost Percentage Increases, <http://www.puc.state.pa.us/naturalgas/pdf/PGC.pdf>. "As stated in the OTS Main Brief, purchased water expenses are not as volatile as the quarterly fluctuations affecting purchased gas cost. OTS RB, p. 15.

Brief outlines the possible negative consequences arising from an uncapped PWAC:

OTS submits that many expenses recovered through Section 1307 automatic adjustment clauses carry statutory assurances of just and reasonable rates. The Act 129 costs are subject to audit by a statewide evaluator. Purchased gas costs recovered through Section 1307 are subject to least cost procurement laws. Contrarily, NAWC's proposed PWAC would expose ratepayers to the whims of BCWSA. OTS Reply Brief, p. 14.

If the Commission approves NAWC's proposed PWAC, without the cap recommended by the ALJ, NAWC's ratepayers would be subject to potentially large and frequent rate increases. The Commission has never granted a PWAC to a water utility as large as NAWC, particularly one with only a single supplier of purchase water. OTS Reply Brief, p. 9. With an uncapped PWAC in place, BCWSA might increase the frequency of its purchased water rate increases. Additionally, NAWC may be encouraged to further increase its already high percentage of purchased water or relax the measures presently undertaken to minimize its percentage of purchased water.<sup>10</sup> Because the Section 1307 review process generally requires a mathematical accounting instead of a thorough analysis of fiscal prudence, an uncapped PWAC exposes ratepayers increased rates

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<sup>10</sup> In the Recommended Decision, the ALJ observed that NAWC currently takes measures to counter BCWSA price increases finding that "Newtown Artesian steps up its leak detection and eliminates any leaks found, trying to limit BCWSA purchases further. It also maintains its pump stations and other large plant items to avoid major failures when facing BCWSA price increases." RD, p. 6.

without sufficient assurance of the justness and reasonableness of such costs. *See* RD, p. 12, *contra* OTS Exceptions, p. 7.

NAWC's suggestions that ratepayers are protected because the PWAC also provides for automatic decreases of purchased water expenses fail to mitigate against negative incentives as the record does not reflect a single decrease in rates charged by BCWSA since the inception of the Agreement in 1984. OTS MB, pp. 2, 19. The 3% cap provides some assurance that the PWAC will not eviscerate base rate scrutiny of NAWC's operational expenses and thereby assure that all rates recovered are just and reasonable.

Although OTS maintains that no PWAC is required to preserve NAWC's opportunity to earn a just and reasonable return, we recommend that any PWAC approved by the Commission in this proceeding should incorporate the ALJ's 3% cap limitation in order to safeguard against recovery of unjust and unreasonable rates.

## **OTS REPLY EXCEPTION NO. 2**

**OTS replies to the NAWC Exceptions claiming that the ALJ's recommendation to cap the proposed PWAC fails to comply with the statutory requirements of Section 1307 and decisional precedents.**

NAWC Exceptions, Nos. 1C & 1D, pp. 8-11.

Recommended Decision, pp. 12-13, 19.

OTS Reply Brief, pp. 8-11.

OTS Main Brief, pp. 6-10.

In its Exceptions, NAWC argues that the ALJ's proposal to cap the PWAC is inconsistent with Section 1307 and decisional precedents. As described below,

these claims are based on flawed reasoning and OTS recommends that the Commission grant the instant OTS Exception and reject NAWC's claims.

NAWC's claim that the ALJ's proposal to cap the PWAC exceeds the statutory scheme for a 1307(a) automatic adjustment clause conflicts with the plain meaning of the statute and the Commission's broad authority to set just and reasonable rates. As thoroughly described in the OTS Main Brief and clarified by the statute itself, the implementations of a Section 1307(a) automatic adjustment clause not otherwise required by statute is a matter squarely within the discretion of the Commission.<sup>11</sup> The Commission's discretionary power includes the authority to determine "the manner in which automatic adjustment recovery may be instituted..."<sup>12</sup> Further, Section 1301 empowers the Commission to implement rules and regulations to ensure that all rates charged by jurisdictional utilities are just and reasonable.<sup>13</sup> Both Section 1307(a) and Section 1301 provide authority for the Commission to cap NAWC's PWAC.

NAWC's claim that the capped PWAC is inconsistent with decisional precedent must also fail because there are no decisional precedents approving a

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11 OTS MB, p. 9. "Although Section 1307(a) authorizes the mechanic of an automatic adjustment clause, specific expenses to be recovered through an automatic adjustment clause must be expressly authorized by statute *or* within the parameters of the Commission's discretionary powers. [Emphasis added]." *See also* 66 Pa. C.S. § 1307(a). Section 1307(a) indicates that automatic adjustment clauses proposed by public utilities are fully subject to the Commission's broad authority to ensure just and reasonable rates. The statute provides that "The commission may revoke its approval *at any time and fix other rates for any such public utility* if, after notice and hearing, the commission finds the existing rates unjust or unreasonable. [Emphasis added]." *Id.*

12 OTS MB, p. 6, *citing* OTS Statement No. 1, p. 6.

13 66 Pa. C.S. § 1301 (providing that "[e]very rate made, demanded, or received by any public utility... shall be just and reasonable and in conformity with regulations and orders of the commission." *Id.*

PWAC under the instant circumstances and NAWC's attempts to rely on loosely related case law and regulations are unconvincing. Both the OTS Main Brief and the OTS Reply Brief clarify that the Commission has never granted a PWAC for a utility with annual revenues in excess of \$250,000. OTS Main Brief, pp. 10-13, OTS Reply Brief, pp. 8-11.

NAWC's attempts to portray differences between the instant proceeding and tangentially related case law and regulations as precedential inconsistencies are unpersuasive. For example, NAWC argues that the proposed cap fails to conform with precedent because Regulation 52 Pa. Code § 53.54(c) does not cap the PWAC for small water utilities, "nor does the Regulation express any concern that an "uncapped" clause will evade Section 1308 rate review. NAWC Exceptions, p. 10. In proffering this argument, NAWC omits the fact that the entire purpose of Regulation 52 Pa. Code § 53.54 is to provide an alternative regulatory framework for small and troubled water utilities that are unable to engage in the traditional ratemaking process.<sup>14</sup> OTS Main Brief, pp. 10-11. Case law from a proceeding seeking to exempt certain utilities from the traditional ratemaking process cannot provide decisional precedent for the proposed cap because its stated purpose is to preserve the traditional ratemaking process.<sup>15</sup>

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14 "In the 1996 Order adopting this regulation, the Commission emphasized the necessity of enacting provisions to alleviate the extreme financial and operational pressures 'identified as unique to small water and wastewater utilities.'" OTS MB, p. 11.

15 "To address OCA's and OTS's concerns over the disassembling of the traditional rate-making process and an unfair treatment of the ratepayers, I recommend that the proposed PWAC be capped at 3% of the amount billed to customers." RD, p. 13.

Additionally, NAWC acknowledges that the Commission authorized a cap on the Distribution Systems Improvement Charge (“DSIC”) for water utilities but argues that such cap is inappropriate here because increased purchased water expenses are out of the control of the utility. NAWC Exceptions, p. 10. NAWC provided no authority for the contention that expenses that are out of control of the utility cannot be capped under Section 1307 when the Commission deems such a cap to be necessary and in the public interest. To the extent that NAWC argues that the ALJ’s proposed PWAC cap should be increased to match the Commission-approved cap on DSIC expense recovery, OTS submits that the DSIC was *specifically authorized by statute and therefore not an appropriate precedent for NAWC’s PWAC.*

NAWC has failed to provide statutory or decisional precedents that are inconsistent with the ALJ’s proposal to cap the PWAC. Accordingly, OTS requests that the Commission grant the instant OTS Exception and reject the claims that capping NAWC’s proposed PWAC fails to comply with the statutory requirements of Section 1307 and decisional precedents.

### **OTS REPLY EXCEPTION NO. 3**

#### **OTS replies to the NAWC Exception rejecting the Recommended Decision's provision of one-directional interest on overcollections.**

NAWC Exceptions, No. 2, pp. 8-11.  
Recommended Decision, pp. 18-19.  
OTS Reply Brief, pp. 14-15.  
OTS Main Brief, pp. 22-24.

In its Exceptions, NAWC requests that the Commission reject the interest component recommended by the ALJ. In the Recommended Decision, the ALJ rejected NAWC's proposal to implement a bilateral interest component and adopted the OTS proposal to recover one-directional interest on overcollections. NAWC now requests that the Commission adopt a PWAC with no provision for interest.

If the Commission grants a PWAC in this proceeding, OTS recommends that the Commission adopt the ALJ's recommendation and provide for one-directional interest payments on overcollections. As stated in the OTS Reply Brief, the one-directional interest scheme currently applied in DSIC proceedings provides for equitable cost recovery. OTS RB, p. 14. If the PWAC were granted, NAWC would experience minimal risk of an undercollection as it is in position to communicate with BCWSA regarding forthcoming rate changes. RD, p. 6. Contrarily, it is appropriate to provide for interest on overcollections as ratepayers are not in any position to prevent overcollections. As observed in the OTS Reply Brief and recognized by the ALJ, "[o]ne directional interest, accrued at the

residential mortgage rate, acknowledges the minimal risk experienced by the utility and fairly compensates the ratepayers for the time value of money.” OTS Reply Brief, p. 15.

In the event that the Commission approves a PWAC in this proceeding, OTS recommends that the Commission grant this Exception and adopt the ALJ’s recommended interest scheme providing for one-directional interest on overcollections at the residential mortgage rate.

### III. CONCLUSION

For the reasons set forth above, the Office of Trial Staff hereby maintains that the Commission should issue an Order concluding this proceeding that incorporates all OTS Exceptions submitted herein.

Respectfully submitted,



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Adeolu Bakare  
Prosecutor  
PA Attorney I.D. # 208541

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Dated: March 4, 2010

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission :  
: :  
v. : Docket No. R-2009-2117550  
: :  
Newtown Artesian Water Company :

**CERTIFICATE OF SERVICE**


I hereby certify that I am serving the foregoing **Reply Exceptions**, dated March 4, 2010, either personally, by first class mail, electronic mail, express mail and/or by fax upon the persons listed below, in accordance with the requirements of § 1.54 (relating to service by a party):

Honorable Ky Van Nguyen  
Office of Administrative Law Judge  
Pennsylvania Public Utility Commission  
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