BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.,	**)**	**ER17-1519-000**
PECO Energy Company	**)**	

PROTEST AND REQUEST FOR HEARING OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

James P. Melia
Aspassia A. Staevska
James Mullins
Counsel for the Pennsylvania Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265
Tel: 717-787-1859
jmelia@pa.gov
astaevska@pa.gov
jamullins@pa.gov

Pursuant to Rule 211 of the Federal Energy Regulatory Commission's (FERC) Rules of Practice and Procedure, 18 C.F.R. §385.211, the Pennsylvania Public Utility Commission (PAPUC) herein files its Protest and Request for Hearing in response to the filing of PECO at this docket seeking establishment of a formula rate.

I. INTRODUCTION

On May 1, 2017, PECO Energy Company (PECO) filed with the FERC for the establishment of a formula rate.[1] PECO is seeking FERC approval to move from its current stated rate to a forward-looking Formula Rate under the PJM Open Access Transmission Tariff (OATT) through which PECO will recover the costs related to its transmission facilities. PECO requests a revenue increase of approximately $21.7 million annually.[2]

The PAPUC has reviewed and analyzed the filing and contends that the requested Return on Equity (ROE) of 10.5% plus a 50 basis- point RTO member incentive adder is not just and reasonable given current market conditions.

PECO alleges that its Formula Rate includes a cost of service Template and Protocols that have been modelled after formula rate templates and protocols recently approved by the FERC. PECO alleges that its transmission revenue requirement has risen primarily due to PECO's construction of PJM-mandated Reliability Transmission Expansion Projects (RTEP) needed to improve its network reliability coupled with

[1] *PJM Interconnection L.L.C.; PECO Energy Company*, Docket No. ER17-1519-000 (Filed May 1, 2017).
[2] PECO Cover Letter, 1-2.

declines in PECO's transmission loads during the last five years.[3] PECO's current stated transmission rate was established in 1998.

The PAPUC has reviewed PECO's Formula Rate Template and Protocols and determined that this portion of PECO's filing may not be just and reasonable and many of the components of the Template and Protocols may not be consistent with FERC precedent regarding forward-looking transmission formula rates. Further, the complexity and magnitude of changes encompassed within the Formula Rate Template and Protocols raise questions which need to be examined through discovery and possibly settlement discussions or litigation.

The PAPUC requests that PECO's Formula Rate filing be suspended and the matter be assigned for evidentiary hearings.

II. PROTEST

The PAPUC raises the following issues as a basis for its protest:

A. PECO's Proposed Return On Equity Has Not Been Shown To Be Just And Reasonable.

PECO witness Adrien McKenzie presents testimony and exhibits supporting a return on equity of 10.5% with a 50-basis point adder for a requested ROE of 11.0%.[4]

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[3] PECO Cover Letter at 6-7.
[4] PECO Attachment E, PEC-200 (Prepared Direct Testimony and Exhibits of Adrien M. McKenzie).

Mr. McKenzie primarily relies on the FERC-approved two-step Discounted Cash Flow (DCF) Model set forth in FERC Orders Nos. 531 and 551.[5] Mr. McKenzie then supplements his DCF analysis with application of the Risk Premium Method, Capital Asset Pricing Method (CAPM), the Expected Earnings Approach and Empirical CAPM. Finally, Mr. McKenzie measures these individual ROE determinations against several benchmarks including examination of a low-risk non-utility DCF model and examination of state-approved ROEs.[6] While Mr. McKenzie's methodologies are fairly well-accepted, the witness advances dubious and creative economic assumptions coupled with reliance on biased data that unrealistically inflate the ROE recommendation.

1. PECO Improperly Includes Algonquin, Avangrid And Pacific Gas & Electric In Its Proxy Group.

Mr. McKenzie includes several utilities in his proxy group that inordinately skew the results of his DCF analysis. The PAPUC proposes that these companies be excluded for the reasons that follow.

Algonquin Power & Utilities (Algonquin) is included as part of witness McKenzie's publicly traded utility proxy group.[7] Algonquin is a Canadian utility company primarily invested in renewable energy projects including solar, wind, hydroelectric and thermal projects encompassed within its Algonquin Power affiliate.

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[5] *Coakley v. Bangor Hydro Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234, *order on paper hearing*, Opinion No. 531-A, 149 FERC ¶ 61,032 (2014), *order on reh'g*, Opinion No. 531-B, 150 FERC ¶ 61,165 (2015), *appeals docketed sub nom. Emera Maine v. FERC*, Nos. 15-1118, *et al.* (D.C. Cir. Apr. 30, 2015); *Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234 (2016), *reh'g pending*.
[6] Testimony of Adrien F. McKenzie, Attachment E, Ex. PEC-200 through 211.
[7] Testimony of Adrien F. McKenzie, Attachment E, Ex. PEC-200 at 26-28.

Mr. David Huff, PAPUC Analyst, critiques the inclusion of Algonquin in his attached affidavit. Mr. Huff states that the majority of these generation facilities are located in Canada. Algonquin also includes an affiliate, Liberty Utilities (Liberty), that primarily consists of water/wastewater operations in the U.S. Liberty also recently acquired gas and electric utilities in New Hampshire (Granite State and Energy North), Massachusetts (LaClede Gas), Georgia (Atmos Energy) and the Midwest (Empire District Electric Company).[8] Mr. Huff notes that Algonquin is not listed in Value Line. Algonquin only generates 20.8% of its revenue from electric utilities (13.5% adjusting for commodity costs). Mr. Huff concludes that Algonquin's diverse generation portfolio, geographical dispersal of assets, vague corporate acquisition strategy and limited financial track record would militate against inclusion in any standard utility proxy group at this time.[9]

Mr. Huff states that the problems inherent in relying on recent utility acquisitions such as Algonquin are obvious from an examination of witness McKenzie's supporting exhibits. Algonquin is unrated by both Moody's and Value Line and has no growth rate valuation by IBES/Yahoo Finance, Zacks and Bloomberg.[10] Algonquin does show extremely high growth rates of 11.5% (S&P/IQ) and 19.1% (FactSet) relative to the rest of the proxy group.[11] Where data does exist on Algonquin, the inordinately high DCF calculations inevitably skew the median, midpoint and upper bound of witness

[8] http://algonquinpower.com/our_business/
[9] Affidavit of David A. Huff at 3-4.
[10] Ex. PEC-203 at 1, Ex. PEC-204 at 2,4,5,6 of 8.
[11] Ex. PEC-204 at 2.

McKenzie's two-step DCF analysis.[12] Data is also absent for Algonquin in Mr. McKenzie's CAPM, Expected Earnings and ECAPM analyses.[13] The PAPUC contends the inclusion of Algonquin was solely to inflate the results of Mr. McKenzie's DCF analysis and it should be excluded from the utility proxy group.

Mr. McKenzie includes Avangrid as a part of the electric utility proxy group for purposes of his DCF analysis.[14] Avangrid is an electric and gas utility operating throughout New York and New England. Avangrid is the result of a merger between UIL Holdings Corporation and Iberdrola in 2015. Although this was a recent merger, Avangrid is included in the Value Line electric utility group.[15]

Avangrid's business profile includes the ownership and operation of a significant portion of natural gas distribution and renewable generation assets. Calculating the ROE of a firm by using another firm as a proxy requires one to choose a proxy operating in markets with equivalent risk, thereby resulting in the expectation of a comparable rate of return. No proxy company has the exact same risk or growth profile. As was the case with Algonquin, Avangrid's operations in both natural gas distribution and renewable generation make the firm a less-than-ideal equivalent risk proxy that unreasonably inflates the growth component in PECO's ROE calculations.[16] The PAPUC submits that inclusion of Avangrid is solely for purposes of inflating the ROE range of reasonableness

[12] Ex. PEC Ex. PEC- 204 at 7, 8.
[13] Ex. PEC Ex. PEC 206 at 1, PEC-208 at 1, PEC 209 at 1.
[14] Ex. PEC-203 at 1, PEC-204 and PEC-205.
[15] Ex. PEC-203 and PEC-204.
[16] Huff Affidavit at 6-7.

and ultimately PECO's recommended ROE. Avangrid should be excluded from the utility proxy group.

Mr. McKenzie's DCF Value Line growth rate model at Exhibit No. PEC-205 is also inflated by the inclusion of a Value Line growth component for Pacific Gas & Electric (PG&E) of 11.0% that is far in excess of other growth rates in the electric utility proxy group.[17] While Value Line does calculate an annual growth rate estimate of 11% for the 2014-2016 to the 2020-2022 timeframe, PG&E had a negative 2.0% growth rate for the past 5 years and positive 1.0% for the past ten years.[18] Value Line states as follows: "Ever since a gas pipeline explosion in San Bruno, California in September of 2010, PG&E earnings have been hurt by unrecovered costs associated with this incident. The dividend yield and 3- to 5-year total return potential are not far from the averages for the electric utility industry."[19] If we calculate an EPS annual growth rate from 2010 to 2020, we see a modest annual growth rate of 4.78%.[20]

On this basis, the PAPUC contends the PG&E 11% annual earnings growth rate is inaccurate, misleading and skews the results. This growth rate fails to account for the effects of an outsized event that clearly depressed the company's earnings per share number for several years. Excluding PG&E would reduce the top-end of the range of reasonableness from 12.13% to 9.84%, over a 200 basis point difference. [21]

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[17] Ex. PEC-205, p. 1.
[18] *Value Line Summary* April 28, 2017, prepared by Paul E. Debbas, CFA
[19] *Value Line Summary*, April 28, 2017, prepared by Paul E. Debbas, CFA
[20] Value Line lists a 2010 EPS of $2.82 and an estimated 2020-2022 EPS of $4.50.
[21] Huff Affidavit at 8.

The PAPUC notes that eliminating Avangrid from the DCF IBES Growth Model (Exhibit PEC 204) significantly reduces the top end of the ROE range of reasonableness. For example, the top end of the DCF range drops from 12.03% to 11.11%, the upper midpoint would drop from 10.80% to 10.01% and the upper median would change from 10.26% to 9.74%.[22]

The PAPUC also disagrees with Mr. McKenzie's exclusion of the following companies from his Value Line analysis at Ex. PEC-205 specifically Avista Corp., Edison International, El Paso Electric Company and IDACORP, Inc. Exclusion of these companies is based on an erroneous interpretation of the Low-End Outlier Test which is discussed later in this protest. Removing Algonquin and PG&E from Mr. McKenzie's Value Line Growth analysis at Ex. PEC-205, p. 1 coupled with inclusion of the above-listed four companies' results in the following revisions to Mr. McKenzie's analysis at Ex. 205:[23]

[22] Huff Affidavit at 8.
[23] Huff Affidavit at 8-9.

	PECO Ex. PEC-205	PAPUC
Lower end	7.14%	6.25%
Upper end	12.13%	9.82%
Median	8.83%	8.22%
Upper Median	10.48%	9.02%
Midpoint	9.63%	8.04%
Upper Midpoint	10.88%	8.93%

Mr. Huff performed the same revisions to Mr. McKenzie's IBES/ Yahoo Finance model at Ex. PEC-204 at 4 by excluding Avangrid and including American Electric Power (AEP) and IDACORP with the following results:

	PECO Ex. PEC-204	PAPUC
Lower end	7.11%	6.80%
Upper end	12.03%	11.08%
Median	8.49%	8.39%
Upper Median	10.26%	9.74%
Midpoint	9.57%	8.94%
Upper Midpoint	10.80%	10.01%

The PAPUC protests PECO's ROE request on the basis of inclusion, within Mr. McKenzie's DCF proxy group, of utility companies whose business and operational characteristics do not fit the requirements of a typical DCF proxy group. Further, PECO's ROE request should be rejected insofar as it improperly excludes certain utilities based on an incorrect application of the two step DCF method. For these reasons, the PAPUC requests suspension of the rate filing and an evidentiary hearing on the ROE issue.

2. PECO's Witness Fails To Properly Apply The Commission's Low-End Outlier Test.

Mr. McKenzie suggests that using a 100 basis point spread above the 6-month historical average equivalent public utility bond yield to remove low-end ROE outliers, as referenced in FERC Orders 531 and 551, does not accurately remove low-end values.[24] He further states that adding a margin of 100 basis points is insufficient to reflect investors' required returns going forward. Instead, Mr. McKenzie adjusts the 100-basis point threshold to account for the increase in the equity risk premium that accompanies a fall in bond yields. The witness calculates the revised risk premium to be 243 basis points (which is the sum of his "Adjustment to Low End Threshold" of 143 basis points plus the standard 100 basis point adder) which he adds to the current 4.60% average yield on Baa rated utility bonds resulting in a low-end threshold of 7.03%.[25]

FERC case law on this issue has held that companies whose cost of equity estimates fail tests of reasonableness and economic logic should be excluded from the

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[24] McKenzie Testimony, Ex. PEC-200 at 40-41.
[25] *Id.*

proxy group through application of the low-end outlier test.[26] The purpose of this test is to "exclude from the proxy group those companies whose ROE estimates are below the average bond yield or are above the average bond yield but are sufficiently low that an investor would consider the stock to yield essentially the same return as debt." The FERC has used the 100 basis points above the cost of debt as an estimate of this threshold.[27]

The PAPUC has examined Mr. McKenzie's analysis and believes his creative adjustment to reflect an increased equity premium to compensate for lower bond yields is not empirically supported and is designed to artificially inflate his DCF result. By comparison, reliance on the traditional low-end DCF outlier test results in a more reasonable low-end threshold of 5.6% (4.6% plus 100 basis points).

The PAPUC protests PECO's filing on this basis and requests this issue be assigned for evidentiary hearing.

3. PECO's Witness Fails To Properly Apply The Median As The Appropriate Measure Of Central Tendency.

Mr. McKenzie's recommended base ROE utilizes the midpoint instead of the median as the measure of central tendency in his 2-step DCF analysis.[28] The FERC has established a policy of using the median DCF result for single utilities of average risk based on the decision in *Southern California Edison v. FERC* .[29] In that decision, the Court explained that "using the median also has the advantage of taking into account

[26] Opinion 531 at 122.
[27] Opinion 531 at 121-123.
[28] McKenzie Testimony, Ex. PEC-200 at 12-13.
[29] 717 F.3d 177 (D.C. Circ. 2013).

more of the companies in the proxy group rather than only those at the top and bottom."[30] The decision left untouched the propriety of using the midpoint for electric utilities applying jointly as a regional group for an ROE determination.[31] FERC Opinion Nos. 531 and 551 both reaffirmed the propriety of use of the midpoint as the proper measure of central tendency for a region-wide group of utilities but did not alter the policy of utilization of the median for single utility ROE determinations.[32]

The PAPUC protests PECO's reliance on the midpoint as the best measure of central tendency for its proxy group of utilities in its two-step DCF analysis and requests this issue be set for evidentiary hearing.

4. PECO's Proposal To Include A 50 Basis Point Adder For RTO Membership Is Unjust And Unreasonable.

PECO requests an incentive adder of 50 basis points to its requested ROE of 10.5% to reward PECO for its continuing membership in PJM. Mr. McKenzie's testimony reiterates that FERC's standard policy has always been to reward transmission companies a RTO participation adder.[33]

The PAPUC protests PECO's request for an additional 50 basis point "incentive" over and above PECO's requested 10.5% ROE. PECO is requesting an incentive for no other reason than the FERC has seen fit to consistently award these incentive requests by transmission operators as "automatic adders" to the base ROE request. The transmission

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[30] *Id*. at 183
[31] *Id*. at 183. *See also, Public Service of N.M*. 142 FERC ¶ 61,168 (2013); *Pacific Gas & Electric Co*., 141 FERC ¶ 61, 168 (2012); *Virginia Electric & Power Co*., 123 FERC ¶ 61,098 (2008).
[32] Opinion 531 at 144; Opinion 551 at 122.
[33] McKenzie Testimony (Ex. PEC-200) at 17-18.

facilities which PECO currently owns have been subject to the requirements of PJM's Open Access Transmission Tariff (OATT) since the late 1990's. PECO has been and will continue to be a member of PJM as evidenced by its testimony in this case attesting to the need for increased transmission revenues due to PJM-mandated RTEP projects.

FERC Order 679-A acknowledged that an RTO-membership adder was an option to incentivize utilities to join and remain in RTOs. Further, Order 679-A required that incentive adders must demonstrate benefits to consumers.[34] PECO has not demonstrated that the proposed adder is just and reasonable. PECO is an obligatory member wholly participating in the many benefits of RTO-membership. There would be no practical benefit for PECO not continuing to participate in the RTO process. The PAPUC contends that the basis for justifying inclusion of the incentive adder should not be "because it's always been done that way" but that real demonstrative benefits accrue to customers.

Order 679-A also stated that FERC would "consider specific incentives on a case-by-case basis." Granting PECO's RTO adder simply because the FERC has done so for other transmission companies would violate the case-by-case approach adopted in Order 679-A and employed in other cases.[35]

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[34] Order No. 679-A, 72 Fed. Reg. 1152, FERC Stat. & Regs. ¶ 31,236 (January 10, 2007) (Order No. 679-A) at 86.

[35] Order No. 679-A at 326; *Allegheny Power System Operating Companies*, 111 FERC ¶ 61,308 (2005) at 54.

The PAPUC protests the PECO filing on the basis that its request for a 50 basis point incentive is unjust and unreasonable. The PAPUC requests that this issue be set for evidentiary hearing.

B. PECO's Proposed Formula Rate Methodology And Protocols Raise Complex Issues That Require Additional Time For Review.

PECO's proposed Formula Rate Methodology and Protocols encompass a major portion of its rate filing. As detailed in the Testimony of Alan C. Heintz, PECO is proposing a transition from its stated rate method dating to 1998 with a formula rate methodology that may remain in place for many years into the future. A rate transition of this magnitude and potential duration cannot be implemented without a thorough examination of the many facets of the proposal. Mr. Heintz's testimony raises a number of potential issues which will require further discovery and analysis as well as discussion with the company in a settlement context or in litigation. The PAPUC has identified specific potential issues as follows:

- Examination of the operation and components of the Formula Rate Template and Formula Rate Implementation Protocols;

- The operation of the Formula Rate on an annual basis including the computation of actual and projected cost and revenue data, operation of the true-up mechanism and calculation of interest;

- How calculations are made within Attachment H-7 of the filing and the accounting classifications of the data that will populate the schedules contained therein;

- Calculation of rate base components and adjustments for deferred income taxes, unfunded reserves, construction work in progress (CWIP), pension, operation and maintenance (O&M) expense and other components;

- Examination of applied depreciation rates and expenses under the formula rate;
- Formula rate development of income and other taxes;
- Formula rate treatment of rate of return and incentive rates;
- Formula rate treatment for RTEP projects and the process for calculating competitive concessions for projects as part of the competitive bid process;
- Timing of formula rate annual filings and the time allowed for parties to review and challenge components of those filings.

A plethora of issues potentially exist with this filing for which additional time will be necessary. Similar issues are currently being examined by the parties (including PAPUC) to the formula rate filings by First Energy and its transmission affiliate Mid-Atlantic Interstate Transmission (MAIT) at FERC Dkt. Nos. ER17-211-000 and ER17-216-000. Further, PECO's assertions that the formula rate protocols are similar to recently approved protocols for Midcontinent Independent System Operator (MISO)[36] and other transmission entities should not diminish the ability of impacted state regulators, consumer advocates and end-users to thoroughly examine the details of the formula rate filings.

[36] *See, e.g.*, FERC, Staff's Guidance on Formula Rate Updates (July 17, 2014), https://www.ferc.gov/industries/electric/indus-act/oatt-reform/staff-guidance.pdf; *Midwest Indep. Transmission Sys. Operator, Inc.*, 139 FERC ¶ 61,127 (2012), *order on investigation of formula rate protocols, Midwest Indep. Transmission Sys. Operator, Inc.*, 143 FERC ¶ 61,149 (2013), *order on reh'g*, 146 FERC ¶ 61,209 (2014), *order on compliance, Midcontinent Indep. Sys. Operator, Inc.*, 146 FERC ¶ 61,212 (2014), *order on reh'g and clarification*, 150 FERC ¶ 61,024 (2015), *order on compliance*, 150 FERC ¶ 61,025 (2015). *Midcontinent Indep. Sys. Operator, Inc.*, Compliance Filing Revising Attachment O Formula Rate Protocols, Docket No. ER13-2379-004 (filed Feb. 13, 2015).

The PAPUC protests PECO's Formula Rate Methodology and Protocols for the foregoing reasons and requests that the matter be set for evidentiary hearing.

C. The PAPUC Protests PECO's Request For a Blanket Waiver Of The 18 C.F.R. Part 35 Requirements.

The PECO formula rate filing requests a blanket waiver of the 18 C.F.R. § 35.13 requirements that are not satisfied by the statements submitted by PECO and of any other applicable requirements for which waiver is not specifically required.[37] The blanket waiver request is apparently sought out of expediency in order to allow the requested formula rates to become effective July 1, 2017.

The PAPUC protests PECO's failure to more specifically identify those portions of 18 C.F.R. § 35.13 for which a waiver is sought.   The parties should not be put in a position of having to discern which of the detailed requirements of 18 C.F.R. §35.13 are or are not encompassed within the filing. A more detailed recitation of the Part 35 requirements for which waiver is requested will assist the PAPUC and other parties in more effectively evaluating the contents of the filing

D. The PAPUC Requests An Evidentiary Hearing And Further Requests A Five Month Suspension Of The Effective Date Of The Proposed Formula Rates.

PECO's filing proposes a revenue increase of $21.7 million over current rates and a proposed ROE of 11.0%. The impact on Pennsylvania ratepayers will be significant and permanent. PECO's filing raises serious issues of material fact with regard to its ROE proposal and the formula rate protocols. These issues deserve careful examination.

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[37] PECO Cover Letter at 39.

The PAPUC has a statutory obligation to protect its ratepayers from exorbitant and possibly imprudent transmission investment. Moreover, other parties to this proceeding should have ample time to fully investigate the details of this filing. Consequently, the PAPUC requests that this matter be assigned for an evidentiary hearing and be suspended for a five month period beyond the requested effective date of July 1, 2017 pursuant to 16 U.S.C. § 824d(e) and that a refund effective date be established. The PAPUC reserves the right to identify additional issues based on discovery by it and other parties to the case and to supplement its Protest.

III. CONCLUSION

WHEREFORE, the Pennsylvania Public Utility Commission respectfully requests that the Commission: (1) deny Applicants' request to accept without a hearing or suspension the proposed formula rate template and protocols, (2) suspend the effective date for a period of five months, (3) establish a refund effective date; and (4) schedule this matter for an evidentiary hearing.

Respectfully submitted,

/s/ James P. Melia
James P. Melia
Aspassia V. Staevska
James Mullins
Counsel for the Pennsylvania Public
Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265
Tel: 717-787-1859
jmelia@pa.gov

Dated: May 30, 2017

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

	:	
PJM Interconnection L.L.C.	:	**ER17-1519-000**
PECO Energy Company	:	

Affidavit of David L. Huff

I, David L. Huff, being duly sworn, depose and say:

1. My name is David L. Huff. I am employed by the Pennsylvania Public Utility Commission (PA PUC) as the Supervisor of the Finance section in the PA PUC's Bureau of Technical Utility Services. I have a Masters of Business Administration Degree with a concentration in finance and over 30 years of experience working for a regulated public utility and/or for a public utility regulatory agency. This experience includes 13 years of experience analyzing financial filings and utility rate filings for the PAPUC and 17 years of work experience working for GTE Telephone Operations, and following its merger with Bell Atlantic, Verizon. During my employment in the telephone industry, I had a broad range of responsibilities in areas such as accounting operations, regulatory accounting, business sales, strategic planning and budgeting, pricing and wholesale account management. While working for GTE and Verizon, I was involved in the preparation of financial schedules for rate case proceedings, earnings monitoring reports and price cap filings for the Federal Communications Commission.

Currently at the PA PUC, I supervise a staff that provides technical assistance to the Commission and the Commission's Office of Administrative Law Judge in determining a utility's rate of return in rate proceedings, provide rate of return schedules and analysis in small water and gas utility filings, provide return on equity analysis for the PA PUC's quarterly earnings monitoring report, write draft orders for securities registration, mergers and change of control applications and affiliated interest agreement application and write detailed reports on financial matters as they relate to regulatory policy. My qualifications are attached as an appendix to this application.

2. The purpose of this affidavit is to provide comments in support of the Protest of the PAPUC to the recent filing of PECO Energy Company (PECO) for the establishment of a formula rate. PECO is seeking Federal Energy Regulatory Commission (FERC) approval to move from its current stated rate to a forward-looking Formula Rate under the PJM Open Access Transmission Tariff (OATT) through which PECO will recover the costs related to its transmission facilities. PECO requests a revenue increase of approximately $21.7 million annually.

3. I have reviewed and analyzed the Testimony and Exhibits of PECO witness Adrien M. McKenzie. Mr. McKenzie recommends a return on equity (ROE) of 10.5 % coupled with a 50 basis point incentive adder for RTO membership resulting in an overall ROE of 11.0%. Mr. McKenzie primarily relies

on the FERC-approved two-step Discounted Cash Flow (DCF) Model set forth in FERC Orders Nos. 531 and 551. Mr. McKenzie then supplements his DCF analysis with application of the Risk Premium Method, Capital Asset Pricing Method (CAPM), the Expected Earnings Approach and Empirical CAPM. Finally, Mr. McKenzie measures these individual ROE determinations against several benchmarks including examination of a low-risk, non-utility DCF model and examination of state-approved ROEs.

4. My review and analysis of Mr. McKenzie's ROE recommendation concludes that his overall analyses, while traditionally sound, utilizes incorrect assumptions and relies on biased data to inflate his ROE recommendation. Overall, I believe his ROE recommendation is far in excess of what should be allowed given current market conditions.

5. Mr. McKenzie includes a number of utilities in his publicly-traded utility proxy group which, in my opinion, are inappropriate for the application of the two-step DCF model to evaluate investors' required rate of return for PECO.

6. Witness McKenzie includes in his DCF utility proxy group Algonquin Power & Utilities (Algonquin) which is a Canadian company primarily invested in renewable energy projects including solar, wind, hydroelectric and thermal projects encompassed within the Algonquin Power affiliate. The majority of these generation facilities are located in Canada. Algonquin also includes an affiliate,

Liberty Utilities (Liberty), that primarily consists of water/wastewater operations in the U.S. Liberty recently acquired gas and electric utilities in New Hampshire (Granite State and Energy North), Massachusetts (LaClede Gas), Georgia (Atmos Energy) and the Midwest (Empire District Electric Company). In my opinion, Algonquin's diverse generation portfolio, geographical dispersal of assets, less than clear corporate acquisition strategy and limited financial track record would militate against inclusion in any standard utility proxy group at this time.[1]

7. The problems inherent in relying on recent utility acquisitions such as Algonquin are obvious from an examination of witness McKenzie's supporting exhibits. Algonquin is unrated by both Moody's and Value Line as well as having no growth rate valuation by IBES/Yahoo Finance, Zacks and Bloomberg.[2] Algonquin does show inordinately high growth rates of 11.5% (S&P/IQ) and 19.1% (FactSet) well above the rest of the proxy group.[3]

8. FERC Order 531 held that the proxy group should be a national group of companies considered electric utilities by Value Line Investment Survey.[4] Algonquin is not followed by Value Line and is not included in the Value Line Investment Survey Electric Industry group. Nor does Mr. McKenzie provide evidence that Algonquin is followed by any other investor service shown to be

[1] McKenzie Testimony at 26-28.; http://algonquinpower.com/our_business/
[2] Ex. PEC-203 p. 1, Ex. PEC-204 p. 2 of 8,
[3] Ex. PEC-204 p. 2 of 8.
[4] FERC Order 531 at 92.

reliable and commonly relied upon by investors.[5] IBES data is the FERC-preferred data source for computing the short-term growth rate. As shown in McKenzie Exhibit No. PEC-204 page 4, Algonquin does not have IBES-Yahoo! Finance data available.[6]

9. Algonquin only generates 20.8% of its revenue from electric utilities, or 13.5% adjusting for commodity costs. Below is an excerpt from Algonquin's 2016 Annual Information Form[7]:

> For the year ended December 31, 2016, APUC derived approximately 22.2% of its revenues from its interests in power generation facilities (21.7% in 2015), 20.8% of its revenues from electrical distribution utilities (21.8% in 2015), 37.0% of its revenues from natural gas distribution utilities (45.2% in 2015) and 16.6% of its revenues from its interests in water distribution and wastewater utilities (7.6% in 2015). The purchase of electricity and natural gas by the Corporation's electric distribution and natural gas distribution system is a significant revenue driver and component of operating

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[5] Order 531 at 102.

[6] While the Commission has refrained from mandating the exclusive use of IBES data in its natural gas and oil pipeline rate of return cases, the Commission has stated that "IBES data is the preferred data source for computing the short-term growth rate."**144** The Commission has explained that the "IBES data is a compilation of projected growth rates from various knowledgeable financial advisors within the investment community."**145** As such, the IBES short-term growth estimates generally represent consensus growth rate estimates by a number of analysts. **144** *Nw. Pipeline Corp.*, 92 FERC ¶ 61,287, at 62,002 (2000). *See also Nw. Pipeline, Corp.*, 79 FERC ¶ 61,309, at 62,385 (1997) (finding that "[t]he IBES figures should be used for the short-run growth rate of reach of the proxy companies."). **145** *See, e.g., Northwest Pipeline Corp.*, 87 FERC ¶ 61,266, at 62,058-62,059 (1999); *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at P 234 (2002).

[7] Algonquin 2016 Annual Information Report at 48-49. .http://investors.algonquinpower.com/Cache/1500097027.PDF?Y=&O=PDF&D=&fid=1500097027&T=&iid=4142273

> expenses, but these costs are effectively passed through to its customers. As a result, the Corporation uses 'net utility sales' (see non-GAAP Financial Measures) as a more appropriate measure of the results. Adjusting for the impact of these commodity costs, APUC derived approximately 27.6% of its revenues from its interests in power generation facilities (29.9% in 2015), 13.5% of its revenues from electrical distribution utilities (14.2% in 2015), 33.0% of its revenues from natural gas distribution utilities (38.0% in 2015) and 21.2% of its revenues from its interests in water distribution and wastewater utilities (12.1% in 2015).

In my opinion, Algonquin should be excluded from Mr. McKenzie's DCF proxy group.

10. Mr. McKenzie includes Avangrid as a part of his electric utility proxy group for purposes of his DCF analysis. Avangrid is an electric and gas utility operating throughout New York and New England. Avangrid is the result of a merger between UIL Holdings Corporation and Iberdrola in 2015. According to Avangrid's SEC Annual Report for 2016, the vast majority (81.5%) of Avangrid shares are owned by a foreign company – Iberdrola, S.A. ("Iberdrola").[8] On page 41 of its 2016 SEC Form 10-K, Avangrid notes that Iberdrola will be able to exercise significant influence over it and that Iberdrola's interests in Avangrid may conflict with the public shareholders of the remaining 18.5% of Avangrid's common stock. Avangrid notes: "We have elected to take advantage of the 'controlled company' exemption to the corporate governance rules for NYSE-

[8] Avangrid 2016 SEC Form 10-K at 1,7.

listed companies, which could make our common stock less attractive to some investors or otherwise harm our stock price."[9]

11. Additionally, Mr. McKenzie's Exhibit No. PEC-203 shows no Value Line Beta risk measure for Avangrid and his Exhibit No. PEC-205 showing his two-step DCF Model Value Line Growth, shows no data for earnings per share growth and therefore no DCF rate calculation for Avangrid. Because the company was formed on December 16, 2015, Avangrid has very little historical data on which to form a reliable opinion and the absence of this information in witness McKenzie's DCF analysis is not surprising. For the foregoing reasons, I would recommend the exclusion of Avangrid as part of the utility proxy group for purposes of calculation of a two-step DCF ROE for PECO.

12. Mr. McKenzie's DCF Value Line growth rate model at Exhibit No. PEC-205 is inflated by the inclusion of a Value Line growth component for Pacific Gas & Electric (PG&E) of 11.0% that is far in excess of other growth rates in the electric utility proxy group. While Value Line does calculate an annual growth rate estimate of 11% for the 2014-2016 to the 2020-2022 timeframe, PG&E had a negative 2.0% growth rate for the past 5 years and positive 1.0% growth rate for the past ten years.[10] PG&E experienced a gas pipeline explosion in San Bruno, California in September of 2010. Since that incident, PG&E earnings have been

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[9] *Id.* at 41.
[10] Value Line Summary April 28, 2017, prepared by Paul E. Debbas, CFA

hurt by unrecovered costs associated with this incident. Value Line maintains a neutral stance on PG&E. The dividend yield and 3- to 5-year total return potential are not far from the averages for the electrical utility industry.[11] I note that calculation of an EPS annual growth rate from 2010 to 2020 produces a modest annual growth rate of 4.78%.[12]

13. On this basis, I believe that PG&E's 11% annual earnings growth rate in Ex. PEC-205 is inaccurate, misleading and skews the results. This growth rate fails to account for the effects of an outsized event that has depressed the company's earnings per share number for several years. Excluding PG&E from the analysis at Ex. PEC-205 would reduce the top-end of the range of reasonableness from 12.13% to 9.84% over a 200 basis point difference.[13]

14. For McKenzie's Exhibit 204, I have eliminated Avangrid from the DCF IBES Growth Model which significantly reduces the top end of the ROE range of reasonableness. For example, the top end of the DCF range drops from 12.03% to 11.11%, the upper midpoint would drop from 10.8% to 10.01% and the upper median would change from 10.26% to 9.74%.

15. For Ex. PEC-205, I eliminated both Avangrid and PG&E. I also disagree with Mr. McKenzie's arbitrary exclusion of the following companies from

[11] *Id.*
[12] Value Line lists a 2010 EPS of $2.82 and an estimated 2020-2022 EPS of $4.50.
[13] Per Mr. McKenzie's calculation.

his Value Line analysis at Ex. PEC-205 specifically Avista Corp., Edison International, El Paso Electric Company and IDACORP, Inc. Exclusion of these companies is based on an erroneous interpretation of the Low-End Outlier Test which is discussed later in this protest. Removing Avangrid and PG&E from Mr. McKenzie's Value Line Growth analysis at Ex. PEC-205 coupled with inclusion of the above-listed four companies results in the following revisions to Mr. McKenzie's analysis at Ex. 205[14] :

	PECO Ex. PEC-205	PAPUC
Lower end	7.14%	6.25%
Upper end	12.13%	9.82%
Median	8.83%	8.22%
Upper Median	10.48%	9.02%
Midpoint	9.63%	8.04%
Upper Midpoint	10.88%	8.93%

[14] My calculations for this table also reflect a correct application of the two-step DCF model which includes 2/3 short term growth and 1/3 long term growth when calculating the dividend yield. This diverges from Mr. McKenzie's method of calculating the growth component of the dividend yield.

16. I performed the similar revisions to Mr. McKenzie's IBES/Yahoo Finance model at Ex. PEC-204 at 4 with the following results[15] :

	PECO Ex. PEC-204	PAPUC
Lower end	7.11%	6.80%
Upper end	12.03%	11.08%
Median	8.49%	8.39%
Upper Median	10.26%	9.74%
Midpoint	9.57%	8.94%
Upper Midpoint	10.80%	10.01%

17. Mr. McKenzie suggests that using a 100 basis point spread above the 6-month historical average equivalent public utility bond yield to remove low-end ROE outliers, as referenced in FERC Orders 531 and 551, does not accurately remove low-end values.[16] He further states that adding a margin of 100 basis points is insufficient to reflect investors' required returns going forward. Instead, Mr. McKenzie adjusts the 100 basis point threshold to account for the increase in the equity risk premium that accompanies a fall in bond yields. The witness calculates the revised risk premium to be 243 basis points (which is the sum of his "Adjustment to Low End Threshold" of 143 basis points plus the standard 100

[15] Mr. Huff excludes Avangrid only and includes American Electric Power (AEP) and IDACORP.
[16] McKenzie Testimony, Ex. PEC-200 at 40-41.

basis point adder) which he adds to the current 4.60% average yield on Baa utility bonds resulting in a low-end threshold of 7.03%.[17]

18. I have examined Mr. McKenzie's analysis and believe his creative adjustment to reflect an increased equity premium to compensate for lower bond yields is not empirically supported and is designed to artificially inflate the DCF growth rate. Further, he rejects FERC's well-settled low- end outlier test the purpose of which "exclude from the proxy group those companies whose ROE estimates are below the average bond yield or are above the average bond yield but are sufficiently low that an investor would consider the stock to yield essentially the same return as debt."[18] I would instead recommend reliance on the traditional low end DCF outlier test which results in a more reasonable low end threshold of 5.6% (4.6% plus 100 basis points).

19. Mr. McKenzie's recommended base ROE utilizes the upper midpoint instead of the median as the measure of central tendency in his two-step DCF analysis.[19] The FERC has established a policy of using the median DCF result for single utilities of average risk based on the decision in *Southern California Edison v. FERC*.[20] FERC Opinion Nos. 531 and 551 both reaffirmed the propriety of use of the midpoint as the proper measure of central tendency for a region-wide group

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[17] *Id.*
[18] Order 531 at 121-123.
[19] McKenzie Testimony, Ex. PEC-200 at 12-13.
[20] 717 F.3d 177 (D.C. Circ. 2013).

of utilities and I believe that use of the median is more appropriate insofar as PECO is a single utility.

20. This concludes my affidavit.

Appendix

Educational and Professional Background of David L. Huff Current Work Experience/Training:

July 2012 to Present:
Bureau of Technical Utility Services, Finance Division, Pennsylvania Public Utility Commission, Harrisburg, Pennsylvania.
Supervisor Finance Section:

- Supervises a staff of six Financial Analysts in the preparation of complex technical reports and recommendations in response to utility filings, utility initiatives, Commissioner inquiries and request from other bureaus within the PA PUC.

- Supervise analyst in their review of securities filings, change of control applications, affiliated interest filings, tariff changes and tax matters filed by natural gas distribution, electric distribution, water and wastewater distribution, pipeline operators, telephone and other fixed utilities operating in the Commonwealth.

- Reviews draft Commission Orders and Reports for securities registration, mergers and change of control applications, tariff compliance and affiliated interest agreements.

- Provide both written and oral testimony, and/or, assist prosecutorial staff in developing briefs and cross examination in formal cases on an as needed basis.

June 2004 to July 2012:
Bureau of Technical Utility Services, Finance Division, Pennsylvania Public Utility Commission, Harrisburg, Pennsylvania.

Rate Case Review Specialist/Fixed Utility Financial Analyst:

- Analyzes complex financial, accounting and economic data submitted by gas, electric, water, sewer, pipeline, telephone and other fixed utilities operating in the Commonwealth relative to rate requests, securities, taxes, cost of capital and affiliated interests.

- Writes draft Commission Orders and Reports for securities registration, mergers and change of control applications and affiliated interest agreements.
- Write detail reports (white papers) on financial matters as they relate to regulatory policy.
- Provide financial analysis and advice to other bureaus such as Audits, Law, and the Office of Administrative Law Judge related to financial transactions, utility financing and credit ratings, cost of capital and corporate structure.
- Monitor credit ratings of large electric, gas, telephone, and other foxed utilities operating in Pennsylvania.

Previous Work Experience:

November 2003 to June 2004:
Pennsylvania Department of Banking, Harrisburg, Pennsylvania. Associate Financial Institution Examiner

- Examine financial depository institutions to ensure compliance with established laws, regulations and sound business practices.
- Analyze and rate financial institutions earnings, capital, assets/liabilities, investments, operations and management to determine its overall fiscal health.

March 1998 to May 2003:
Wholesale Services, GTE Telephone Operations/Verizon Communications, Harrisburg, Pennsylvania.

Account Manager - Wholesale Services

- Manage complex business relationship between Verizon and 5 large Competitive Local Exchange Carriers and Local Exchange Carriers doing business in PA, VA and WV. Total revenue - $10 Million.
- Sell strategic products such as high capacity DS-1s, DS-3s and Sonet Services. Negotiate service contracts for Operator Services, Directory Assistance Services and CNAM/LIDB Services.

- Manage inter-company relations with approximately 30 other Local Exchange Carriers in the state of Pennsylvania to advocate company policy positions within the telephone industry.
- Insure accuracy of financial settlements exceeding $6 Million between GTE and other Local Exchange Carriers.
- Participate in various PA Telephone Association committees and in industry forums such as North American Numbering Plan Administration (NANPA).

February 1992 to March 1998:
GTE Telephone Operations (HQ), Irving, Texas.

Staff Manager - Access Pricing

- Calculate special and switched access prices in 41 jurisdictions for Federal Price Cap and other FCC access price filings. Revenue stream for GTE telephone operations exceeded $4 Billion.
- Provide cost support for specific state and federal special access product filings.

Staff Accountant - Regulatory Accounting

- Prepare financial monitoring reports by state jurisdiction as required by the state Public Utility Commissions for the states KY, SC, OH and HI.
- Prepare financial statements and determine revenue requirements for various rate case proceedings.
- Team member of Gold Team award winner for work on the Hawaii Rate Case (GTE awarded $28M by commission). Also team member for $31M high cost fund award to Contel California, a GTE subsidiary.

Budget Analyst - Domestic Budget

- Produce consolidated financial statements including contribution statements, balance sheet and cash flow statements and other supporting schedules for annual budget and monthly outlook.

October 1986 to February 1992:
GTE South Company, Durham North Carolina

- Budget Analyst - Sales Administration
- Analyze revenues and margins by product line such as Key systems, PBX systems for the South Area Business Sales organization.
- Calculate incentive compensation payout for 30 individual Account Executives and 5 Regional Sales Managers and 2 Area Sales Managers.

Staff Accountant - Accounting Operations Capital Recovery

- Proper accounting of $180M in annual depreciation/amortization expense, monthly forecast of depreciation and amortization expense, and monthly analysis of depreciation reserve activity.
- Maintain and update accounting and mortality data for annual FCC and State PUC capital recovery studies. Gross Plant investment exceeded $2B.
- Supervised 2 Management and 1 clerical employee.

October 1986 to February 1992:
Ogden/Allied Service Corporation, New York, New York

Staff Accountant - General Accounting

- Contribution analysis by operating segments, analysis of general and administrative expenses, capital budget analysis of new business projects, monthly general ledger closings, allocation of operational overheads, and special projects as assigned by the VP of Finance.

EDUCATION

Master of Business Administration (MBA), Indiana University of Pennsylvania 05/1984
Bachelor of Science in Food and Nutrition, Indiana University of Pennsylvania 05/1979

Other Relevant Training:

- PA PUC Emerging Leaders Program January 2012 through June 2012
- SNL Center for Financial Education, Atlanta, GA, *Essentials of Utility Finance*, October 18-19, 2010
- Institute of Public Utilities - Michigan State University, *Water Rate Case School*, May 10-14, 2010
- SNL Center for Financial Education, Stamford, CT, *Analyst Training in the Power and Gas Sector*, December 7-8, 2009.
- The Society of Utility and Regulatory Financial Analysts, *39th Financial Forum – Equity Risk Premium Workbook*, April 19-20, 2007
- PGS Energy Training, Harrisburg, PA, *Fundamentals of Energy/Electricity Futures, Options & Derivatives*, September 23, 2006

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Commonwealth of Pennsylvania	)	
	)	**ss**
County of Dauphin	)	

AFFIDAVIT OF WITNESS

DAVID L. HUFF, having being first sworn, deposes and says that the statements and exhibits attached hereto were prepared and reviewed by him, and are true and correct to the best of his knowledge and belief.

David L. Huff

Sworn to and subscribed before me this 26th day of May, 2017

Victoria R. Moore

Notary Public

My Commission Expires:

COMMONWEALTH OF PENNSYLVANIA
NOTARIAL SEAL
VICTORIA R. MOORE, Notary Public
City of Harrisburg, Dauphin County
My Commission Expires September 3, 2018

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I am on this date serving a copy of the foregoing document upon each person designated on the official service list compiled by the Federal Energy Regulatory Commission in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure.

Dated at Harrisburg, PA this 30th day of May, 2017.

Respectfully submitted,

/s/ James P. Melia
James P. Melia

Counsel for the Pennsylvania
Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265
Tel: (717) 787-5000