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July 2, 2018

VIA ELECTRONIC FILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

**Re: Pennsylvania Public Utility Commission v.
UGI Utilities, Inc. - Electric Division
Docket No. R-2017-2640058**

Dear Secretary Chiavetta:

Enclosed for filing is the Main Brief of UGI Utilities, Inc. – Electric Division in the above-referenced proceeding. Copies will be provided as indicated on the Certificate of Service.

Respectfully submitted,

Garrett P. Lent

GPL/jl
Enclosures

cc: Honorable Steven K. Haas
Honorable Andrew M. Calvelli
Certificate of Service

CERTIFICATE OF SERVICE

Docket No. R-2017-2640058

I hereby certify that a true and correct copy of the foregoing has been served upon the following persons, in the manner indicated, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	Docket No. R-2017-2640058
Office of Consumer Advocate	:	Docket No. C-2017-2646178
Office of Small Business Advocate	:	Docket No. C-2017-2647268
Matthew Josefwicz	:	Docket No. C-2017-2647099
Barbara McDade	:	Docket No. C-2017-3000056
	:	
v.	:	
	:	
UGI Utilities, Inc. – Electric Division	:	

MAIN BRIEF OF
UGI UTILITIES, INC. – ELECTRIC DIVISION

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I. INTRODUCTION

A. UGI ELECTRIC

UGI Electric ("UGI Electric" or the "Company") provides electric distribution services to approximately 61,832 customers in a certificated service territory that spans approximately 1,200 square miles in portions of Luzerne and Wyoming Counties. UGI Electric Book I, I. General Filing Information, I-B-1; UGI Electric Book X – Exhibit F, Current Tariff. UGI Electric is a "public utility" and an "electric distribution company" ("EDC") as those terms are defined under the Public Utility Code, 66 Pa. C.S. §§ 102 and 2803.

Through this proceeding, UGI Electric requests Pennsylvania Public Utility Commission ("Commission") approval of an increase in annual jurisdictional distribution operating revenues of $7.705 million.[1] *See* Appendix A (UGI Electric Exhibit A – Fully Projected, Schedule A-1 (Main Brief)). The requested increase is based upon a FPFTY ending September 30, 2019 ("FPFTY") and is designed to provide the Company with an opportunity to earn an 8.24% overall rate of return on rate base, including an 11.25% return on common equity,[2] on a claimed rate base of $119.242 million. In addition, the distribution rate increase reflects UGI Electric's status as a distribution only electric utility and is based on the financial and operating data for that single business line. The requested rate increase reflects the business environment the Company currently faces, including: accelerated investment in the repair, replacement or

[1] UGI Electric's Initial Filing sought a revenue increase of approximately $9.254 million. However, the Tax Cuts and Jobs Act of 2017, Pub. L. 115-97, 131 Stat. 2054 (the "TCJA") was passed and became effective while UGI Electric prepared its initial filing. The Company served Supplemental Direct Testimony and revised supporting exhibits—*i.e.* Revised UGI Electric Exhibit A – Fully Projected, Revised UGI Electric Exhibit A – Future, Revised UGI Electric Exhibit D – Cost of Service Study and Revised UGI Electric Exhibit E – Proof of Revenue—that reflected the impacts of the TCJA on the Company's Initial Filing and updated its claimed revenue increase to $8.491 million. Further adjustments adopted by UGI Electric resulted in a claimed revenue increase of $8.092 million. The final claimed revenue requirement of $7.705 million reflects additional updates to the Company's claim based upon its Rebuttal Testimony and the Partial Stipulation in Settlement, which uses a total rate base of $119.242 million and a return on equity of 11.25%. *See* Appendix A.

[2] *See* UGI Electric St. No. 5-SD, p. 7 (adjusting the recommended return on common equity to reflect the impacts of the TCJA). *See* Appendix A.

improvement of aged and aging distribution system; the modernization of core technology systems occurring as a part of the UGI Next Information Technology Enterprise ("UNITE") system modernization initiative at UGI Utilities, Inc.; the modernization, consolidation and relocation of UGI Electric operations personnel out of outdated facilities and into a new operations center location; and modest increases in employee wages and salaries since its last base rate case in 1996. UGI Electric St. No. 1, pp. 5-6. The growth in operating and capital costs, along with relatively stagnant customer usage and growth trends, prevent UGI Electric from earning a fair rate of return on its investment, at present rate levels.

Based on the results of a class cost allocation study and the requirements of the Commonwealth Court's decision in *Lloyd v. Pa. P.U.C.*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006) *appeal denied*, 591 Pa. 676, 916 A.2d 1104 (2007) ("*Lloyd*"), the Company proposes to allocate the requested increase to rate classes that are below the proposed system average rate of return, *i.e.* the residential customers taking service under Rate R. As a part of its Rebuttal case, however, the Company proposed to split the general service rate (*i.e.* Rate GS) into two rate classes (Rate GS-1 and Rate GS-4) and, based on revised cost of service study results, proposes a rate increase for new Rate GS-1 and a rate decrease to new Rate GS-4. The proposed rate design also reflects UGI Electric's continued commitment to recover fixed costs through demand and customer charges, rather than through kilowatt hour ("kWh") usage charges. Consistent therewith, UGI Electric is proposing to increase the residential customer charge from $5.50 to $14.00 per month to more closely reflect the costs that are incurred in providing service to these customers. The proposed rates are designed to reflect the cost of service for each rate class, move each rate class closer to the system average rate of return, reduce cross-subsidization of rate classes, and appropriately apply principles of gradualism in rate design. UGI Electric St. No. 8, pp. 15-20.

If approved, the requested distribution rate increase will move UGI Electric's inadequate return on equity from an estimated 6.65% for the 12-month period ended September 30, 2017, to an allowed 11.25% for the FPFTY. This return is the minimum required for the Company to attract capital on reasonable terms, provide safe and reliable service to its customers, and fully fund the various initiatives and programs described in its filing. The return on equity proposed in this proceeding is particularly appropriate in view of UGI Electric's management effectiveness, ability to provide safe and reliable service and innovative programs throughout its territory while maintaining among the lowest rates in the state, and award-winning customer service. UGI Electric St. No. 1, pp. 12-18; UGI Electric Book I, Statement of Reasons. For all of these reasons, as explained below and in the filing, UGI Electric's proposed distribution rate increase is just and reasonable, and should be approved by the Commission.

B. HISTORY OF THE PROCEEDINGS

This proceeding was initiated on January 26, 2018, when UGI Electric filed Tariff Electric PA. P.U.C. Nos. 6 and 2S with the Commission. In Tariffs Electric – PA. P.U.C. Nos. 6 and 2S, issued to be effective for service rendered on or after March 27, 2018, UGI Electric initially proposed changes to its base retail distribution rates designed to produce an increase in revenues of approximately $9.254 million, based upon data for the FPFTY ending September 30, 2019 ("2018 Base Rate Case"). The filing was made in compliance with the Commission's regulations and contains all supporting data and testimony required to be submitted in conjunction with a tariff change seeking a general rate increase. In its Initial Filing, however, the Company noted that it intended to submit Supplemental Direct Testimony to address the impact of the recently enacted federal Tax Cuts and Jobs Act of 2017, Pub. L. 115-97, 131 Stat. 2054 (the "TCJA").

Tariffs Electric – PA. P.U.C. Nos. 6 and 2S were suspended by operation of law pursuant to Section 1308(d) of the Public Utility Code, 66 Pa. C.S. § 1308(d), for up to nine months, or until October 27, 2018, unless permitted by Commission Order to become effective at an earlier date. By Order entered March 1, 2018, the Commission initiated an investigation of UGI Electric's proposed general rate increase. The matter was assigned to the Office of Administrative Law Judge, and Administrative Law Judges Steven K. Haas and Andrew M. Calvelli (the "ALJs") were assigned to preside over the proceeding.

The Commission's Bureau of Investigation and Enforcement ("I&E") filed a Notice of Appearance. Complaints against the proposed rate increase were each filed by the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), Matthew Josefwicz, and Barbara McDade.

On March 12, 2018, UGI Electric filed the Supplemental Direct Testimony of five witnesses, as well as Revised Exhibit A – Fully Projected, Revised Exhibit A – Future, Revised Exhibit D – Cost of Service Study, and Revised Exhibit E – Proof of Revenues. The Supplemental Direct Testimony and revised exhibits reflect the effects of the TCJA on the 2018 Base Rate Case, as noted above. These adjustments reduced the Company's revenue increase from $9.254 million to $8.491 million.

An initial Prehearing Conference was scheduled and held on March 20, 2018. Parties participating in the Prehearing Conference filed Prehearing Memoranda identifying potential issues and their expected witnesses. At the Prehearing Conference, the parties proposed a procedural schedule, which was adopted by the ALJs. In addition, the parties agreed to, and the

ALJs approved, modified discovery rules, which included shorter response times than those provided for in the Commission's regulations at 52 Pa. Code §§ 5.321 *et seq*.

In the Scheduling Order, dated March 30, 2018, the ALJ set forth the litigation schedule for the proceeding and the revised periods for responding to discovery requests. In addition, the ALJs listed the parties who had filed notices of appearance and formal complaints in the proceeding. Further, the ALJs indicated that the parties had agreed that there should be two "smart" public input hearings, which were held on Wednesday, April 18, 2018, in Harrisburg, PA, at 1:00 p.m. and 6:00 p.m.

The parties engaged in substantial formal and informal discovery. UGI Electric responded to more than 485 discovery requests, many of which had multiple subparts. In addition, substantial discovery requests were propounded to other parties.

On April 26, 2018, parties other than UGI Electric served their Direct Testimony and associated exhibits. On May 25, 2018, UGI Electric, OCA and OSBA filed Rebuttal Testimony and associated exhibits. I&E, OCA and OSBA served Surrebuttal Testimony and exhibits on June 7, 2018. On June 11, 2018, UGI Electric served Rejoinder Testimony and exhibits.

Evidentiary hearings were held before the ALJs on June 11 and June 12, 2018. At the hearing, the parties' respective testimony and exhibits were admitted into the evidentiary record and certain parties' witnesses were cross-examined.

C. LEGAL STANDARDS

Under the Public Utility Code, a public utility's rates must be just and reasonable and cannot result in unreasonable rate discrimination. 66 Pa. C.S. §§ 315(a), 1301 and 1304. A public utility seeking a general rate increase has the burden of proof to establish the justness and reasonableness of every element of the rate increase request. 66 Pa. C.S. § 315(a); *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No. R-00038805, 236 PUR 4th 218, 2004 Pa. PUC LEXIS 39 at *48 (Order entered Aug. 5, 2004) ("*Aqua 2004 Order*"). "It is well-established that the evidence adduced by a utility to meet this burden must be substantial." *Lower Frederick Twp. v. Pa. Pub. Util. Comm'n*, 409A.2d 505, 507 (Pa. Cmwlth. 1980).

However, a public utility, in proving that its proposed rates are just and reasonable, does not have the burden to affirmatively defend claims made in its filing that no other party has questioned. As the Commonwealth Court has explained:

> While it is axiomatic that a utility has the burden of proving the justness and reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged.

Allegheny Center Assocs. v. Pa. P.U.C., 570 A.2d 149, 153 (Pa. Cmwlth. 1990).

Although the ultimate burden of proof does not shift from the utility seeking a rate increase, a party proposing an adjustment to a ratemaking claim of a utility bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment. *See, e.g., Pa. P.U.C. v. PECO*, Docket No. R-891364, *et al.*, 1990 Pa. PUC LEXIS 155 (Order dated May 16, 1990); *Pa. P.U.C. v. Breezewood Telephone Company*, Docket No. R-901666, 1991 Pa. PUC LEXIS 45 (Order dated Jan. 31, 1991). In addition, tariff provisions previously approved by the Commission are deemed just and reasonable and, therefore, a party challenging a previously-approved tariff provision bears the burden to demonstrate that the Commission's prior approval is no longer justified. *See, e.g., Pa. P.U.C. v. Philadelphia Gas Works*, Docket Nos. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 45, at *165-68 (Order entered Sept. 28, 2007) (adopting the ALJ's discussion on burden of proof).

Further, a party that raises an issue that is not included in a public utility's general rate case filing bears the burden of proof. For example, in *Pa. P.U.C. v. Metropolitan Edison Company, et al.*, Docket Nos. R-00061366, *et al.*, 2007 Pa. PUC LEXIS 5 (Order entered Jan.11, 2007), a party offered proposals to have the companies incur expenses not included in their filings. The ALJ held that, as the proponent of a Commission order with respect to its proposals, the party bears the burden of proof as to proposals that are not included in the companies' filings. The Commission agreed and adopted the ALJ's conclusion that Section 315(a) of the Public Utility Code cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose. *Id.*, at *111-12.

II. SUMMARY OF ARGUMENT

As updated to account for all adjustments in its Rebuttal and Rejoinder Testimony, as well as the Joint Stipulation, UGI Electric requests a $7.705 million overall revenue increase in this proceeding. *See* Appendix A. This increase, if granted in full, would increase the average residential customer's total bill by 9.09% or $10.21 per month. This is UGI Electric's first base rate increase since 1996, over 20 years ago. Since that time, the Company has made significant system investments, which have increased its rate base by nearly 60% to over $100 million. Over this same period, the Consumer Price Index has increased by more than 60%.

Going forward, the Company, like many public utilities in Pennsylvania, faces aging infrastructure issues and has committed to a major infrastructure improvement program designed to upgrade its facilities in order to continue to provide safe and reliable service to customers. These facilities replacement programs include (1) wood pole replacement, (2) distribution substation transformer replacement, and (3) underground cable replacement, all undertaken pursuant to the Company's Commission-approved Long-Term Infrastructure Improvement Plan ("LTIIP"). In addition, UGI Electric has engaged in several initiatives targeting distribution automation, major system improvement projects, the installation of additional distribution sectionalizing, and right-of-way reliability relocations. These initiatives will require the

Company to raise additional capital in the financial markets. Supportive regulation, through adequate rate relief, is a key component of the Company's ability to complete its infrastructure improvement program.

The Company has presented extensive evidence to support its filing, and in accordance with Section 523 of the Code, 66 Pa. C.S. § 523 (requiring Commission to consider management effectiveness and efficiency in setting just and reasonable rate), has presented extensive evidence of management efficiency and effectiveness. For instance, the Company has taken substantial efforts to improve the quality and effectiveness of its management performance, including, but not limited to: (1) a Commission-approved LTIIP to accelerate the replacement and repair of aged and aging infrastructure; (2) a voluntary Energy Efficiency and Conservation ("EE&C") Plan; (3) a new, state of the art Customer Information System ("CIS"); (4) improvements to aged and outdated financial systems; (5) implementation of the UGI-1 initiative; and (6) expansive customer assistance and support under its Universal Service offerings. The bottom line in determining management effectiveness is quality of service and reasonable rates. UGI Electric provides top tier customer service and reliability, at rates which are among the lowest in the Commonwealth. These efforts and results should be recognized in this proceeding, as required by Section 523 and good public policy. Notably, this evidence is entirely unrebutted.

Opposing parties (I&E and OCA) have essentially ignored all of this evidence and propose a variety of adjustments that, if adopted, would eliminate most of the proposed increase. I&E proposes a revenue increase of only $824,000,[3] reflecting a return on common equity of 8.62%, while the OCA initially proposed an increase of $1,237,000, and a return on equity of

[3] Reflected in I&E St. No. 1-SR, Errata.

just 8.50%. As a result of the Partial Stipulation in Settlement, which resolved certain revenue requirement issues, OCA's proposed increase is now approximately $2.1 million.[4]

The opposing parties' proposals deny meaningful rate relief to a Company that has not increased its rates in 22 years, has had modest to non-existent revenue growth, has increased operating expenses, has invested and will invest substantial capital in new plant and facilities necessary to provide safe and reliable service to customers, and has presented unrebutted evidence of superior management. The opposing parties achieve this unreasonable result by: (1) ignoring the plain language of the Public Utility Code; and (2) ignoring long-standing Commission and judicial precedent on fundamental ratemaking issues. By correcting these errors and authorizing a reasonable return on common equity, the differences between UGI Electric and the opposing parties largely disappear, and demonstrate that the Company should be awarded all or nearly all of its requested rate relief. A summary of the opposing parties' major errors is set forth below.

Cost of Common Equity. The most important, and generally the most controversial and difficult issue in a base rate proceeding, is determining the cost of common equity capital. This issue is of particular importance in this proceeding. UGI Electric and many other utilities in the Commonwealth are in the midst of major infrastructure improvement programs that are vitally important to continuing safe and reliable service to customers. To fully and successfully implement these programs, UGI Electric must have reasonable access to capital markets. Supportive regulation and, in particular, a fully compensatory cost of common equity are critically important for UGI Electric to attract equity capital investments. Investors have a wide

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[4] The Partial Stipulation in Settlement, however, resolved certain issues raised by I&E and the OCA related to: the Company's capital structure; the proposed depreciation rates; the proposed Rate EV and Storm Expense Rider; PURTA; and the Company's Universal Service Programs. *See* Partial Stipulation Resolving Certain Contested Issues, Docket Nos. R-2017-2640058, et al. (filed June 20, 2018).

range of choices as to where they invest their capital. As such, the investment community will carefully examine the outcome of this case and other pending cases to determine whether the Commission intends to continue its recent supportive regulation and maintain its recently achieved "above average" rating from Regulatory Research Associates ("RRA").

The Company has presented extensive data and analyses fully supporting its proposed 11.25% return on common equity and demonstrating that the 8.62% and 8.50% proposals of I&E and OCA, respectively, are woefully deficient. Apart from this technical analysis, several fundamental facts must be considered. The average allowed return on equity by U.S. regulatory commissions in 2017 was 9.74%. UGI Electric's allowed return, which is based on conditions for a 2019 FPFTY must be substantially higher than 9.74% for several important reasons:

1. The 2017 national average does not reflect undisputed rising interest rates in 2018 and beyond. It is undisputed that interest rates and return on equity are directly linked and, therefore, it is clear that the return of equity in this case must be substantially higher than 2017 national average returns.

2. The 2017 national average does not reflect the impact of the TCJA on deferred federal corporate income taxes. The TCJA decreases the Company's pre-tax interest coverage, thereby reducing its credit quality, and also increases the amount of investor-supplied capital necessary to fund infrastructure programs, thereby further reducing its credit quality. As such, the Company faces substantially more risk in the face of the TCJA than it did in 2017, which must be recognized in a higher cost of common equity.

3. The 9.74% return represents the average allowance by other states. The Commission, however, is currently ranked above average in supportive regulation. If the

Commission wishes to maintain its well-deserved reputation for supportive regulation, it should provide a significantly higher return on common equity for UGI Electric and other similarly situated Pennsylvania public utilities.

4. The 9.74% average figure reflects no adjustment for management effectiveness. In accordance with the requirements of Section 523 of the Code, 66 Pa. C.S. § 523, UGI Electric presented extensive evidence of excellent management, including the litmus test of efficient management—low rates and excellent service. No party challenged any aspect of UGI Electric's evidence—it is unrebutted and fully supports an upward adjustment to the return on common equity.

5. As noted above, UGI Electric is in the midst of a major infrastructure improvement program and must raise substantial capital in the financial markets. A supportive return on equity finding will improve access and decrease capital costs to the benefit of customers.

By contrast, the deficient proposals of I&E and OCA cannot be considered reasonable or reflective of the current financial climate. I&E and OCA's proposals ignore the financial climate in which UGI Electric operates. In particular, they ignore evidence of rising interest rates, the negative consequences of the TCJA on the credit quality and ability of utilities to attract equity capital, and the Commission's well-recognized policy of supporting capital investments to replace aging infrastructure. Moreover, I&E and OCA attempt to disregard, without disputing, UGI Electric's implementation of programs that significantly benefit its customers and evidence of strong management performance. Finally, it is worth noting that the Commission has not awarded a single digit return on equity for an electric utility since the end of fair value ratemaking in the early 1980's. As such, I&E's and OCA's proposals must be rejected and a supportive return on equity should be approved.

Average vs. End of Year Test Plant In Service.[5] Consistent with long-standing, uniform Commission precedent, the Company's rate base claim is based on projected balances at the end of the test year, in this case, a FPFTY. I&E and OCA propose an "average" approach, averaging the beginning and end of FPFTY balances. This adjustment is fundamentally inconsistent with the plain language of the Act of Feb. 14, 2012, Pub. L. 72, No. 11 ("Act 11") (amending Section 315 of the Code, 66 Pa. C.S. § 315, to authorize the use of a FPFTY in Pennsylvania), which unequivocally states: "Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission may permit facilities which are projected to be in service during the fully projected future test year to be included in the rate base." The I&E and OCA adjustment would disallow half of all plant added "during the fully projected future test year" and obviously conflicts with the plain language of Act 11. It also is inconsistent with Act 11's stated purpose to reduce regulatory lag.

The only argument offered by I&E and OCA is that use of the end of test year balance would result in customers paying for plant that is not yet in service and therefore not "used and useful." This argument is factually wrong because it erroneously assumes that rates are set based on a monthly revenue requirement, and not on an annual basis. Under the Company's method, customers, on an annual basis, will pay a full year's depreciation and return on all plant added during the FPFTY, no more and no less. The I&E and OCA "used and useful" argument has already been addressed and specifically rejected by Act 11, which expressly states that Section 1315 (the section of the Code which codifies the used and useful standard) does to not apply to

[5] As explained below, the use of end of year data also impacts other elements of the ratemaking formula, including depreciation, ADIT, revenues and certain operating expenses.

Act 11 and imposes no limitation on including in rate base all plant added "during" the FPFTY. The Commission should follow the plain language of Act 11 and its underlying purpose to reduce regulatory lag and reject the I&E and OCA adjustment which would disallow half of all plant added "during" the FPFTY.

TCJA. On March 12, 2018, UGI filed supplemental direct testimony revising its filing to reflect a full year's prospective effect of the TCJA. Despite this fact, I&E and OCA propose two additional adjustments: (1) flow back through a surcharge of the effects of the TCJA for the period January 1, 2018 through the effect date of rates in this proceeding, *i.e.* the "2018 Effects"; and (2) a reduction in rate base for Excess Accumulated Deferred Income Taxes ("EADIT"). Neither adjustment is lawful or appropriate.

As to 2018 Effects, controlling case law demonstrates that the I&E and OCA proposal constitutes impermissible single issue/retroactive ratemaking. Single issue/retroactive ratemaking is only permitted where the expense is extraordinary <u>and</u> non-recurring. All parties agree that the change in tax rates is a recurring item; it is an ongoing, permanent change in tax rates. Moreover, controlling appellate precedent requires at least some examination of current earnings before a single issue rate adjustment can be adopted. Neither I&E or OCA has presented any evidence of any kind showing that UGI Electric is earning an excessive return in 2018, or the future test year ending September 30, 2018 ("FTY"). UGI Electric, on the other hand, has presented unrebutted evidence that its 2018 earnings are deficient under any reasonable standard. The I&E and OCA adjustment should be rejected.

As to EADIT, it is undisputed that there are two prospective impacts of the TCJA: (1) lower annual tax expense (both current and deferred); and (2) a reduction in Accumulated Deferred Income Taxes ("ADIT") resulting from the lower tax rates. Item 1 reduces rates; item

2 increases rates.[6] I&E and OCA propose to fully refund to customers item 1, but, as to item 2 propose to reduce rates to continue a rate base deduction for excess deferred taxes that no longer exists. Opposing parties apparently seek to only reflect the effects of the TCJA that reduce rates and ignore the effects that increase rates. This sort of "cherry picking" is not appropriate. Moreover, the opposing party adjustments improperly seek to add a return component to the amortization of a regulatory liability. This is patently inconsistent with 40 years of Commission and appellate precedent that has uniformly denied a return on the unamortized balance of regulatory assets and liabilities. I&E's and OCA's unprecedented and inconsistent adjustment must be rejected.

Other Revenue Requirement Issues. In addition to these three major issues of statewide importance, I&E and OCA propose several other expense adjustments that are either factual wrong or inconsistent with controlling precedent. These include vegetation management, Company-owned services, incentive compensation, environmental remediation expense, and investment in a new Electrical Engineering Operations Center. These adjustments are at odds with clear and controlling precedent and the undisputed facts presented by the Company and, therefore, should be rejected.

Revenue Allocation and Rate Design. UGI Electric's cost allocation study is based on the same Commission-approved methodology used by PPL Electric in its 2012 base rate proceeding, including the use of a minimum system study to classify distribution assets as customer and/or demand related. I&E and OSBA support or do not oppose the minimum system method. OCA flatly rejects any customer component to the distribution system despite the fact that every electric utility in the Commonwealth uses and has used the minimum system method for over 40 years, and despite the fact that this precise issue was litigated in the last two litigated

[6] ADIT is a deduction from rate base, so a lower ADIT balance increases rate base.

PPL Electric base rate proceedings in 2010 and 2012. OCA provides no basis for departure from this long-standing practice or its flawed conclusion that the number of customers bears no relationship to the design and cost of a distribution system.

UGI Electric proposes to allocate the revenue increase in accordance with the results of its cost of service study. OCA disagrees, but its argument is based entirely on its flawed cost allocation study.

As to rate design, the primary issue is the residential customer charge. Because it has not been in for a base rate increase in over 20 years, UGI Electric's current customer charge of $5.50 per month is far too low and does not reflect the cost of serving the residential class. UGI Electric's proposed customer charge is based on the same methodology employed by PPL Electric and approved by the Commission in its 2012 base rate proceeding. OCA simply refuses to accept the Commission's decision on this issue and continues to advance its flawed "rural/urban" study which has no bearing on the issue and, in fact, demonstrates that there is a substantial, fixed-cost, customer component to the distribution system.

I&E and OCA also contend that the customer charge proposed by UGI Electric violates principles of gradualism, but ignores the fact that gradualism applies to the rates as a whole and not to individual rate components. Customers pay all of the rates in a tariff, not just the customer charge or energy charge. Any meaningful application of the principle of gradualism must apply to rates as a whole.

Finally, OCA argues that a higher customer charge is harmful to low-income customers who allegedly use less energy than average residential customers. OCA is factually wrong, at least regarding UGI Electric's service territory, where low-income customers in general and low-income customers participating in its Universal Service programs use substantially more than the system average amount of electricity. As a result, at least for UGI Electric, low-income customers benefit from a higher customer charge. If OCA is truly concerned about low-income customers, it would support the Company's proposed residential customer charge.

Quarterly Earnings Reports. I&E contends that UGI Electric's QERs improperly reflect projected plant additions during the FPFTY. I&Es argument should be rejected for three reasons. First, the proper method for calculating QERs is not relevant to a base rate proceeding. I&E concedes that resolution of this issue will have no impact on the outcome of this case, and in fact, utilities are not even required to file QERs when they are in a base rate proceeding. Second, the QER regulations mandate "uniform" standards for QER filing. As a result, this is clearly an issue of statewide importance, and other affected utilities should have an opportunity to address this issue before any change in policy is made. Third, the plain language of the QER regulations requires utilities to make such annualization, normalization and other ratemaking adjustments to reflect the results of its operations on a ratemaking basis, which are consistent with current Commission policy and practices. With the adoption Act 11, the use of a FPFTY is now a standard ratemaking practice in Pennsylvania, and UGI Electric's adjustments are in full accord with this new practice and the plain language of the QER regulations.

Conclusion. UGI Electric has demonstrated that its proposed revenue increase, revenue allocation, and rate design, are just and reasonable. The adjustments and arguments of the opposing parties should be rejected, and UGI Electric's proposed rate increase should be approved.

III. STIPULATION OF PARTIAL SETTLEMENT

On June 20, 2018, the parties filed a "Partial Stipulation Resolving Certain Contested Issues" ("Joint Stipulation") in this proceeding. The Joint Stipulation resolved a number of items that would otherwise have been addressed in this brief and decided as part of this proceeding.

This section of the Company's brief provides support for each of the items addressed in the Stipulation.

Commission policy promotes settlements. *See* 52 Pa. Code § 5.231. Settlements lessen the time and expense that parties must expend litigating a case and, at the same time, conserve administrative resources. The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully litigated proceeding. *See* 52 Pa. Code § 69.401.

The Commission has explained that parties to cases resolved through settlement are afforded flexibility in reaching amicable resolutions, so long as the resolution is in the public interest. *Pa. P.U.C. v. MXenergy Electric Inc.*, Docket No. M-2012-2201861, 2013 Pa. PUC LEXIS 789, 310 P.U.R.4th 58 (Order entered Dec. 5, 2013). In order to approve a settlement, the Commission must first determine that the proposed terms and conditions are in the public interest. *Pa. P.U.C. v. Windstream Pennsylvania, LLC*, Docket No. M-2012-2227108, 2012 Pa. PUC LEXIS 1535 (Order entered Sept. 27, 2012); *Pa. P.U.C. v. C.S. Water and Sewer Assoc.*, Docket No. R-881147, 74 Pa. PUC 767 (Opinion entered July 22, 1991).

As explained in this section, UGI Electric believes that the Joint Stipulation is just and reasonable and in the public interest and, therefore, should be approved without modification.

A. CAPITAL STRUCTURE

The Company described its capital structure in the direct testimony of Paul R. Moul. In his testimony, Mr. Moul recommended using the Company's actual capital structure ratios at the end of the FPFTY of 45.98% long-term debt and 54.02% common equity. UGI Electric St. No. 5, p. 15. Mr. Rothschild, the witness for the OCA, criticized Mr. Moul's capital structure, and proposed an alternative capital structure in his direct testimony. OCA St. No. 3, pp. 7-9.

As part of the Stipulation, the Joint Petitioners agree to accept UGI Electric's capital structure, as proposed by the Company in the testimony of Paul R. Moul, UGI Electric St. No. 5. Joint Stipulation ¶ 6. UGI Electric submits that this provision is in the public interest because it properly reflects the Company's capital structure, which is within the barometer group proposed in the testimony of UGI Electric and I&E, and otherwise conforms to the practice normally adopted by the Commission in determining capital structure.

B. DEPRECIATION RATES

UGI Electric's depreciation studies, accrued depreciation claim, and annual depreciation expense claim were set forth in UGI Electric St. No. 7 and UGI Electric Exhibits C (Historic), C (Future), and C (Fully Projected). The OCA proposed to reduce the Company's claim, based on testimony of its witness, Mr. Garren. *See generally* OCA St. No 2. The OCA's recommendation to reduce depreciation expense was based on two primary changes: (1) increasing the service lives for certain distribution plant accounts; and (2) changing the longstanding, approved depreciation calculation procedure known as the Equal Life Group ("ELG") procedure to the Average Service Life ("ASL") procedure. *See generally* OCA St. No. 2.

In rebuttal, UGI Electric explained that OCA's recommendations to increase service lives for distribution plant accounts is incongruent with the Company's outlook and plans, including Company's plan to accelerate replacements of its distribution plant assets as part of its LTIIP. *See generally* UGI Electric St. No. 7-R. UGI Electric also explained that OCA's recommendation to use the ASL procedure is inconsistent with the ELG procedure that has been used by UGI Electric and most other Pennsylvania utilities for many years. *See generally* UGI Electric St. No. 7-R.

As part of the Stipulation, the Joint Petitioners agree to accept UGI Electric's as-filed depreciation rates. Joint Stipulation ¶ 7. UGI Electric submits that this provision is in the public interest because it properly accounts for the Company's outlook and plans, including the Commission-approved LTIIP, and is consistent with the depreciation procedure used by most other Pennsylvania utilities.

C. EV RIDER

In its direct case, the Company proposed to install and maintain electric vehicle ("EV") charging station equipment. The proposed rates consisted of a flat monthly charge based on the equipment costs and maintenance expenses associated with the station type and energy usage rates at the applicable Generation Supply Rate ("GSR") or electric generation supplier ("EGS") generation rate. UGI Electric St. No. 8, p. 14. In addition, customers electing service under the rate would be responsible for installation costs incurred by the Company. UGI Electric St. No. 8, p. 14.

This rider was opposed by OCA witness Mr. Mierzwa and OSBA witness Mr. Knecht, for a variety of reasons. OCA St. No. 4, p. 26; OSBA St. No. 1, pp. 26-27.

As part of the Stipulation, Rate EV is withdrawn at this time without prejudice to the Company's right to refile the EV Rider in a future rate case or in a separate proceeding at the Company's discretion. Joint Stipulation ¶ 8. UGI Electric submits that this provision is in the public interest because it removes a contentious issue from this case and will allow the Company to continue to explore options that further the Commission's goal of fostering the development of a market for EVs in Pennsylvania.

D. STORM EXPENSE RIDER

The Company initially proposed a new Storm Expense Rider ("SER") to recover or refund certain storm damage expenses in excess of or below a base amount of $275,000 claimed in base rates, to provide for timely tracking of storm expenses. UGI Electric St. No. 8, p. 13. I&E witness Wilson recommended that the proposed SER be denied because there was insufficient evidence that the Company needed the rider. I&E St. No. 1, p. 41. OCA witness Mierzwa recommended that the SER be rejected, because he believes that the SER reflects single-issue ratemaking. OCA St. No. 4, pp. 25-26.

The Company will withdraw the proposed SER without prejudice to its right to refile the SER in a future rate case or to file with the Commission for deferral of any major storm expenses incurred on and after June 1, 2018. Joint Stipulation ¶ 9. The Company continues to believe that the riders for storm recovery are appropriate because of the unique nature of storm events and their potentially devastating physical and financial impacts. However, UGI Electric submits that this provision is in the public interest because it resolves a contested issue in this proceeding in a way that does not reduce or undermine the Company's ability to recover appropriately identified storm expenses as part of this proceeding, does not limit the Company's ability to file for deferred accounting of any storm expenses incurred after the period reflected in actual storm expenses in this base rate proceeding, and also does not impact the Company's ability to seek a SER in the future, should the Company believe that it is appropriate to do so.

E. PURTA

In this proceeding there was a dispute regarding the appropriate Pennsylvania Public Utility Realty Tax ("PURTA") to be reflected in rates. I&E's witness Mr. Grab recommended an adjustment to the Company's PURTA claim. Mr. Grab's adjustment was based on his belief that the 2016 PURTA Notice of Determination issued by the Pennsylvania Department of Revenue in the amount of $449,000 is an outlier that will not be repeated in future years. He argued that this uncommon occurrence should not be used as the basis for the Company's claim. I&E St. No. 4, pp. 7-9.

In the Stipulation, the parties agree that base rates established in this proceeding shall reflect $97,000 for PURTA obligations. Any future recalculations of the State Tax Adjustment

Surcharge ("STAS") after the effective date of new rates in this proceeding shall also reflect this base amount unless and until a different tax obligation is established by the Pennsylvania Department of Revenue. Joint Stipulation ¶ 10. UGI Electric submits that this provision is in the public interest because it addresses I&E's concern that the 2016 PURTA Notice received by the Company is an outlier, while still allowing the Company to recover future PURTA assessments, pursuant to the STAS mechanism.

F. UNIVERSAL SERVICE PROGRAMS

UGI Electric did not propose any changes regarding the administration, services provided, or funding levels of its universal service programs in this distribution base rate proceeding. Notwithstanding the foregoing, OCA recommended a variety of structural changes to UGI Electric's Universal Service programs. *See generally* OCA St. No. 5. OCA's recommendations regarding the Company's universal service offerings were largely unrelated to the proposed rate increase. While UGI Electric believes that these issues are better dealt with in the Company's triennial Universal Service Program filing, which is currently pending Commission review,[7] the Company has agreed to address and adopt certain proposed changes to UGI Electric's Universal Service programs in this proceeding.

In the Stipulation, the Joint Petitioners agree to use a base CAP participation of 2,448, which reflects the 12-month period ending December 2017, for purposes of applying a CAP credit and arrearage forgiveness credit offset to CAP costs collected through Rider C. The number of CAP participants shall be the average monthly number of CAP participants in the 12-

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[7] By design, the Commission has established an entirely separate process to evaluate issues regarding universal service and energy conservation programs. *See* 52 Pa. Code § 54.74. The Commission has declared that "Commission practice is to address all aspects of [Universal Service Programs] through the triennial filing process and to collect all revenues through a rider to base rates." *Pa. Pub. Util. Comm'n, et al., v. PPL Elec. Utils. Corp.*, Docket Nos. R-2012-2290597, et al., at p. 51 (Order Entered Dec. 28, 2012).

month period for which costs are being reconciled. Joint Stipulation ¶ 11(a). The Stipulation on CAP enrollment adopts the OCA's position.

The Stipulation provides that UGI Electric will accept self-certification of low income status for purposes of identifying "confirmed low-income customers" in the same way that self-certification is required to be accepted by the UGI gas affiliates. Joint Stipulation ¶ 11(b). The Company believes this provision of the Stipulation is in the public interest, as it will harmonize UGI Electric's practices with those of its affiliate natural gas companies.

The Stipulation provides that UGI Electric will modify Rider C (proposed tariff page 42) to include the following italicized language: "CAP costs will be calculated to include: 1) the projected CAP credit; 2) projected CAP customer application and administrative costs <u>*paid to external agencies that would not have been incurred in the absence of CAP*</u>; and…". Joint Stipulation ¶ 11(c).

Finally, the Company has agreed in the Stipulation to clarify that it is currently acting in accordance with two of OCA's universal service recommendations. First, the Company agrees to allow year-round rolling enrollment for its budget billing program and shall modify related tariff language accordingly in its compliance filing. Joint Stipulation ¶ 11(d). Second, the Company agrees that for customers completing payment plans, the Company will automatically retain the customer on budget billing unless the customer explicitly requests to be removed from budget billing Joint Stipulation ¶ 11(e). Regarding the Company's budget billing program, the Company has been permitting year-round rolling enrollment; however, it appears that the Company's tariff language had not been updated to properly reflect that rolling enrolling was available to its customers. With respect to the OCA recommendation to retain customers on budget billing upon completion of payment plans, the Company will do so now that this error has been identified. The Company already keeps customers on budget billing once they have completed a payment plan, and will continue to follow this practice.

G. MISCELLANEOUS ACCOUNTING ISSUES

In its filing, UGI Electric proposed to capitalize certain costs incurred to develop new data base assets in connection with the Company's use of cloud-based information services. Under generally accepted accounting principles ("GAAP"), such costs are ordinarily accounted for as operating expenses. In this case, however, the Company is requesting Commission approval to record these costs as a long-lived capital asset. UGI Electric St. No. 4, pp. 13-15. No party challenged or otherwise opposed the Company's proposed accounting treatment for the cloud-based information services. As such, the Joint Petitioners agreed that the Company shall be permitted to record the Cloud Based Implementation Costs, as described on pages 13-15 of the direct testimony of Megan Mattern, UGI Electric St. No. 4, as a capital asset and shall begin depreciation of the costs after the systems are placed in service. Joint Stipulation ¶ 12(a). The Joint Petitioners also agree that with regard to the Company's UNITE Phase 2 Costs, UGI Electric shall be permitted to capitalize the pre-implementation costs, as described on page 15 of the direct testimony of Megan Mattern, UGI Electric St. No. 4 and shall begin depreciation of the costs after the systems are placed in service. Joint Stipulation ¶ 12(b).

These Stipulation provisions are in the public interest because they recognize that the new data bases will provide benefits to customers over extended periods of time and not just the period in which the costs are incurred. UGI Electric's cloud based services will offer many advantages to traditional on premise software such as enhanced security, reliability, and flexibility. The data bases created for the cloud-based services will be used by the Company to optimize various aspects of the utility service provided to its customers over, at a minimum, the life of the cloud based service agreement. Moreover, the Company will retain ownership and control of these data bases after the close of the cloud based service for which they are being created and likely will use the information in subsequent applications. Accordingly, the costs for these cloud-based services should be capitalized and depreciated over the life that the data bases will remain used and useful.

IV. RATE BASE

The Company's claim for rate relief in this case is based upon data for the FPFTY ending September 30, 2019. UGI Electric Book I, Statement of Reasons. Additionally, in accordance with the Commission's regulations, UGI Electric has provided extensive data for the historic test year ended September 30, 2017 ("HTY"), and a FTY ending September 30, 2018. *See* UGI Electric Exhibit A – Future; UGI Electric Exhibit A – Historic; *see also* Revised UGI Electric Exhibit A – Future. However, unless specifically noted, all figures referenced herein will be based upon FPFTY data only.

UGI Electric's final claimed rate base of $119,242,000 (*see* Appendix A, Schedule A-1), which reflects all adjustments adopted by the Company throughout this proceeding and reflects the effects of the Joint Stipulation, consists of the depreciated original cost of its utility plant in service at September 30, 2019, together with rate base additions and deductions made in accordance with accepted ratemaking procedures, as explained below.

A. ORIGINAL COST UTILITY PLANT IN SERVICE

The Company claim for original cost utility plant in service of $188,423,000 is based on projected plant in service at the end of the FPFTY, *i.e.* September 30, 2019. *See* UGI Electric Exhibit A – Fully Projected (Rebuttal). Witnesses on behalf of I&E and OCA oppose the Company's calculation of plant in service at the end of the FPFTY and instead propose an "average" rate base calculation. I&E St. No. 3, pp. 4-13; OCA St. No. 1, pp. 6-9. In addition, OCA witness Mr. Morgan, for the first time in Surrebuttal Testimony, opposes the inclusion in rate base of the Company's new operations center. OCA St. No. 1-S, pp. 1-3. For the reasons set forth below, these proposed adjustments should be rejected.

1. End of Year vs. Average Rate Base Methodology.

As noted above, the Company's claimed plant in service is based on plant projected to be in service at the end of the FPFTY. This is consistent with the Company's approach taken for both the HTY and FTY, and is consistent with long-standing Commission precedent, which has uniformly approved the calculation of plant in service at a point in time, *i.e.* the end of the relevant test year. *See, e.g., Pa. Pub. Util. Comm'n, et al. v. PPL Electric Utilities Corporation*, Docket Nos. R-2012-2290597, et al., at p. 12 ("We agree with PPL that rate base items…are balances <u>to be in effect at the end of the test year</u>." (emphasis added)) ("*PPL 2012 RC Order*"); *see also Pa. Pub. Util. Comm'n, et al. v. UGI Utilities, Inc. (Electric Division)*, Docket Nos. R-00832862 et al., 1994 Pa. PUC LEXIS 138 at *40 (Recommended Decision dated May 23, 1994) (noting the OCA's recognition of "the matching principle whereby revenues and expenses are synchronized as of the end of the test period."). OCA witness Mr. Morgan acknowledged this practice on cross examination. Tr. 135:12-21.

I&E and OCA oppose this methodology for the FPFTY and propose instead an "average" test year approach under which plant in service is calculated by averaging the beginning of test year and end of test year plant balances. Specifically, these parties add the September 30, 2018 beginning of test year balance ($159,319,636) to the September 30, 2019 end of test year balance ($183,333,690), divide by two, and submit the resulting "average" as their proposed original cost plant in service. *See* I&E St. No. 3, p. 13 (using figures provided in Revised UGI Electric

Exhibit A – Fully Projected and Revised UGI Electric Exhibit A – Future); *see also* OCA St. No. 1, pp. 8-9).[8]

The principal argument advanced by these parties is that new rates will be effective in October 2018 and, by using the end of test year balance September 30, 2019, customers will be paying for plant that is not yet in service. Based on this analysis, the parties contend that a portion of the end of test year plant is not "used and useful" and should not be included in rate base. In addition, I&E contends that use of end of test year data delays implementation of the DSIC after base rate cases and complicates the calculation of the DSIC. *See* I&E St. No. 3, pp 10-11. For the reasons set forth below, the I&E and OCA arguments are factually and legally wrong, would be completely inconsistent with the General Assembly's goals in enacting Act 11, and therefore should be rejected.

a. The Opposing Parties' "Used And Useful" Argument Is Factually Wrong.

As noted above, opposing parties point out that when new rates go into effect in October 2018, customers will be paying rates that reflect, in part, plant that will not be in service until September 2019. This statement is accurate as far as it goes, but does not support their opposition to the Company's claim. Rates are established based on a test year and a utility's <u>annual</u> revenue requirement. For example, rates set in this proceeding will provide for 12 months return of, through depreciation, and return on the approved rate base. As a result, over the course of an <u>annual</u> period, customers will pay exactly one year of revenue requirement associated with plant in service regardless of when particular plant is placed in service during the

[8] The proposal to alter the methodology used to determine the FPFTY extends beyond plant in service; it impacts a number of other components of the Company's total claim in this proceeding which have been challenged by I&E and OCA on the same grounds regarding their calculation. *See* Sections V.F., V.G., VI.F.1., VI.F.2. *infra*. The arguments supporting the Company's calculation of the FPFTY with regard to plant in service, and those supporting rejection of the approach utilized by I&E and OCA, extend to those other components of the Company's claim, as well.

test year. For billing purposes, this <u>annual</u> requirement is divided and collected in 12 monthly increments, pursuant to applicable rate designs, but this says nothing about when plant goes into service and when that plant is "used and useful." All plant that is placed in service during the applicable test year is used and useful in providing service in that test year. The mere fact that the revenue requirement is billed monthly does not and cannot change that fact.

OCA witness Mr. Morgan, on cross examination, agreed with this analysis. Tr. 136:6-137:16. Mr. Morgan specifically testified as follows:

> Q. And, again, if we have a certain amount of plant in service, each month the customer would pay roughly, subject to the summer-winter differential, one-twelfth of the depreciation, annual depreciation and one-twelfth of the annual return over the course of that year?
>
> A. Yes. But at the end it will pay the equivalent of - - in this case you were saying 8 million, so they would pay the equivalent of the full rate increase.

Tr. 137:9-16.

This is further demonstrated by the fact that the same "problem" identified by the opposing parties also applies to their "average" test year proposal. Specifically, the Company's beginning of test year balance, *i.e.* the balance on October 1, 2018, is approximately $159,319,700. Yet, the "average" test year balance proposed by these parties of approximately $171,326,700, is substantially higher than the beginning of test year balance. As a result, when new rates go into effect in October 2018, customers would be paying rates based on substantial plant that is not yet in service, *i.e.* approximately $12,007,000, representing the difference between the proposed average utility plant in service and the beginning of test year balance. So, while the opposing party "average" approach ameliorates the impact, it still results in customers paying monthly rates in the beginning of the test year that reflect plant that is not yet in service and therefore not, in opposing parties' view, "used and useful." In fact, the only way to avoid this "problem" would be to use a beginning of the test year balance for the FPFTY, which would effectively eliminate all FPFTY plant additions. Moreover, under the average rate base theory, at some point during the first year rates are in effect, rates will become insufficient to cover the used and useful plant placed into service during that year. Thus, there is simply no factual basis for the opposing parties' proposal. It should be rejected.

b. The Opposing Parties' "Used and Useful" Argument Is Inconsistent With The Plain Language of Act 11.

In 2012, the legislature enacted Act of Feb. 14, 2012, Pub. L. 72, No. 11 ("Act 11"), which provides in part for the use of a FPFTY. Act 11 amended Section 315 of the Code to add the FPFTY as a new ratemaking tool in Pennsylvania:

> (e) Use of future test year.--In discharging its burden of proof the utility may utilize a <u>future test year or a fully projected future test year, which shall be the 12-month period beginning with the first month that the new rates will be placed in effect after application of the full suspension period permitted under section 1308(d) (relating to voluntary changes in rates)</u>. The commission shall promptly adopt rules and regulations regarding the information and data to be submitted when and if a future test period <u>or a fully projected future test year</u> is to be utilized. Whenever a utility utilizes a future test year <u>or a fully projected future test year</u> in any rate proceeding and such future test year <u>or a fully projected test year</u> forms a substantive basis for the final rate determination of the commission, the 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 <u>or a fully projected future test year</u>, and the commission may after reasonable notice and hearing, in its discretion, adjust the utility's rates on the basis of such data. <u>Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission may permit facilities which are projected to be in service during the fully projected future test year to be included in the rate base.</u>

66 Pa. C.S. § 315(e) (underline indicating language added by Act 11).

Act 11 fully supports use of end of test year balances. First, the Act does not contain a separate provision for the FPFTY. It simply adds the FPFTY to the existing statute authorizing use of a FTY. As noted above, for the FTY it is standard ratemaking practice to use end of test year balances for determining plant in service. There is no reason that the FPFTY plant balances should be calculated any differently.

Opposing parties will likely contend that there is an important difference between FTY and FPFTY, *i.e.* rates go into effect at the end of the FTY and, therefore, do not have the "used and useful" "problem" discussed above. However, the legislature already specifically addressed this issue in Act 11, as follows: "Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission may permit facilities <u>which are projected to be in service during the fully projected future test year</u> to be included in the rate base." 66 Pa. C.S. § 315(e) (emphasis added). Section 1315 is the Code's anti-CWIP provision, which provides:

> Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.

66 Pa. C.S. § 1315.

Thus, the General Assembly anticipated the I&E and OCA "used and useful" argument and specifically rejected it by (1) expressly noting the FPFTY may include plant projected to be in service "during," *i.e.* throughout, the FPFTY, and (2) expressly noting that Section 1315, which codified the "used and useful" standard, does not apply and provides no bar to including in rate base all plant added during the FPFTY.

c. The Use Of End Of Test Year Plant Balances Is Consistent With The Policy Underlying Act 11 And The Commission's Interpretation And Application Of The DSIC.

It is well-established that many electric, gas and water companies in Pennsylvania have aging infrastructure and must undertake substantial capital investments in order to continue to provide safe and reliable service to customers. UGI Electric is among those utilities facing this issue. *See* UGI Electric St. No. 1, pp. 5-6; UGI Electric St. No. 3, pp. 11-14; *see also Petition of UGI Utilities, Inc. – Electric Division for Approval of its Long-Term Infrastructure Improvement Plan*, P-2017-2619834, at pp. 8-9 (Order entered Dec. 21, 2017) (approving UGI Electric LTIIP and noting planned eligible property replacements for fiscal years 2018 through 2022). It also is well known that "regulatory lag" is a major issue that must be addressed in order to promote infrastructure improvement programs. *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611, 2012 Pa. PUC LEXIS 1223 at *4-5, 7, 90 (Order entered Aug. 2, 2012) (recognizing that a primary purpose of Act 11 was "to reduce regulatory lag due to the use of rate case inputs that are outdated by the time new base rates become effective") ("*Act 11 Implementation Order*"); *see also Lower Paxton Twp. v. Pa. Pub. Util. Comm'n*, 317 A.2d 917, 921 (Pa. Cmwlth. Ct. 1974) (recognizing regulatory lag as an important variable the Commission should address in the ratemaking process). In response, the legislature adopted Act 11 which was to reduce regulatory lag and thereby encourage plant investment to address aging infrastructure.

Act 11 addresses regulatory lag and encourages plant investment to address aging infrastructure in two separate, but related, ways. First, it authorized the use of a FPFTY, which if properly applied should reduce regulatory lag. Second, it authorized a Distribution System Improvement Charge ("DSIC"), authorizing electric, gas, water, and waste water utilities to file for a DSIC to recover approved and qualifying infrastructure improvements between rate cases. The stated goal of the DSIC is to reduce regulatory lag and the need to file frequent base rate cases.

Taken together and properly applied, these two provisions can substantially reduce regulatory lag and lengthen the time between base rate cases. However, the proposal to use an "average" rate base would substantially undercut the benefits envisioned by the legislature when it adopted Act 11. First, by using an "average" instead of an end of year balance, I&E and OCA would eliminate essentially half the benefits of using a FPFTY by effectively denying rate recovery on half of the plant placed into service during the FPFTY.[9] In this case, UGI Electric has budgeted $31,838,000 of plant additions for the FPFTY, and $13,303,000 for the FTY. UGI Electric Exhibit A – Fully Projected (REBUTTAL). I&E and OCA would disallow half of the additions budgeted between the end of the FTY and end of the FPFTY.[10]

Second, as applied by the Commission, the DSIC is set to zero coming out of a base rate case and cannot be restarted until plant investment equals the amount of plant included in rate base in the base rate case. Using the "average" rate base approach, the DSIC would restart substantially sooner and therefore reach the 5% DISC rate cap much sooner. This would result in more frequent base rate proceedings, particularly for utilities like UGI Electric that have accelerated investment programs. For investments that are not DSIC-eligible, the average rate base approach would increase regulatory lag and substantially undercut the benefits of FPFTY and the DSIC mechanism.

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[9] If the Pennsylvania General Assembly had intended for only a *partially projected* future test year, then it would have so specified. The witnesses for I&E and OCA both acknowledge that the result produced by their approach will reduce the *fully projected* future test year to a *partially projected* (*i.e.* mid-year) future test year. *See* I&E St. No. 3, pp. 9-11; Tr. 140:24-141:8 (OCA witness Morgan).

[10] Using the average rate base methodology proposed by I&E and OCA, these plant additions would total $22,570,500 (*i.e.* ($31,838,000 + $13,303,000)/2).

The Commission has recognized this fact in its DSIC Implementation Order. *Act 11 Implementation Order*, 2012 Pa. PUC LEXIS 1223 at *67-69 (recognizing "[t]he DSIC rate is reset to zero if new base rates are established. *See* 66 Pa. C.S. § 1358(b)(1)."). It also has been recognized that the restart of the DSIC is based on end of test year plant invest investment, not average investment. *See Implementation of Act 11 of 2012*, Supplemental Implementation Order, Docket No. M-2012-2293611, pp. 13-14 (Order entered Sept. 21, 2016) (recognizing the number of months that comprise a FTY and FPFTY, and the use of year-end figures to restart the DSIC) ("*Supplemental DSIC Implementation Order*").

Specifically, in the *Supplemental DSIC Implementation Order* the Commission explained:

> The calculation of rates is developed on the device of a "test year," which is a <u>12-month period that is to be representative of operating conditions when the rates being established will be in effect</u>. The test year can consist of a future test year or a fully projected future test year (FPFTY) as its baseline for setting new base rates. See 66 Pa. C.S. § 315. As such, a utility requesting to establish new base rates pursuant to a filing under Section 1308(d) of the Code, is seeking to recover the costs of all DSIC-eligible plant in service, plus the DSIC-eligible plant that is <u>projected to be in service either within 9 to 21 months depending on if the utility has used a future test year or a FPFTY to calculate its rates.</u> In other words, if a utility has used a future test year or a FPFTY as the basis for the projection of the costs of all the DSIC-eligible plant that it will place in service, the new base rates should provide for the prospective recovery of the annual costs of all the DSIC-eligible property placed into service and that was previously being recovered under the utility's DISC mechanism.

Supplemental DSIC Implementation Order, at p. 13 (emphasis added). The above-quoted language confirms that a FTY or FPFTY consists of a 12-month period, and reflects a utility's plant in service at <u>the end</u> of that period.

For these reasons, use of the "average" approach should be rejected and the Company's end of test year methodology should be approved.

d. Authority From Other Jurisdictions Is Not Relevant In The Interpretation And Application Of Act 11 And Is Clearly Distinguishable.

I&E and OCA may point to other jurisdictions which utilize some variation of their "average" methodology. These citations should be rejected for at least three reasons.

First, as the Commission and Pennsylvania courts have made clear, the practices and policies of other jurisdictions have little if any relevance for Pennsylvania. *See, e.g.*, *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of its Long-Term Infrastructure Improvement Plant; Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge*¸ Docket No. P-2012-2338282, 2014 Pa. PUC LEXIS 93, at *34-35 (Recommended Decision Feb. 25, 2014) ("Although the OCA points to the practice of utilities in other states to support its argument to include ADIT in the DSIC, the jurisdictions that the OCA has identified in this proceeding have mechanisms that are dissimilar from the Pennsylvania mechanism. In the instant case, even if a review of the practices of other states in interpreting the Pennsylvania statute was appropriate, the mechanisms in the other states vary significantly from the Pennsylvania DSIC such that that they provide no relevant guidance in judging the reasonableness of the proposed ADIT adjustment."), *adopted*, Docket Nos. P-2012-2338282, et al. (Order entered May 22, 2014); *Performance Metrics & Remedies (PMO III F0013) 2008 Guidelines Updates*, 2008 Pa. PUC LEXIS 1105, at *19-20 (Order entered July 22, 2008) ("[W]hether the NY PSC has adopted a particular change for use in NY (or whether other states in the footprint have adopted a particular change) does not control Pennsylvania's decision to adopt or reject a particular change for use in Pennsylvania. . . . We shall not, however, adopt changes or refrain from adopting changes for use in Pennsylvania based solely on what happens in NY or any other jurisdiction."); *Petition for Declaratory Order Regarding Ownership of Alt. Energy Credits, Associated with Non-Utility Generating Facilities Under Contract to Pa. Elec.*

Co. and Metro. Edison Co., 2007 Pa. PUC LEXIS 7, at *26-27 (Order entered Feb. 12, 2007) (stating that neither the ALJ nor the Commission grounded their decisions on the analysis of the decisions of foreign jurisdictions); *see also Elder v. Orlucky*, 515 A.2d 517, 522 (Pa. 1986) (noting that it was not appropriate to consider another jurisdiction's statute where there was no indication that the General Assembly based Pennsylvania legislation on legislation adopted in other jurisdictions).

Second, it is clearly inappropriate to cite to one provision of on jurisdiction's ratemaking practice without looking at other issues and aspects of that jurisdiction's overall ratemaking policy. Different jurisdictions adopt very different approaches to various ratemaking issues, including capital structure, cost of equity, normalization, annualization and amortization, automatic adjustment clauses and post-test year adjustments. It is not appropriate, as OCA does here, to cherry pick one isolated element of the ratemaking formula from another jurisdiction and graft it onto Pennsylvania ratemaking policy.

Third, the statutes, regulations and decisions relied on to date are clearly distinguishable. For instance, the Illinois statute and regulations promulgated thereunder, 83 Ill. Admin. Code. §§ 287.20 and 285.2005(e), which were relied upon by the OCA, do permit the use of a year-end rate base where certain evidentiary requirements are met.

e. Conclusion As To Test Year Methodology.

For the reasons set forth above, UGI Electric's proposed original cost of plant in service claim should be approved.

2. Electrical Engineering And Operations Center.

UGI Electric has reflected the cost of its Electric Engineering and Operations Center ("Operations Center") in plant in service in this proceeding, because it will be placed into service in the FPFTY. UGI Electric St. No. 3-R, p. 17. The new facility will remodel an existing 54,000 square-foot facility and associated property. UGI Electric St. No. 3-R, p. 17. The new Operations Center will accommodate all UGI Electric needs at one location, including consolidation of office and field personnel, development of a dedicated electric training area, creation of a back-up Energy Control Center, and existing and future warehouse needs. UGI Electric St. No. 3-R, p. 17. The Company's timeline is to move into the new Operations Center by September 2019. UGI electric St. No. 3-R, p. 17.

When the Company determined that a new Operations Center was necessary, it investigated the options available to meet its needs. In the Company's service territory, there are a limited number of suitable existing facilities able to accommodate all of the Company's proposed need, and the selected location was determined to be the most ideal structure and location for a new Operations Center under a remodel scenario. UGI Electric St. No. 3-RJ, p. 11. In addition to the current plan to remodel an existing facility, UGI Electric also evaluated a new construction option. UGI Electric St. No. 3-R, p. 18. The cost estimate for the new construction option was $19.952 million. UGI Electric St. No. 3-R, p. 18. UGI Electric based this estimate on a potential site that offered the necessary land, utilities, access and location required to meet the needs of the business. UGI Electric St. No. 3-R, p. 18. Ultimately, concerns over the structural integrity of the land based on geotechnical reports ruled out this option. UGI Electric St. No. 3-R, p. 18. Based on this analysis, the Company determined that the remodel was the best option for meeting the Company's operational needs.

The original preliminary cost anticipated for the remodel of the existing facility was $10 million. UGI Electric St. No. 3, p. 16. As the case progressed, the Company continued to move forward with its plan for the Operations Center. The Company obtained an estimate from a third-party contractor for the full scope of work associated with the remodel, which increased the anticipated cost to $17.3 million. UGI Electric St. No. 3-R, p. 18. The cost increase reflects a comprehensive estimate, which includes a building/property appraisal, architectural cost estimates for the renovation of the building and grounds along with addition of the warehouse yard, site preparation, interior finishes and furniture, security, and environmental considerations including water retention requirements. UGI Electric St. No. 3-R, p. 18. The original preliminary estimate had significantly underestimated the construction cost per square foot, in addition to other significant cost areas such as site preparation (cut & fill), paving, utilities, furnishings and storm water retention costs. UGI Electric St. No. 3-R, p. 18. The original estimate also had not provided adequate room for growth, training facilities, warehouse space and staging areas for mutual assistance crews and vehicles. UGI Electric St. No. 3-R, p. 18.

No party has challenged the need for this facility, the choice of location or the projected cost. Indeed, no party raised any objection to this project in their direct testimony. However, in response to the Company's additional data, presented in its rebuttal testimony, OCA proposed a complete disallowance of the entire claim for the Operations Center. OCA St. No. 1S, p. 3. Specifically, Mr. Morgan claims that the revised proposal shows that there is still uncertainly because (1) the Company only recently toured the facilities; (2) there is no contract to acquire the property; and (3) there is no construction contract for the remodel. OCA St. No. 1S, p. 2.

OCA's adjustment should be rejected for several reasons. First, the OCA concerns regarding uncertainty and lack of contracts are misplaced. The Company's revenue requirement in this case is based on a FPFTY ending September 30, 2019. The original budget for the building was prepared in the fall of 2017, almost two years from the end of the FPFTY. The fact that various details of the project are continuing to develop as work progresses is not surprising and provides no basis for disallowing the Company's claim. If Mr. Morgan's standard of certainty were to be adopted, it would substantially undermine the use of a FPFTY, not only for the Operations Center but for numerous other projected capital additions. Moreover, the fact that Mr. Morgan did not challenge the project in his direct testimony and then proposed a total disallowance in his surrebuttal testimony after the Company provided substantial additional detail is counterintuitive, at best.

Second, Mr. Morgan ignores the fact the proposed facility is well-known to UGI Electric management due to the fact that prior to the acquisition of UGI Penn Natural Gas, Inc. and the co-housing of that company and UGI Electric in the current electric headquarters, UGI Electric leased this facility for a period of twenty years. UGI Electric St. No. 3-RJ, p. 11. Therefore, the Company is very familiar with this facility and what would be needed to remodel it for future use. This also reduced the need for earlier or more numerous site visits to tour the facilities.

Third, due to the small size of the Company's service territory and the desire of the Company to locate its facilities within the service territory, there were a limited number of existing commercial properties available and suitable for the housing of the Operations Center. Likewise, there are a limited number of commercial enterprises interested in the type and size of facility being considered. UGI Electric St. No. 3-RJ, p. 11. As a result of these limited location options and limited other potentially interested purchases for the site, the Company will devote less time to the active negotiation process, which has been underway with the property owner during this proceeding.

Finally, the Company's revised estimate is reliable because it has had recent headquarter construction experience, based on the development of a new headquarters for UGI Utilities, Inc. in Denver, Pennsylvania. UGI Electric St. No. 3-RJ, p. 11. The Company has relied upon this recent experience in anticipating the total timeline from proposal through move for UGI Electric's new Operations Center. Mr. Sorber testified that he was confident that the Company would meet its FPFTY in service due date. UGI Electric St. No. 3-RJ, p. 12. OCA has not challenged the anticipated timeline.

A utility is entitled to "a fair return upon the fair value of the property of such public utility, used and useful in its public service." *Pa. Power & Light Co. v. Pa. Pub. Util. Comm'n*, 516 A.2d 426, 430 (Pa. Cmwlth. 1986). "The touchstone for determining whether or not a prudently constructed unit should be included in a utility's rate base is whether or not, <u>during the test year involved</u> the unit will be used and useful in rendering service to the public." *Id.* at 430, (quoting *Philadelphia Elec. Co. v. Pa. Pub. Util. Comm'n*, 433 A.2d 620, 623 (Pa Commw. 1981) (emphasis added). As the Operations Center will be placed in serve "during the test year involved," *i.e.* the FPFTY, UGI Electric's proposal to include the full value of the center in rate base is reasonable and should be approved.

B. ACCRUED DEPRECIATION

As explained in Section III.B *supra*, the parties have agreed to use the Company's proposed accrued depreciation claim. Joint Stipulation ¶ 7. Therefore, the Company's claim is reasonable and should be approved.

C. ADDITIONS TO RATE BASE

1. Cash Working Capital.

Cash Working Capital ("CWC") is the capital requirement arising from the difference between (1) the lag in the receipt of revenue for rendering service and (2) the lag in the payment of cash expenses incurred to provide that service. UGI Electric St. No. 4, p. 8. The Company's base CWC amount for O&M expense is $5.7 million. UGI Electric St. No. 4, p. 9. The average daily expense balance is $196,000. UGI Electric St. No. 4, p. 9. While much of the Company's calculation of CWC was not challenged, I&E did challenge the meter read lag. I&E St. No. 1, pp. 45-46. Meter reading lag reflects the time between when a meter is read and the bill is mailed to customers, and is an accepted component of CWC. *See, e.g., Pa. P.U.C. v. National Fuel Gas Distribution Corp.*, Docket No. R-00942991, 1994 Pa. PUC LEXIS 134 (Order dated Dec. 6, 1994). The Company's claimed meter read lag is 2.70 days. I&E has recommended a meter read lag of 1.5 days, based on the belief that the Company's new software system should produce some reduction in meter read lag. I&E St. No. 1, pp. 45-46. I&E also proposed an adjustment to the O&M Expense Lag calculation, which the Company accepted. UGI Electric St. No. 4-R, p. 8.

There is no record evidence to support the conclusion that the Company's new software system has reduced meter read lag by the 44% claimed by I&E. First, initial implementation of UNITE Phase 1 (*i.e.* the new CIS) did not include a specific scope of work related to reducing meter read lag times. UGI Electric St. No. 4-R, p. 8. Second, I&E provided no basis for how it arrived at the 1.5 day figure. UGI Electric St. No. 4-R, p. 8. I&E's witness said that her basis for concluding that 1.5 days was appropriate was her "years of experience as a witness." I&E St. No. 1-SR, p. 47. However, Ms. Wilson acknowledged that her expertise and training is in accounting; she has no specialized training in electric utility operations. I&E St. No. 1, Appendix A; Tr. 114-117. Further, there is no evidence that Ms. Wilson is an IT specialist. I&E St. No. 1, Appendix A; Tr. 114-117. Therefore, Ms. Wilson's experience as a witness is not sufficient grounds to establish that the Company's new software system would impact meter read lag, particularly where that positive result was not identified in the scope of work for the software system. I&E's adjustment has no evidentiary support, and should not be adopted.

2. Materials and Supplies.

UGI Electric's initial filing also included a claim of $1.44 million for various materials and supplies in inventory for use in its operations. UGI Electric St. No. 4, p. 14; *see also* UGI Electric Exhibit A – Fully Projected, Schedules A-1 and C-1. The Company based its claim on the HTY balance for these items. UGI Electric St. No. 4, p. 14.

I&E recommended that the Company's claim be increased by $24,692, based on the most recent 13-month average. I&E St. No. 3, p. 21. The Company agreed with and adopted this adjustment as a part of its rebuttal case. UGI Electric 4-R, pp. 15-16; *see also* UGI Electric Exhibit A – Fully Projected (REBUTTAL).[11] Therefore, the Company's final claim of $1,465,000 is reasonable and should be approved.

D. DEDUCTIONS FROM RATE BASE

1. Accumulated Deferred Income Taxes.

UGI Electric claimed an ADIT balance at the end of the FPFTY of $16,572,000, inclusive of adjustments reflecting the impacts of the TCJA. UGI Electric St. No. 9-SD, pp. 3-4; Revised UGI Electric Exhibit A – Fully Projected, Schedule C-6. I&E and OCA both contested the Company's claim. I&E St. No. 1, pp. 36-39; OCA St. No. 1, pp. 14-15.

This issue is fully addressed in Section VIII *infra* and will not be restated here. For the reasons explained therein, the Company's position should be adopted, and I&E's and OCA's adjustments should be rejected.

2. Act 40.

UGI Electric's initial filing demonstrated that the amount of the consolidated tax savings adjustment applicable to UGI Electric, in the absence of Act 40, would have been $75,400 (*i.e.*

[11] No additional adjustments to this claim were adopted as a part of the Company's Rejoinder Testimony or the Joint Stipulation.

$41,000 multiplied by the gross revenue conversion factor). UGI Electric St. No. 2, pp. 24-25. OCA contested the Company's claim. OCA St. No. 1, pp. 22-25.

This issue is fully addressed in Section VIII.C *infra* and will not be restated here. For the reasons explained therein, the Company's position should be adopted, and OCA's adjustments should be rejected.

3. Customer Deposits

UGI Electric's initial filing included an offset for customer deposits of $1.42 million, as of end of the HTY, shown on UGI Electric Exhibit A – Fully Projected, Schedule C-6. UGI Electric witness Ms. Mattern explained that Act 155 of 2014 prohibits the Company to collect customer deposits for customers who qualify for low-income programs, which has decreased the Company's customer deposits balance. UGI Electric St. No. 4, pp. 13-14.

I&E witness Mr. Cline recommended an increase to the Company's customer deposit claim of $76,692. I&E St. No. 3, p. 24. Mr. Cline principally disagrees with the methodology used by the Company, because the balance at the end of the HTY was lower than the 17-month period provided by the Company in discovery; as such, Mr. Cline proposes the use of the most-recent 13-month average. *Id.* Mr. Cline also noted that this proposed should not be adjusted to account for the I&E's proposed average rate base methodology.

I&E ignores the fact that the Company continues to see lower customer deposits due to the fact that it can no longer collect deposits from low-income customers. UGI Electric St. No. 4-R, p. 16. Moreover, I&E's position is at odds with OCA's position. Ms. Mattern explained in her Rejoinder Testimony that, as a result of adopting OCA's proposal to revise the definition and practices used to identify "confirmed low-income customers," the Company will be will be required to refund deposits held for a certain number of customers who are currently not identified as "confirmed low-income." UGI Electric St. No. 4-RJ, pp. 12-13. The Company's position is, therefore, a reasonable reflection of the impacts related to deposit refunds and shortfalls, which will be made to confirmed low-income customers. As such, the Company's claimed offset of $1.42 million for customer deposits is reasonable and should be approved.

E. CLOUD BASED PROGRAM

As explained in Section III.G *supra*, the parties have agreed that the Company will be permitted to capitalize the costs associated with its cloud based information services. Joint Stipulation ¶ 12(a). The Joint Stipulation regarding the accounting treatment for these costs is, therefore, reasonable and should be approved.

F. UNITE PHASE 2 COSTS

As explained in Section III.G *supra*, the parties have agreed that the Company will be permitted to capitalize the pre-implementation costs of its UNITE Phase 2 program. Joint Stipulation ¶ 12(b). The Joint Stipulation regarding the accounting treatment for these costs is, therefore, reasonable and should be approved.

G. CONCLUSION AS TO RATE BASE

For the reasons more fully explained above, the Company's final claimed rate base of $119,242,000 is reasonable and, therefore, should be approved.

V. <u>REVENUES</u>

As part of this proceeding, the Company provided its anticipated revenues in the testimony of Mr. Lahoff and his associated exhibits. *See* UGI Electric St. No. 8, pp. 3-9; UGI Electric Exhibit A (Fully Projected), Schedule D-5. The Company's claimed revenue was unchallenged by the parties in this proceeding, except for the revenues associated with the Hanover Industrial Park. UGI Electric documented a significant increase in new business line extensions as well as the purchase of transformers during the last two quarters of fiscal year 2017. UGI Electric St. No. 3-R, p. 16. This was primarily due to the expansion of the primary underground distribution system in the Hanover Industrial Park to serve new customers and expansion of load at existing customer locations. UGI Electric St. No. 3-R, p. 16.

OCA proposed a $158,000 adjustment to reflect the revenues associated with the Hanover Industrial Park project. OCA St. No. 1, pp. 15-16. UGI Electric agreed that the FPFTY budget sales and revenues did not reflect the additional sales and associated revenue associated with the additional customer load served by these projects. UGI Electric agreed with the OCA proposal to reflect a $158,000 adjustment to increase revenues. UGI Electric St. No. 3-R, pp. 15-16.

The adjusted revenues were reflected in UGI Electric Exhibit A – Fully Projected (REBUTTAL), Schedule A-1, and further updated as a result of the Joint Stipulation. *See* Appendix A. The Company submits that its final claimed revenues at proposed rates of $96,767,000, which are consistent with OCA's proposed increase, are reasonable and should be approved.

VI. <u>EXPENSES</u>

As part of the proceeding, the Company has proposed to include a broad range of expenses that are incurred in order to provide service to its customers. The full range of these expenses are reflected in the Company's initial filing in UGI Electric Exhibit A – Fully Projected, Schedules C-1 through C-8 and Schedules D-1 through D-35. A subset of the expenses included in the Company's original filing have been challenged by I&E and OCA, and are described in this Section of the Company's brief.

The case law regarding the appropriate analysis to be applied when considering the recovery of expenses is clear. Public utilities in Pennsylvania are entitled to recover all reasonable expenses. In *Butler Township Water Co. v. Pa. P.U.C.*, 81 Pa. Cmwlth. 40, 43-44, 473 A.2d 219, 221 (1984) ("*Butler Township*"), the Commonwealth Court concluded:

> The general rule is that a public utility is entitled to recover in rates those expenses reasonably necessary to provide service to its customers and to earn a fair rate of return on the investment and plant used and useful in providing service. *Western Pennsylvania Water Co. v. Pennsylvania Public Utility Commission*, 54 Pa. Cmwlth. Ct. 187, 422 A.2d 906 (1980). Operating expenses include prudently incurred rate case expenses. *Driscoll v. Edison Light and Power Company*, 307 U.S. 104 (1939); *West Ohio Gas Company v. Public Utility Commission of Ohio*, 294 U.S. 63 (1935). Obviously, the refusal to allow the recovery of a proper expense diminishes to the same extent the utility's return on investment. There is no evidence in the record that the … expenses claimed here were unreasonable, imprudently incurred or excessive in amount.

See also T.W. Phillips Gas and Oil Co. v. Pa. P.U.C., 81 Pa. Cmwlth. 205, 474 A.2d 355 (1984). As the Commonwealth Court determined in *Butler Township*, the relevant question in a base rate proceeding is whether the expense is reasonable and appropriate for the furnishing of service to customers. As the Company will show herein, the expenses it has included in this proceeding are reasonable and appropriate in order to provide service to its customers. Therefore, its expense claims should be approved.

A. VEGETATION MANAGEMENT EXPENSE

In its direct case, UGI Electric included a claim for vegetation management expense of $2,118,501 for the FPFTY, including a level of increased costs related to the Emerald Ash Borer ("EA"). Mr. Sorber described the vegetation impact caused by the EAB. UGI Electric St. No. 3-R, p. 6. The EAB is causing significant mortality of ash trees throughout the Company's service territory. UGI Electric St. No. 3-R, p. 6. The cost of performing planned maintenance work has increased as trees affected by the EAB are identified and removed during line clearance work. UGI Electric St. No. 3-R, p. 6. The EAB causes rapid decline of once healthy trees. UGI Electric St. No. 3-R, p. 6. It also increases the propensity for impacted ash trees to fail at the root system resulting in more significant risk to distribution lines. UGI Electric St. No. 3-R, p. 6.

The difficulty of removing these trees due to off right-of-way locations coupled with unsafe climbing conditions, combined with the sheer number of impacted trees, has created an unprecedented vegetation management issue. UGI Electric St. No. 3-R, p. 6. Given the number of ash trees that could impact the electric distribution system, UGI Electric expects to be dealing with this issue for the next seven to ten years. UGI Electric St. No. 3-R, p. 8. To address this issue, UGI Electric has added one additional vegetation maintenance crew in the FTY, which is reflected fully in the FPFTY. UGI Electric St. No. 3-RJ, p. 5.

I&E, however, recommended a $206,235 reduction to the Company's claim. I&E St. No. 1, p. 13. I&E contends that the Company's proactive effort to address the impact of the ash borer in its service territory is already reflected in the historic test year. I&E St. No. 1, pp. 13-15. I&E witness Ms. Wilson further stated that, in her view, the Company did not adequately support the increase between the HTY, FTY, and FPFTY. I&E St. No. 1, p. 15. In I&E's Surrebuttal Testimony, Ms. Wilson argued that future vegetation management costs should be reflected in the historic average of the expense modified by a yearly inflation factor. I&E St. No. 1-SR, p. 11.

This is not a credible approach to calculating the Company's vegetation management expenses in this proceeding because the difference in the vegetation management costs between the historic and FPFTY claim is due to additional resources in the form of one additional vegetation management crew that was added during the FTY. UGI Electric St. No. 3-RJ, p. 5. The Company's inclusion of this quantifiable increase in costs is clearly reasonable. Ms. Wilson's approach, which would effectively eliminate the cost of the new crew, should be rejected. UGI Electric St. No. 3-RJ, p. 5.

At the hearing, Ms. Wilson testified that "other items may reduce in cost when you're looking at the historic average; thus, an increase in other related costs may be recovered in historic average adjusted for inflation and upward trends represented by the company." Tr. 125:10-14. Ms. Wilson testified that she was not certain that her proposed methodology would account for an additional crew. Tr. 125:15-19. However, in redirect, Ms. Wilson conceded that "if there is a very large unforeseeable event," the historic average with inflation would not reflect that event, and additional relief may be granted by the Commission. Tr. 130:20-23.

UGI Electric is required to provide safe and reasonably reliable service to its customers, pursuant to 66 Pa. C.S. § 1501. Further, the Company is required to carefully monitor the reliability of its system, and to file regular reports to the Commission regarding outages and other metrics. 52 Pa. Code §§ 57.191-57.197. Vegetation management is a critical tool for reducing outages and ensuring safe and reliable service. Adding a vegetation crew in the face of a new and growing threat is a reasonable and prudent step that will ensure that the quality of the Company's service is not diminished as a result of the devastation caused by the EAB.

I&E's approach on vegetation management expense is not supported by the evidence in this proceeding. The increase reflected in the FPFTY is associated with a specific and quantifiable expense – one additional vegetation management crew. This crew was hired to address a previously identified and growing threat throughout the state. I&E's witness acknowledged the serious nature of this threat. I&E St. No. 1, p. 14. There is simply no logic to support the adoption of I&E's historic average approach, as it fails to reflect the increased expense of an additional crew to address a growing vegetation management crisis.

I&E's adjustment ignores the clear evidence presented in this proceeding, and does not reflect a logical or coherent analytical approach to expenses associated with vegetation management. I&E's adjustment should be rejected, and the Company's position should be adopted.

B. COMPANY OWNED SERVICES PROGRAM

UGI Electric has included in its expense claim an amount of $454,418 for a Company-Owned Service ("COS") Transition Program.[12] This program will address nearly 5,000 residential company-owned services, which were installed as a result of a program that ended in the early 1970s, and are currently owned and operated by UGI Electric. UGI Electric St. No. 3, p. 15. These UGI Electric-owned facilities include the service entrance cable, meter socket, panel box, main breaker and 240 volt breakers. Some of this equipment is located inside the customers' homes. UGI Electric St. No. 3, p. 16. Maintenance of the equipment within the home has proven difficult due to the Company's service technicians' limited ability to gain access to the equipment. UGI Electric St. No. 3, p. 16.

In response to these circumstances, UGI Electric has proposed to implement a new program to transition ownership of these COS facilities to homeowners. UGI Electric St. No. 3, p. 16. As part of this program, UGI Electric will send notices to affected customers, will conduct inspections, and, if necessary, will repair or replace the COS equipment so that it passes an inspection by an approved electrical inspector certified by the Pennsylvania Department of Labor and Industry. UGI Electric St. No. 3, p. 16. Once the inspection is completed, the Company's former COS equipment will be deemed customer-owned equipment consistent with the terms of UGI Electric's tariff. UGI Electric may transfer ownership by having the customer execute a bill of sale for a nominal stated consideration. UGI Electric St. No. 3, p. 16. UGI Electric expects this program will result in the inspection and transfer of responsibility for approximately 500 services a year for the next ten years. UGI Electric St. No. 3, p. 16.

[12] Service lines are typically owned by the customer.

OCA acknowledged that this program is intended to address a unique safety issue and indicated it does not oppose the program, provided the Company does not profit from the program and no customer is terminated for refusing to provide access to the service facilities. OCA St. No. 4, pp. 26, 28-29. OCA recommended that UGI Electric coordinate this program with the Bureau of Consumer Services ("BCS") and OCA. OCA St. No. 4, p. 26. In response to Mr. Mierzwa's testimony, the Company indicated that it will not profit from this program, because UGI Electric is not capitalizing any portion of the COS program, and is proposing only to recover the associated expenses. UGI Electric St. No. 3-R, pp. 9-10. UGI Electric is willing to coordinate its program with BCS and OCA. UGI Electric St. No. 3-R, p. 10. Finally, the Company indicated that while it has the right under its tariff to terminate service for failure to allow inspection of these facilities, UGI Electric has no desire to terminate service to any customer and will work with OCA and BCS on developing potential alternatives to achieve access without the threat of termination. UGI Electric St. No. 3-R, p. 10. And, in rejoinder testimony, Mr. Sorber explained that the Company can obtain a court order granting entry if a homeowner refuses to allow inspection of the service facilities. UGI Electric St. No. 3-RJ, p. 7. Thus, there should be no need to terminate electric service.

I&E has argued that the inspection program should be voluntary, and rates should include an allowance of $140,000 per year in program costs based on the Company's historic experience, which reflects a reduction of $314,418 from the Company's claim. I&E St. No. 1, p. 30. This reduction is based on the conclusion that the total costs of the program are not currently known, and that fewer affected customers may be affected than the Company has projected. I&E St. No. 1, pp. 30-31.

In response, the Company indicated that a voluntary program would not produce the same critical safety benefits as a mandatory inspection program. UGI Electric St. No. 3-R, pp. 10-11. As Mr. Sorber stated in his testimony, the "Company believes that it cannot transfer ownership of and responsibility for these facilities without a mandatory inspection program where the Company will replace or repair equipment when it is determined to be necessary and appropriate in order to ensure that the facilities are safe and reliable for future customer use." UGI Electric St. No. 3-R, p. 11. Further, Mr. Sorber noted that I&E's witness appears to have misunderstood the Company's projections, which are based on actual experience in the field, changes in electrical code requirements over time, and the normal life of the services. UGI Electric St. No. 3-R, pp. 11-12; UGI Electric St. No. 3-RJ, p. 8.

Two issues are raised by I&E. The first is whether the program will be mandatory or voluntary. The second is the reasonableness of the Company's projected expenses, which would be recovered through the rates set in this proceeding. I&E's position on both of these was shown to be insufficient and inappropriate, as admitted by I&E's own witness when she testified at the hearing.

In order to ensure the safety of all customers who currently have Company owned services, this program must be mandatory. UGI Electric is obligated pursuant to 66 Pa. C.S. § 1501 to provide safe and reliable service to its customers, including the maintenance of all Company owned facilities. At this point in time, the services at issue in this program are all Company owned facilities. The Company is obligated to make periodic inspections of its equipment pursuant to 52 Pa. Code § 57.194(c), and to maintain its facilities in compliance with the National Electrical Safety Code pursuant to 52 Pa. Code § 57.194(b). The Company is proposing this program because it recognizes that on a going forward basis, facilities inside a customer's home are difficult to access in order to perform the necessary inspection and maintenance that will allow the Company to meet its obligations under Section 1501 of the Code and Section 57.194 of the Commission's regulations. Thus, there is no dispute at this point in time, that the Company is obligated by law to repair and replace these services should they fail. Tr. 118-119. The only question is whether the Company <u>must</u> inspect the facilities to ensure they are in good repair, or to make necessary repairs, prior to transfer of ownership to customers.

While I&E challenged whether a mandatory program is needed from a safety perspective, I&E did not produce a safety expert in this proceeding. Tr. 118. The only witness who was qualified to talk about the relative safety risks and benefits of a mandatory versus voluntary program was the Company's witness, Mr. Sorber. Mr. Sorber opined that this program must be mandatory, given the age of the equipment, the location of its installation, and the fact that the Company seeks to transfer ownership of the equipment to customers. Further, I&E's own witness conceded at the hearing that the only way to know whether the equipment was safe and reliable was to conduct an inspection. Tr. 120:1-4. She also conceded that such an inspection was necessary in order to safely facilitate the transfer of ownership of the services to customers. Tr. 120:12-19. Finally, pursuant to 52 Pa. Code §§ 57.194(b) and (c), the Company has a legal obligation to periodically inspect its facilities and ensure compliance with the National Electrical Safety Code. There are no grounds for concluding that a voluntary inspection program is sufficient under these circumstances.

I&E has recommended a disallowance in this proceeding which is driven primarily by I&E's disagreement with the total scope of the program, over the entirety of its life. The Company indicated that it anticipated inspecting, and repairing or replacing, approximately 5,000 services over a ten-year period, at an annual rate of 500 services per year. I&E believes the

Company's total anticipated spend over the ten year life of the program is too high. Specifically, Ms. Wilson stated, "The largest part of my criticism relies upon the fact that the company is projecting ten years out into the future and wants to claim costs ten years out into the future when that does not represent a totally measurable cost." Tr. 121:8-12. However, I&E's approach to its proposed reduction is improper. I&E provided no specific criticism of the Company's anticipated inspection and replacement of the 500 services identified for the FPFTY. Further, I&E's criticism of the anticipated nature of the work was not based on her expertise in safety, and was based primarily on her misunderstanding of the Company's information. UGI Electric St. No. 3-RJ, p. 8. I&E has produced no meaningful evidence-based criticism that justifies reducing the Company's proposed expense associated with this program. Therefore, the Company's proposed program cost of $454,418 should be approved.

C. ENVIRONMENTAL REMEDIATION EXPENSE

In its direct case, UGI Electric identified remediation work in one of the Company's warehouse buildings, with a total estimated cost of $417,000. UGI Electric St. No. 3, p. 19. The structure was built in the 1920s and is currently used to provide covered parking for line construction vehicles and to store miscellaneous items, such as pole trailers and wire pulling equipment. UGI Electric St. No. 3, p. 19. Given its long use in this capacity, the packed earth floor has experienced surface contamination. Based on an environmental analysis showed that the packed earth floor has experienced surface contamination and soil remediation is required to an estimated depth of two-feet. UGI Electric St. No. 3, p. 19. UGI Electric proposed a three-year amortization for this expense. UGI Electric St. No. 3, p. 19.

In response to this proposal, both I&E and OCA recommended disallowing the entirety of the remediation claim. I&E has argued that there are four reasons this expense should not be allowed: (1) it is preliminary, (2) it is speculative because it is being done in preparation of selling the building which will occur after the end of the FPFTY, (3) that the Commission did not approve deferral of these costs, and (4) that no environmental agency has directed the incurrence of these costs. I&E St. No. 1, pp. 7-8; I&E St. No. 1-SR, p. 4-5. If the costs are allowed to be included, then I&E believes they should be amortized over five years. I&E St. No. 1, p. 8. OCA argues that remediation costs should be removed from the cost of service and not recovered from ratepayers, because these costs should be recovered from the sales proceeds associated with the property. OCA St. No. 1, p. 17.

As to the claims that these costs are preliminary or speculative in nature, there is ample evidence that the total costs reflected in this claim are accurate. UGI Electric has provided an estimate from its long-standing remediation contractor in support of the costs. UGI Electric St. No. 3-R, p. 4. The estimate was reviewed by the environmental group at UGI Electric, who has extensive experience with site remediation, to ensure that the proposal and its costs were appropriate. UGI Electric St. No. 3-R, p. 4. All preliminary work has been completed. I&E's claim that these costs are preliminary and speculative is simply not accurate.

I&E's testimony regarding the need for Commission approval of deferred accounting costs is incorrect, as a matter of law. These costs have not occurred, but will occur during the FPFTY. Thus, it is appropriate to include them in this proceeding. It is not appropriate to include them in a petition for deferred accounting treatment, as such petitions are for costs incurred between rate cases. The Company does recognize that the nature of this expense is non-recurring, UGI Electric St. No. 3-R, p. 5, and has proposed to amortize the cost over three years. This is the appropriate and accepted way to treat non-recurring expenses during a rate case test year.

With regard to I&E's argument that no environmental agency has compelled this remediation work, I&E has taken an overly narrow and very troubling position as to the Company's responsibilities. While an expense incurred in response to a directive from a regulatory agency may be considered a *de facto* prudent expense, the lack of a directive from a regulatory agency does not diminish the reasonableness and prudency of improving the conditions at this facility. UGI Electric is required to:

> furnish and maintain adequate, efficient, safe and reasonable service and facilities, and shall make repairs, changes, alterations, substitutions, extensions and improvements in or to the service and facilities necessary or proper for the accommodation, convenience and <u>safety of its…employees and the public</u>.

66 Pa. C.S. § 1501(emphasis added); *see also* 52 Pa. Code § 57.194(a). Even absent a directive from a state or federal environmental agency, the Company has shown that it is reasonable to incur the cost of improving this facility for the benefit of its current workforce and for the public at large. The current state of the Forty-Fort warehouse is inconsistent with the Company's goals as a participant in the Voluntary Protection Plan ("VPP"), a certification program of the Federal Occupational Safety and Health Administration ("OSHA"). UGI Electric St. No. 1-RJ, p. 5. The VPP program ensures employee safety, by requiring compliance with certain OSHA program specifications. This may include facility improvement where facilities do not meet those standards. UGI Electric St. No. 1-RJ, p. 5. The environmental remediation identified in this proceeding is necessary, at a minimum, to improve an employee work environment. Thus, improvement of this facility, in and of itself, supports the reasonableness of the remediation, irrespective of the Company's future plans to sell the building. The Commission should encourage utilities to remediate environmental contamination, because it benefits employee safety and the local community.

Regarding the Company's plans to eventually sell this property, OCA's proposal to offset the cost remediation with net proceeds from the sale, which I&E concurred with in its surrebuttal testimony, should be rejected for several reasons. First, the Company is utilizing a FPFTY in this proceeding, and the environmental remediation expense will be incurred in the FPFTY, whereas the sale of the property is not expected until after the FPFTY. UGI Electric St. No. 3-R, p. 4. It would be improper ratemaking to include an out-of-test-year adjustment to permit the recognition of the future sale of the property. In fact, I&E's witness acknowledged at the hearing, that it is not appropriate to evaluate costs based on events occurring outside the test year. Tr. 121:13-18.

Second, the sales price for the building is not known or knowable at this time. While the Company has obtained an appraisal, the appraisal assumed remediation of the facility would occur, and relied upon current market conditions. Those market conditions are likely to change between now and the time when the Company will sell the facility, which is not anticipated until after the FPFTY. The building may or may not be sold for more than its depreciated original cost, and there may or may not be any net proceeds to offset the cost of the environmental remediation work.

Third, any net proceeds that are realized will be credited to net salvage expense which is an accepted element of the ratemaking formula. Specifically, in Pennsylvania, a utility's revenue requirement includes a five-year average of net salvage expense. Any net proceeds from the sale will be recorded in net salvage expense and reflected in the Company's next rate case. UGI Electric St. No. 3-R, p. 5.

The Company has shown that the remediation expense will occur in the FPFTY, and that the estimated cost is reasonable. The remediation is necessary as a result of years of use of the building in service to customers, and will allow the Company to provide a safe environment to its employees and the public. Any net proceeds from an eventual sale of the building will be reflected in future cost of service as part of net salvage expense. Therefore, the arguments raised by OCA and I&E should be rejected, and the Company's environmental remediation expense claim should be allowed.

D. STORM DAMAGE EXPENSE

As part of its original filing, UGI Electric proposed that the Company's storm expense in this proceeding be captured in a reconcilable rider. The SER would have included the average storm expense over the past five years, which would be adjusted annually for over or under collections. In the Stipulation, as described in Section III of the Company's Initial Brief, above, UGI Electric agreed to withdraw its proposed SER at this time. However, as a result of the withdrawal of the proposed Rider, the Commission must determine an appropriate amount of normalized storm expense to include in the Company's revenue requirement.

In its direct case, the Company used a five-year average of storm expense, reflecting expense from the years 2013 to 2017, to develop an average annual storm expense of $275,000. UGI Electric St. No. 8-R, pp. 22-23. In its rebuttal testimony, the Company updated its claim to correct an error in the original data and to reflect the actual experience of fiscal year 2018 to date. UGI Electric St. No. 8-R, pp. 22-23. These updates produced a revised claim of $301,000. UGI Electric St. No. 8-R, p. 23.

I&E is the only party that has filed testimony contesting the appropriate level of normalized storm expense to be reflected in this case.[13] First, it is critical to note that Ms. Wilson agreed that a minimum of $253,229 should be reflected in revenues as storm expense in

[13] While OCA's witness Mr. Mierzwa did file testimony regarding the SER and the Company's initial storm expense calculation, *see* OCA St. No. 4, pp. 25-26, he did not address or challenge the normalized storm expense claimed by the Company in its rebuttal testimony or the inclusion of the 2018 data. OCA St. No. 4-S, pp. 13-14.

this proceeding. Tr. 122:21-22. However, in its Surrebuttal Testimony, I&E challenged the Company's method for calculating its storm expense. I&E St. No. 1-SR, pp. 43-44. Specifically, I&E has challenged the inclusion of the 2018 storm related data. I&E St. No. 1-SR, pp. 43-44. I&E's basis for excluding the 2018 storm data is that it is improper to include only a partial year's data in the five-year historic average. I&E St. No. 1-SR, pp. 43-44.

During the hearing, Ms. Wilson acknowledged that it is the standard practice of utilities in base rate proceedings to update their claims during the pendency of the proceeding to reflect actual data. Tr. 123:3-6. Ms. Wilson also agreed that Mr. Sorber's testimony reflected actual storm damage expense incurred in fiscal year 2018. Tr. 124:2-5. Further, Ms. Wilson acknowledged that the partial year data provided by the Company for its 2018 storm expenses either correctly reflects the total storm expense for fiscal year 2018, or would understate the actual storm expense should any additional storm events occur in the remaining months of fiscal year 2018. Tr. 123:11-19. It is not possible for the inclusion of the partial year 2018 storm expenses to overstate the actual expense experienced by UGI Electric in the full fiscal year 2018. Ms. Wilson agreed that excluding fiscal year 2018 actual expenses would improperly reduce the Company's storm expense claim based on her own five-year average methodology. Tr. 124:6-11. Therefore, inclusion of the Company's actual experience for 2018 would make the Company's numbers more reflective of its actual experience, while posing no risk of over-recovery from rate payers.

I&E's recommended storm damage is artificially low, and does not reflect the most up to date data based on the Company's actual experience. Ms. Wilson's testimony at the hearing acknowledges that this adjustment improperly reduces the actual expense experienced by the

Company. I&E's adjustments to the Company's claim should be rejected, and the Company's updated claim of $301,000 for storm expense should be adopted.

E. RATE CASE EXPENSE

As part of its direct case in this proceeding, UGI Electric included a total claim of rate case expense of $676,000. UGI Electric St. No. 2-R, p. 5. UGI Electric proposed to amortize this expense over a three year period, consistent with the anticipated frequency of base rate proceedings going forward, and with numerous prior Commission proceedings. This resulted in a normalized claim of $225,000. UGI Electric St. No. 2-R, pp. 5-6. I&E did not challenge the total claim, but proposed a five-year amortization, for a normalized claim of $90,000. I&E St. No. 1, p. 10; I&E St. No. 1-SR, p. 9.

I&E has argued that the normalization period for rate case expense should be based on the history of prior filings, citing *Emporium Water Company*, Docket No. R-2014-2402324 (Order Entered Jan. 18, 2015). Ms. Wilson misrepresents the holding in Emporium, which properly read, fully supports the Company's position. In *Emporium*, the Commission stated that the history of rate filings "often" represents the best evidence for normalization of rate case expense. *Id.*, at p. 48. However, the Commission then noted that there are exceptions to this general principle citing the *2012 PPL RC Order*. *Id.*, at p. 49.

In the *PPL 2012 RC Order*, PPL Electric sought a two-year normalization of rate case expense, while I&E and OCA, based on a three-year rate filing history, proposed a three-year period. *PPL 2012 RC Order*, pp. 44-45. The ALJ accepted the I&E and OCA adjustment, but the Commission reversed. *Id.*, pp. 45-46, 47-48. The Commission acknowledged PPL Electric's three-year filing history, but also noted its major capital improvement program to address aging infrastructure. *Id.*, pp. 47-48. For these reasons, the PUC approved PPL Electric's two-year normalization of rate case expense. The same logic appliers here. UGI Electric last filed for a base rate increase 22 years ago, in 1996. No party, including I&E, proposes that the Commission rely on this history. UGI Electric has demonstrated that, given its major capital investment program, it will likely file for a base rate case every three years. There is no basis for I&E's proposed adjustment and it should be rejected.

In addition, while history is one factor to be considered, it not the only factor the Commission considers. *See, e.g., Butler Township* 81 Pa. Cmwlth. 40, 47-48 (the Court affirmed that while historic practice was informative it need not be the exclusive factor relied upon by the Commission). Ratemaking is prospective and the goal of ratemaking is to reasonably reflect future conditions when new rates are in effect. *See, e.g., Columbia Gas v. Pa. Pub. Util. Comm'n*, 613 A.2d 74, 76 (Pa. Cmwlth. 1992), *aff'd*, 636 A.2d 627 (Pa. 1994) ("Ratemaking is *prospective* in nature, that is, once established by the Commission, base rates are final for the period in which they apply." (emphasis in original)). Thus, while history can provide guidance on anticipated future conditions, it cannot and should not be the sole basis for determining revenue requirements as this would defeat the purpose of using a FTY or FPFTY in setting rates.

I&E's proposal also does not reflect any consistent legal principle. First, I&E's adjustment is clearly not based exclusively on history. The Company has not filed for a base rate increase in 22 years. UGI Electric St. No. 2-RJ, p. 4. If I&E had relied solely on history, then it would have proposed a 22-year normalization period. Second, I&E's adjustment does not appear to consider the Company's planned accelerated spending in determining a reasonable amortization period. The Company has produced clear testimony that a long period between base rate proceedings is very unlikely to occur going forward, and the Company's most likely projection is that it will need to seek additional rate relief in approximately three years. UGI Electric St. No. 2-RJ, p. 4. This is because the Company's LTIIP has significantly increased capital spending in order to repair, replace or improve qualifying distribution asset categories such as poles, underground and overhead conductor and transformers. UGI Electric St. No. 2-RJ, p. 4. In total, the Company will spend over $8.0 million annually on these capital projects in each of the years following the FPFTY. UGI Electric St. No. 2-RJ, p. 4. Just with regard to an LTIIP spending level of $8.0 million per year, over a 3-year period, the Company will expend approximately $24.0 million in related capital. All else being equal, this $24.0 million equates to an approximate $3.0 million revenue requirement shortfall, or an amount which certainly would warrant a request for rate relief via base rate case. UGI Electric St. No. 2-RJ, p. 4. This also does not include any other non-LTIIP capital spend which would be additive to this rate relief picture. UGI Electric St. No. 2-RJ, p. 4. This clear and major increase in capital spending makes it apparent that the Company will require further rate relief sooner rather than later. Accordingly, the Company's three-year proposal reflects a reasonable normalization period and should be approved.

F. EMPLOYEE EXPENSES

1. Salaries And Wages Net Of Employee Additions.

In its direct case and in accordance with long-standing and well-accepted ratemaking practice, UGI Electric proposed to include $4,993,000 associated with salaries and wages – net of employee additions, which included, amongst other things, a $34,000 annualization adjustment to reflect end of test year conditions. I&E proposed to exclude the annualization adjustment consistent with its broader argument that the FPFTY should reflect "average" and not year-end conditions. I&E St. No. 1, p. 16; I&E St. No. 1-SR, p. 13.

This issue is fully addressed in Section IV.A.1 *supra* will not be restated here. For the reasons explained therein, the Company's position should be adopted, and I&E's adjustments should be rejected.

2. Employee Additions.

The Company has claimed $382,000 associated with employee additions. I&E has recommended a reduction of $64,000 to disallow the annualization of newly added positions in the FPFTY, consistent with its position on the calculation of the FPFTY. I&E St. No. 1, p. 19; I&E St. No. 1-SR, p. 14. OCA also reflected an adjustment to reflect the costs incurred during the FPFTY based on the expected date of employment, in line with the OCA's proposed adjustment for the calculation of the FPFTY using an average rate base method. OCA St. No. 1, p. 17.

This issue is fully addressed in Section IV.A.1. *supra* and will not be restated here. For the reasons explained therein, the Company's position should be adopted, and I&E's and OCA's adjustments should be rejected.

3. Outside Services Employed.

As part of its initial filing, the Company included $191,000 identified as Miscellaneous Outside Services Employed. I&E recommended disallowance of $39,000 of this claim that was specifically an increase in worker's compensation expense. I&E St. No. 1, p. 24. I&E also recommended an additional disallowance of $142,000 that the Company had originally incorrectly identified as UNITE audit fees. I&E St. No. 1, p. 23. Instead, I&E recommended that the Company use a three-year historic average, which resulted in a total claim of $21,000. I&E St. No. 1, p. 24. I&E's primary reason for proposing the disallowance was that the Company did not provide sufficient detail to justify these expenses. I&E St. No. 1, p. 22.

The Company's initial filing did incorrectly attribute the bulk of these expenses to UNITE audit fees. However, this cost category captures many smaller groups of costs. Those include the following: $17,000 of costs associated with Management Development programs organized by the Human Resource Department; $19,000 of printing costs that are budgeted to account 923 but are booked to the actual accounts when the printing jobs are processed; and $91,000 of other professional services costs across various groups which support UGI Electric. UGI Electric St. No. 4-R, p. 9. These amounts are in addition to the worker's compensation claim of $39,000 that the Company has budgeted in Account 923. UGI Electric St. No. 4-R, p. 9. The Company was able to show, and I&E recognized in its surrebuttal testimony, the source of $166,000 of these expenses. I&E St. No. 1-SR, p. 17. At a minimum, the Company should be allowed to reflect $166,000 in its rates. UGI Electric St. No. 4-RJ, p. 8. Further, I&E's methodology should be rejected, because the historic data is artificially deflated as a result of the mismatch between the account that the Company budgets to and the account where the Company books its expenses. UGI Electric St. No. 4-RJ, p. 8.

I&E's primary criticism in its direct testimony was that UGI Electric did not provide sufficient certainty as to the costs claimed in Outside Services Employed. However, in surrebuttal, Ms. Wilson acknowledged that the Company had provided data to identify the majority of these claimed expenses. I&E St. No. 1-SR, p. 17. I&E's position on these expenses should be rejected.

4. Employee Activity Costs.

UGI Electric has proposed to recover the cost of Employee Activities in this proceeding, totaling $11,848. The primary source of this cost is the Company's annual picnic. The employee activity costs claimed by the Company in this proceeding provide important business benefits. Specifically, the claimed special events are to recognize the employees' hard work and dedication, as well as to boost employee engagement and the morale of the overall workforce. UGI Electric St. No. 4-R, p. 10. In addition to being viewed as compensation, employee engagement activities provide numerous specific benefits that relate to customer service. UGI Electric St. No. 4-R, p. 10. They foster a sense of community, which increases communication between employees, enhances problem solving and improves productivity, all of which benefit customers. UGI Electric St. No. 4-R, p. 10.

I&E recommended a disallowance of $11,848 for costs associated with Employee Activities. I&E does not believe that ratepayers should pay for these costs, "because they are not necessary for the provision of safe and reliable service." I&E St. No. 1, p. 25. I&E's witness further stated in her Surrebuttal Testimony that she does not believe that "hosting a picnic or party just to boost morale or employee engagement justifies it as a business meeting suitable for recovery from ratepayers." I&E St. No. 1-SR, p. 19.

Pursuant to Section 1321 of the Public Utility Code, utilities may not claim certain employee meeting expenses for ratemaking purposes if they are unrelated to the business or civic purpose of the event. However, the evidence in this proceeding shows that the Employee Activity expense is a reasonable expense related to providing quality service to customers, as required by *Butler Township,* 81 Pa. Cmwlth. 40 *supra*. The positive impact employee events can have on morale, which will improve customer service, has been identified not only by the Company, but it has also been acknowledged by the Commission's spokesperson and I&E's witness. Tr. 127-128. As Ms. Wilson herself agreed, a motivated workforce provides better service to customers. Tr. 128.

The Commission itself sees value in these types of events, because the Commission also holds an Employee Appreciation Day. Tr. 125. The Commission's Employee Appreciation Day costs $11,500—a remarkably similar expense to the claimed Employee Activity costs in this proceeding. Tr. 126. While Ms. Wilson was not aware of the specific source of funding for the Commission's Employee Appreciation Day, she did acknowledge that the Commission is funded primarily from utility assessments, which are obtained through rates from rate payers. Tr. 126;

see also 66 Pa. C.S. § 510 (providing for utility assessments to pay for Commission operating expenses). At UGI Electric's events, just like at the Commission's Employee Appreciation Day, the Company recognizes special employee milestones and employees that have gone above and beyond in their service. Tr. 127; *see also* UGI Electric St. No. 4-R, p. 10. The Commission has acknowledged that it believes its Employee Appreciation Day motivates employees, and UGI Electric agrees with this assessment. Tr. 127. For these reasons, UGI Electric submits that Employee Activity expenses are an integral part of ensuring customers receive excellent utility service and, therefore, should be recovered in rates. UGI Electric St. No. 4-R, p. 10.

I&E's witness acknowledged that the Commission views employee appreciation activities as a way to motivate employees, and that motivated employees produce betters results for customers. The evidence in this proceeding shows that the Company's expense associated with Employee Activities is a reasonable and prudent cost incurred in order to motivate employees, which leads them to provide better service to customers. This expense should be approved.

5. Allocated Stock Options And Restricted Stock Awards.

As part of the Company's original claim in this proceeding, the Company included $77,000 in costs associated with Allocated Stock Options, and $112,000 for costs associated with Restricted Stock Awards. The Company's combined proposal was $187,000 associated with incentive compensation. UGI Electric St. No. 4-RJ, p. 9.

In I&E's Direct Testimony, it recommended that both the $77,000 and the $112,000 be disallowed in their entirety. I&E St. No. 1, p. 28; I&E St. No. 1-SR, p. 23. I&E recommended disallowance of the costs associated with the Allocated Stock Options because it believes there were no specific criteria for how stock options are awarded, and because stock options are usually tied to earnings targets. I&E St. No. 1, pp. 27-28. I&E also recommended disallowance of the $112,000 for costs associated with Restricted Stock Awards, because it believes that this type of benefit is typically tied to earnings targets. I&E St. No. 1, p. 28. I&E appears to agree that there is value to providing incentive compensation benefits, however, I&E merely believes that ratepayers should not pay for these programs. I&E St. No. 1-SR, p. 23.

In response to I&E's testimony, the Company's witness described that UGI Electric's use of incentive compensation programs is only part of its total compensation package and that the Allocated Stock Options and Restricted Stock Awards are only a part of its incentive compensation program. UGI Electric St. No. 4-R, p. 12.

Regarding the use of incentive compensation, UGI Electric's practice is a normal practice for both employers generally and public utilities specifically, that is documented by industry compensation surveys, as well as professional compensation organizations such as WorldAtWork, AON, and the American Gas Association. UGI Electric St. No. 4-R, p. 13. The 2017 American Gas Association Compensation Survey Report shows that 83% of organizations (53 responses) have at least one plan for management employees (excluding executives) and 79.2% of organizations (54 responses) have at least one plan for non-management exempt employees. UGI Electric St. No. 4-R, p. 13. The 2016 WorldAtWork Compensation and Planning Survey, which included participants from the Utilities, Oil & Gas Sector, showed that 88% of organizations use variable pay. UGI Electric St. No. 4-R, p. 13. According to a 2016 Aon Survey, 77% of participants use business incentive plans where business metrics can be financial, operational, or a combination of the two and they are tied back to the organizational success. UGI Electric St. No. 4-R, pp. 13-14. UGI Electric's incentive compensation is only one part of its total compensation package. UGI Electric St. No. 4-R, p. 12. It is market-driven, and necessary to obtain and retain quality employees. UGI Electric St. No. 4-R, p. 12. I&E did not dispute these facts.

Regarding the Allocated Stock Options and Restricted Stock Awards, these programs are only a part of UGI Electric's incentive compensation program. These programs also include bonuses and other programs that compensate employees who achieve various operating and service goals and metric. As a result, incentive compensation at UGI Electric is based on achieving both financial and operating goals. As explained below, such programs have been repeatedly approved by the Commission.

Further, the Company described in great detail how these programs directly and indirectly benefit customers. UGI Electric St. No. 4-R, p. 11. The achievement of specified financial goals provides important and direct benefits to customers, in the form of better access to capital markets with more reasonable rates. UGI Electric St. No. 4-R, p. 12. This benefit is particularly critical as the Company continues to replace aging infrastructure, because it will represent a less expensive cost of capital for construction. UGI Electric St. No. 4-R, p. 12. Good financial performance also provides an internal source of capital, which reduces the need to access capital markets and may defer the need for, and reduce the amount of, rate increases. UGI Electric St. No. 4-R, p. 12. Thus, meeting the Company's financial goals produces a cost reducing benefit to customers.

In addition, the Company discussed the importance of these incentive compensation programs to attract and maintain qualified candidates in critical areas. UGI Electric St. No. 4-R, p. 12. The employees eligible to receive incentive compensation under these plans are key actors in the process of establishing the operating and customer-focused goals for the entire corporation, including UGI Electric, and are a driving force behind ensuring that these goals are achieved. UGI Electric St. No. 4-R, p. 12. If the Company did not offer incentive compensation programs, then it would have to increase the level of its base salary compensation in order to remain competitive and to attract the same qualified candidates in the areas it serves, which would increase costs to customers. UGI Electric St. No. 4-R, p. 12. Alternatively, if the Company did not stay competitive in attracting and retaining qualified candidates, customer service and overall operations may be negatively impacted.

Incentive compensation is an element of employee pay that is contingent upon performance or the results achieved. UGI Electric St. No. 4-R, p. 13. This pay is considered "at risk" for each performance period, requiring sustained performance to receive this reward. UGI Electric St. No. 4-R, p. 13. This ensures sustained production by the Company's employees. It also provides the Company with valuable information regarding individual employee performance and effort. UGI Electric St. No. 4-R, p. 13.

Importantly, UGI Electric's incentive compensation plans include both financial and operational metrics in their calculations, which is a common practice. UGI Electric St. No. 4-RJ, p. 9. All of the Company's Management employees have goals that include metrics which are not specifically tied to financial performance. UGI Electric St. No. 4-RJ, p. 9. These address areas such as safety, reliability and customer service, which are all metrics utilized in the current cash incentive compensation plan for Company management. UGI Electric St. No. 4-RJ, p. 9. Specific metrics include OSHA VPP assessments, electric reliability indices (SAIDI, SAIFI, CAIDI), emergency response rate, and customer satisfaction. UGI Electric St. No. 4-RJ, p. 10. If these goals are not met, then there is no eligibility for this portion of the cash incentive compensation regardless of the Company's financial performance. UGI Electric St. No. 4-RJ, p. 10.

The incentive compensation provided by UGI Electric benefits ratepayers as well as shareholders. By making a portion of employees' total compensation variable and dependent on their performance, UGI Electric achieves benefits for ratepayers. Specifically, incentive compensation helps drive organizational performance. Incentive compensation provides direction for employees by articulating operational and tactical objectives, setting priorities and establishing measures to create clarity and priorities. Incentive compensation also permits an understanding of the connection between individual performance and organizational success, thereby aligning individual efforts and performance to organizational goals. Incentive compensation also fosters engagement and feedback, making employees understand how their efforts impact organizational results in a tangible way. UGI Electric St. No. 4-RJ, pp. 9-10.

Failure to offer competitive compensation programs would increase the Company's risk of not attracting, hiring, motivating, and retaining the Company's talent. Increased turnover will result in higher costs of recruiting, hiring, training and retraining which could result in increased cost to customers, as well as reduced quality of service. UGI Electric St. No. 4-R, p. 12. Incentive compensation is appropriate because it helps motivate employees to perform at a higher level. UGI Electric St. No. 4-R, p. 13. This performance relates not just to financial goals, but customer service and safety, business strategy, and operational objectives. UGI Electric St. No. 4-R, p. 13.

Public utilities are entitled to recover all reasonable expenses, including incentive compensation. In *Butler Township*, 473 A.2d at 221, the Commonwealth Court concluded:

> The general rule is that a public utility is entitled to recover in rates those expenses reasonably necessary to provide service to its customers and to earn a fair rate of return on the investment and plant used and useful in providing service. *Western Pennsylvania Water Co. v. Pennsylvania Public Utility Commission*, 54 Pa. Cmwlth. Ct. 187, 422 A.2d 906 (1980). Operating expenses

> include prudently incurred rate case expenses. *Driscoll v. Edison Light and Power Company*, 307 U.S. 104 (1939); *West Ohio Gas Company v. Public Utility Commission of Ohio*, 294 U.S. 63 (1935). Obviously, the refusal to allow the recovery of a proper expense diminishes to the same extent the utility's return on investment. There is no evidence in the record that the … expenses claimed here were unreasonable, imprudently incurred or excessive in amount.

See also T.W. Phillips Gas and Oil Co. v. Pa. P.U.C., 81 Pa. Cmwlth. 205, 474 A.2d 355 (Pa. Cmwlth. 1984). A utility such as UGI Electric is entitled to recover in rates all expenses reasonably necessary to provide service to customers. I&E has not claimed that the total compensation expenses were unreasonable, imprudent or excessive. The evidence shows just the opposite; the Company is significantly below the industry median in payment, and UGI Electric's incentive compensation program allows it to keep those costs down. UGI Electric showed that its total compensation, which includes base plus bonus, was significantly below the market median, by 8.3%. UGI Electric St. No. 4-R, p. 12. Base salaries of UGI Electric's employees were 4.7% below the media of the comparison group. UGI Electric St. No. 4-R, p. 12.

The Commission has reviewed and approved incentive compensation programs in numerous prior rate cases. *See, e.g., Pa. Pub. Util. Comm'n v. Aqua Pa., Inc.*, Docket No. R-00072711, 2008 Pa. PUC LEXIS 50 (Order dated July 17, 2008) ("*Aqua 2008*"); *Pa. P.U.C. v. Duquesne Light Co.*, 63 Pa. PUC 337, 1987 Pa. PUC LEXIS 342 (Order dated March 10, 1987); *Pa. P.U.C. v. PPL Gas Utilities Corporation*, R-00061398, at p. 40 (Order dated Feb. 9, 2007); *Pa. P.U.C. v. Philadelphia Gas Works*, Docket No. R-2008-2073938, 2008 Pa. PUC LEXIS 32 (Order dated Dec. 19, 2008). In these cases and others, the Commission has established a bright line test for incentive compensation expense. If the incentive compensation programs of the utility are reasonable and provide a benefit to ratepayers, then they may be recovered in their entirety. *See, e.g.*, *PPL 2012 RC Order*, p. 26. Here, the Company has demonstrated that its incentive compensation plans, as a whole, include both financial and operating metrics and goals. Recovery of this expense item therefore should be approved.

As the Commonwealth Court determined in *Butler Township*, the relevant question in a base rate proceeding is whether the expense is reasonable and appropriate for the furnishing of service to customers. If so, the expense should be recovered in full. The Company has shown that there are meaningful benefits that flow to customers from its incentive compensation programs, and that customer service may be harmed if the Company were to discontinue its use of its incentive compensation programs. The adjustment to the incentive compensation expense proposed by I&E should be rejected.

G. DEPRECIATION EXPENSE

The depreciation rates have been established pursuant to the Joint Stipulation, described above in Section III. However, in addition to the calculation of depreciation expense, OCA challenged the annualized depreciation expense to be reflected in this proceeding. OCA argued that annualized depreciation expense should be based on its proposed methodology for the calculation of the FPFTY, rather than the Company's end of FPFTY plant in service amount. OCA St. No. 1, p. 21. I&E also recommended a reduction in annual depreciation expense to reflect its FPFTY methodology. I&E St. No. 3, p. 15. The Company believes that these adjustments are in error, because the proposed methodologies for calculating the FPFTY advocated by OCA and I&E are improper. UGI Electric St. No. 4-R, pp. 14-15.

This issue is fully addressed in Section IV.A.1. *supra* and will not be restated here. For the reasons explained therein, the Company's position on the calculation of the FPFTY should be adopted, and I&E's and OCA's adjustments should be rejected.

H. OTHER POST EMPLOYMENT BENEFITS

In preparing its direct case, the Company failed to include an adjustment to Other Post-Employment Benefits ("OPEB") to address a significant over-collection in OPEB expenses that has occurred since the Company's last base rate proceeding. UGI Electric St. No. 4-R, p. 17. In the 1996 rate case settlement, UGI Electric was authorized to recover $0.484 million per year for the Company's annual OPEB costs, and was also directed to account for the difference between the net periodic post-retirement benefit expense under SFAS 106 and the amount recovered in rates. UGI Electric St. No. 4-R, p. 17. The difference was to be recorded as a regulatory asset (or liability) and be recovered or refunded in future rate proceedings. UGI Electric St. No. 4-R, p. 17. As a result of the OPEB fund generating more income than its expenses, the Company has accumulated an over-collection (regulatory asset) in the amount of $7.9 million over the 22 years since its last rate case. UGI Electric St. No. 4-R, p. 17.

The Company has proposed a $0.395 million adjustment per year, which relates to the over collection of OPEB expenses since the last UGI Electric rate case. UGI Electric St. No. 4-R, p. 17. UGI Electric has proposed to refund this over-collection to customers over 20 years, *i.e.* to return $0.395 million annually to customers over a similar time period that the current recovery mechanism has been in place, consistent with the 20-year time period established in 52 Pa. Code § 69.351 (regarding recovery of the OPEB costs that investor-owned utilities deferred after the adoption of Statement of Financial Account Standards No. 106). UGI Electric St. No. 4-R, pp. 17-18. This adjustment was reflected in Revised Schedule D-14.

No party to this proceeding opposed this proposal. UGI Electric's unopposed proposal is just and reasonable and, therefore, should be approved.

I. CONCLUSION AS TO EXPENSES

UGI Electric's total expenses of $84.595 million reflect the expense adjustments accepted and identified in the Company's Rebuttal Testimony, Rejoinder Testimony and the Joint Stipulation. The total expense of $84.595 million is inclusive of the full expense claimed by the Company on the litigated issues identified in Section VI of this brief. For the reasons identified in the previous discussion, the various disallowances to the Company's expenses proposed by the other parties in this proceeding should be rejected, and the Company's total expenses should be approved and included in base rates.

VII. FAIR RATE OF RETURN

A. RATE OF RETURN STANDARDS

A public utility, whose facilities and assets have been dedicated to the service of the public, is entitled to an opportunity to earn a fair rate of return on its investment. The standards to be used by the Commission in determining what return rate is fair are well-established, having been set forth by the United States Supreme Court in *Bluefield Waterworks and Imp. Co. v. P.S.C. of West Virginia*, 262 U.S. 679, 690 (1923), ninety-five years ago:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility of its property in violation of the Fourteenth Amendment.

The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. 262 U.S. at 693. These principles have been adopted and applied by the appellate courts of Pennsylvania in numerous cases. *See, e.g., Riverton Consolidated Water Co. v. Pa. Pub. Util. Comm'n*, 186 Pa. Super. 1, 140 A.2d 114 (Pa. Super. 1958); *City of Pittsburgh v. Pa.*

Pub. Util. Comm'n, 182 Pa. Super. 376, 126 A.2d 777 (Pa. Super. 1956); *Lower Paxton Twp. v. Pa. Pub. Util. Comm'n*, 13 Pa. Cmwlth. 135, 317 A.2d 917 (Pa. Cmwlth. 1974).

The return allowed to investors must be commensurate with the risk assumed, as the Supreme Court has stated in three landmark opinions. *Bluefield, supra* at 692, requires that the rate of return reflect:

> . . . a return on the value of the [utility's] property which it employs for the convenience of the public equal to that generally being made at the same time on investments in other business undertakings which are attended by corresponding risks and uncertainties. . . .

Twenty-one years later, the Supreme Court reiterated that standard in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944), as follows:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Later, in reaffirming *Hope*, the Supreme Court, in *Duquesne Light Co. v. Barasch*, observed that "[o]ne of the elements <u>always relevant</u> to setting the rate under Hope <u>is the return investors expect given the risk of the enterprise</u>." *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 109 S. Ct. 609, 102 L. Ed. 2d 646, 661 (1989) (emphasis added).

The determination of a fair rate of return thus requires the review of many factors, including: (1) the earnings that are necessary to assure confidence in the financial integrity of the company and to provide a reasonable credit profile to permit access to capital markets on reasonable terms, and (2) the amount of the investment, the size and nature of the utility and, its business and financial risks, in comparison to other enterprises. *Pa. Pub. Util. Comm'n v.*

Pennsylvania Gas and Water Co. - Water Division, 19 Pa. Cmwlth. 214, 233, 341 A.2d 239 (Pa. Cmwlth. 1975); *Lower Paxton Twp., supra*. Moreover, the Commission's findings must be based upon substantial and competent evidence on the record before it, not upon speculation or hypothesis. *Ohio Bell Telephone Co. v. Pub. Util. Comm'n of Ohio,* 301 U.S. 292 (1937); *United States Steel Corp. v. Pa. Pub. Util. Comm'n*, 37 Pa. Cmwlth. 195, 390 A.2d 849 (Pa. Cmwlth. 1978); *Octoraro Water Co. v. Pa. Pub. Util. Comm'n*, 38 Pa. Cmwlth. 83, 391 A.2d 1129 (Pa. Cmwlth. 1978).

Finally, in estimating the overall fair rate of return, the Commission uses the weighted average cost of capital method. This method determines the percentages of debt, common equity and, where applicable, preferred stock in the Company's capital structure. It then determines the cost rate of capital for each class of capital and "weights" it by multiplying the percentage of each type of capital times the cost rate for that type of capital. This calculation is illustrated below by UGI Electric's calculation of the overall fair rate of return in this proceeding:

Description	Capitalization Ratio	Embedded Cost	Statement Reference	Return-%
Long-Term Debt	46.00%	4.69%	B-6	2.16%
Common Equity	54.00%	11.25%		6.08%
Total	100.00%			8.24%

Revised UGI Electric A – Fully Projected, Schedule B-7.

As noted below, the Company's proposed capital structure and cost of long-term debt are subject to the Partial Stipulation or otherwise undisputed. Therefore, the issues in this proceeding with regard to rate of return relate exclusively to the cost of common equity.

B. CAPITAL STRUCTURE

As explained in Section III.A. *supra*, the parties to this proceeding have agreed to utilize the Company's proposed capital structure for purposes of the fair rate of return determination.

C. COST OF LONG-TERM DEBT

UGI Electric witness Mr. Moul proposed a 4.69% forecast embedded long-term debt cost rate for the FPFTY. *See* UGI Electric St. No. 5, p. 16; *see also* UGI Electric Exhibit B, Schedule 6, p. 3. Neither OCA nor I&E contested Mr. Moul's proposed cost of long-term debt. *See* OCA St. No. 3, p. 9; I&E St. No. 2, p. 13. Therefore, UGI Electric's proposed 4.69% cost of long-term debt is just and reasonable, and should be adopted by the Commission.

D. COST OF COMMON EQUITY

The record in this proceeding contains extensive testimony concerning the cost rate for common equity capital. UGI Electric St. Nos. 5, 5-SD,[14] 5-R, 5-RJ; I&E St. Nos. 2, 2-SR; OCA St. Nos. 3, 3-SR. In these Statements, witnesses for UGI Electric, I&E and OCA apply various theoretical models using various inputs to estimate the cost of common equity. It is important to review these judgments against the reality of the marketplace and concerns of investors, who ultimately determine the cost of equity capital by purchasing common stocks of utilities.

Several fundamental considerations should guide the Commission's evaluation of investor expectations in this proceeding. First, UGI Electric's rate increase is proposed during a period of increasing capital costs revealed by rising interest rates. It is uncontested that there have been six (6) one-quarter percentage point increase the Fed Funds rate since the Federal Open Market Committee ("FOMC") began to normalize interest rates and that, going forward, there is the expectation of possibly three additional interest rate increase in 2018 and three increases in 2019.[15] As interest rates rise, so too are investors' expectations of return on common equity investments. *See* UGI Electric St. No. 5-R, pp. 7, 33.

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[14] Mr. Moul's Supplemental Direct Testimony exclusively dealt with updates to the Company's proposed cost of common equity to reflect the impacts of the TCJA on the Company's risk profile. UGI Electric St. No. 5-SD, pp. 1-2.

[15] Subsequent to the filing of rebuttal testimony, the FOMC increased the fed funds rate twice in 2018 and two additional increases are expected following the increases on March 21, 2018 and June 20, 2018.

Second, the impacts of the TCJA on federal corporate income taxes increase the risks faced by the Company and also increase its cost of common equity. Specifically, the TCJA will significantly decrease the Company's pre-tax interest coverage, thereby reducing its credit quality, and will significantly increase the amount of investor-supplied capital to fund infrastructure programs, thereby further reducing the Company's credit quality. UGI Electric St. No. 5-SD, pp. 3-4. Details regarding these negative impacts are provided in Section VII.D.1.e. *infra*.

Third, the Commission has not limited itself to providing an average financial profile to Pennsylvania utilities, recognizing the need of Pennsylvania utilities to raise significant amounts of capital on a long-term basis to replace aging infrastructure. In this regard, the Commission has been rated by RRA as above average.[16] Supportive regulatory policies and above average return-on-equity ("ROE") allowances are necessary to maintain this rating and permit utilities to continue to attract capital on reasonable terms, particularly where capital costs are rising. Abandoning this policy risks signaling to investors that the Commission no longer supports infrastructure investments and thereby limit the opportunities of Pennsylvania public utilities to attract sufficient amounts of equity capital to finance such projects.

Fourth, the Commission is required by law to consider utility management effectiveness and efficiency when it sets rates. 66 Pa. C.S. § 523. The Commission has previously, and should in this case, include recognition for effective management in its ROE allowance. As explained below, the "bottom line" of effective management is excellent service at reasonable rates. UGI Electric has excelled at both. It has not filed for a base rate increase in 22 years and

[16] As noted in Mr. Moul's Rebuttal Testimony, and explained below, at present, Pennsylvania regulation is currently ranked Above Average/3 by RRA, which reflects an upgrade that occurred on May 10, 2017. UGI Electric St. No. 5-R, pp. 4-5. The return on equity figure serves as the foundation for these ratings, because of its status as a ubiquitous measure of a utility's financial strength, and the regulatory support it receives. If the Commission were to follow the proposals of I&E or the OCA, the regulatory ranking of Pennsylvania would certainly be jeopardized.

its rates are well below the statewide average. At the same time, its reliability and customer service metrics are consistently above the state average. In addition, UGI Electric has focused on a number of areas and programs to enhance and improve the quality and effectiveness of the service it provides to its customers, and these programs are nearly identical to programs the Commission has previously deemed worthy of recognition through a management performance adjustment. The opposing parties do not dispute that these programs have been implemented and do not dispute that ratepayers benefit from these programs, but instead argue against their recognition in a manner that if adopted, would render Section 523 a legal nullity.

Finally, the national average allowed ROE in 2017 was 9.75%. UGI Electric St. No. 5, pp. 5-6. This level of return does not reflect undisputed rising interest rates, does not reflect the undisputed negative financial impacts of the TCJA, would not support a continuation of the Commission's current above average regulatory ranking, contains no recognition of UGI Electric's extensive capital intensive infrastructure improvement program, and contains no recognition of UGI Electric's outstanding management effectiveness and efficiency. These circumstances indicate that the ROE awarded in this case must be well in excess of 9.75%, in order to provide a fair opportunity to earn a fair return under current and projected market conditions. Conversely, it is apparent that OCA's proposed ROE (8.5%) and I&E's proposed ROE (8.62%) are woefully inadequate to assure confidence of investors or attract significant investments in competitive capital markets on reasonable terms.

The above considerations fully support UGI Electric's claimed 11.25% cost of common equity and illustrate that the cost of common equity is rising. Any adopted cost of common equity that fails to reflect these considerations will significantly hinder UGI Electric's ability to attract the capital necessary to provide excellent, cost-effective service for its customers. As explained below, UGI Electric's proposed return on common equity is based upon an analysis that incorporates these considerations, whereas the proposals advanced by both I&E and OCA ignore these considerations and commit numerous additional methodological errors in order to generate artificially and unreasonably low proposed costs of common equity.

1. UGI Electric's Return on Common Equity Should Be Adopted.

UGI Electric's witness, Mr. Moul,[17] summarized his approach to determining the cost rate for common equity and the results of his analysis, as follows:

> My cost of equity determination was derived from the results of the methods/models identified above. In general, the use of more than one method provides a superior foundation to arrive at the cost of equity. At any point in time, a single method can provide an incomplete measure of the cost of equity depending upon extraneous factors that may influence market sentiment. The specific application of these methods/models will be described later in my testimony. The following table provides a summary of the indicated costs of equity using each of these approaches, as shown on page 2 of Schedule 1.

DCF	10.55%
Risk Premium	11.25%
CAPM	11.03%
Comparable Earnings	12.55%

> From these measures, I recommend a cost of equity of 10.95%, which is within the range of results reflected in the above table and also reflects 0.20% for strong management performance, as explained in the testimony of Mr. Paul Szykman.
>
> To obtain new capital to support an expanded construction program and retain existing capital, the rate of return on common equity must be high enough to satisfy investors' requirements. In recognition of its performance, the Company should be granted an opportunity to earn a 10.95% rate of return on common equity.

[17] The methodology employed by Mr. Moul in this proceeding is substantially similar to the analysis employed and accepted in the *PPL 2012 RC Order*. Indeed, Mr. Moul performed the rate of return analysis for both PPL Electric and UGI Electric.

UGI Electric St. No. 5, pp. 4-5.

Mr. Moul further elaborated on the reasons for using multiple models to determine the cost of common equity:

> It is also important to reiterate that no one method or model of the cost of equity can be applied in an isolated manner. Rather, informed judgment must be used to take into consideration the relative risk traits of the firm. It is for this reason that I have used more than one method to measure the Company's cost of equity. As I describe below, each of the methods used to measure the cost of equity contains certain incomplete and/or overly restrictive assumptions and constraints that are not optimal. Therefore, I favor considering the results from a variety of methods. In this regard, I applied each of the methods with data taken from the Electric Group and arrived at a cost of equity of 10.95% for UGI Electric, which includes 0.20% in recognition of strong management effectiveness.

UGI Electric St. No. 5, p. 17.

Without changing his approach or methodology,[18] Mr. Moul provided an updated cost of common equity analysis in his Supplemental Direct Testimony to address the impacts of the TCJA on UGI Electric's ability to attract and retain sufficient capital. *See* UGI Electric St. No. 5-SD, pp. 2-7. Based upon his consideration of the impacts of the TCJA on UGI Electric's risk profile, Mr. Moul updated his proposed cost of common equity from 10.95% to 11.25%. UGI Electric St. No. 5, p. 7.

a. DCF.

Mr. Moul's discounted cash flow ("DCF") cost rate for the Electric Group is comprised of three components: (1) a divided yield; (2) a growth rate; and (3) a leverage adjustment. These components and the resulting cost of common equity under the DCF method proposed by Mr. Moul are:

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[18] Mr. Moul noted that a full study addressing the consequences of the TCJA would not be possible until six-months of market data became available, *i.e.* in approximately July 2018. UGI Electric St. No. 5-SD, p. 7, n.1.

	Dividend	+	Growth	+	Leverage	=	DCF Cost Rate
Electric Group	3.73%		5.75%		1.07%		10.55%

UGI Electric St. 5, p. 28.

As explained below, Mr. Moul demonstrated that each of these components and the resulting DCF cost of common equity are reasonable and should be approved.

i. Dividend Yield.

Mr. Moul used the six-month average historical dividend yield of 3.62% for the Electric Group, adjusted it by eleven basis points to recognize the prospective nature of dividend payments—*i.e.* higher expected future dividends—and arrived at the 3.73% adjusted dividend yield for the Electric Group. UGI Electric St. No. 5, p. 19. Mr. Moul further explained that his eleven basis point adjustment is the result of three different, but generally accepted adjustments to the average dividend yield, and is detailed on Schedule 7 of UGI Electric Exhibit B. UGI Electric St. No. 5, p. 19. It should be noted that Mr. Moul's dividend yield is very likely understated as it is based largely on historic information and does not reflect declines in public utility stock prices post-TCJA. Recognition of this decline in stock prices would increase the indicated dividend yield.

ii. Growth Rate.

Mr. Moul reviewed several methods of calculating investor expected growth rates and concluded that analysts' forecasts of growth rates are the best indicator of investor expect growth. UGI Electric St. No. 5, pp. 19-25. This conclusion is supported by the research of Myron Gordon, the foremost proponent of the use of DCF in utility rate proceedings. UGI Electric St. No. 5, p. 24. The range of such growth rates was 4.33% to 6.06% for the Electric Group. UGI Electric St. No. 5, p. 24. Mr. Moul selected a 5.75% growth rate from this range, as improve economic growth, supports a DCF growth rate near the high end of the range. UGI Electric St. No. 5, p. 25.

iii. Leverage Adjustment.

The parties in this proceeding have devoted substantial portions of their testimony to the reasonableness of employing a leverage adjustment as part of the DCF analysis. In this regard, I&E and OCA attempt to overlook that the Commission has included such an adjustment in numerous prior rate cases. *See, e.g.*, *Popowsky v. Pa. P.U.C.*, 868 A.2d 606, 612-13 (Pa. Cmwlth. 2004) ("*PA American*"); *Pa. Pub. Util. Comm'n v. Pa. American Water Co.*, Docket No. R-0001639 (Order dated Jan. 10, 2012) (approving 60 basis point adjustment); *Pa. Pub. Util. Comm'n v. PPL Gas Utilities Corp.*, Docket No. R-00061398 (Order dated Feb. 8, 2007) (approving 70 basis point adjustment); *Aqua 2004 Order*, at *85-87 (adopting 60 basis point adjustment); *Pa. Pub. Util. Comm'n v. PPL Electric Utilities Corp.*, Docket No. R-00049255 (Order dated Dec. 6, 2004) (approving 45 basis point adjustment). Before addressing these cases, however, UGI Electric will briefly explain the basis for the leverage adjustment.

Mr. Moul explained that the leverage adjustment is designed to adjust the DCF cost rate for the different percentage of debt in the capital structure calculated at market values of equity and long-term debt (*i.e.* the values used by investors in the DCF analysis) as compared to the percentage of debt in the capital structure at book value (*i.e.* the values used in the ratemaking process). UGI Electric St. No. 5, pp. 25-26. For example, a utility that has a stock price above its book value, and has an embedded cost of debt different from the marginal cost of debt, has a market value or capitalization of its equity that is greater than the book value of its equity. When an investor purchases that equity at the market price (*i.e.* the price assumed in the DCF model), the percentage of equity in the market capitalization is greater than the percentage of equity at book value. Under such circumstances, the DCF cost rate based on market prices must be adjusted to reflect the greater financial risk created by a higher debt ratio when that cost rate is applied to a book value capitalization in utility proceedings. *Id.*; *see also* UGI Electric St. No. 5-R, pp. 22-25.

The Commonwealth Court has held that the decision of whether to adopt a leverage adjustment is within the Commission's discretion. In *PA American*, the Commonwealth Court stated:

> As to economic theory, the PUC explains the reasons the common equity costs rate adjustment is appropriate. First, the formula used to estimate cost rate is market based, but Utility's stock is not publicly traded and is listed at a much lower book value. Under these circumstances the formula can understate the cost of capital.
>
> • • •
>
> Similarly, Utility highlights the testimony of its expert, who opined that "the capital structure ratios measured at the utility's book value show more financial leverage, and hence higher risk, than the capitalization measured at its market values." R.R. at 987a.
>
> • • •
>
> The present issue involves the application of a market value cost to a book value amount of common stock. The PUC made its adjustment to the common equity cost rate in recognition of the "financial risk" arising from the different valuation methods.
>
> No witness stated that 0.6% was an appropriate adjustment. However, as Utility's expert opined that an adjustment of about 0.8% was appropriate, the record supports an adjustment larger than that approved. Further, case law supports an adjustment. E.g., West Penn Power Co. Also, the amount of the adjustment is exactly the same in this case as in the last rate proceeding involving Utility. R.R. at 900a. That prior order was not appealed. Under these circumstances, there was no abuse of discretion in making the identical adjustment.

PA American, 868 A.2d at 612-13 (footnote omitted).

Furthermore, the Commission has accepted the leverage adjustment in a number of cases, including. *See, e.g., Pa. Pub. Util. Comm'n v. Pa. American Water Co.*, Docket No. R-0001639

(Order dated Jan. 10, 2012) (approving 60 basis point adjustment); *Pa. Pub. Util. Comm'n v. PPL Gas Utilities Corp.*, Docket No. R-00061398 (Order dated Feb. 8, 2007) (approving 70 basis point adjustment); *Aqua 2004 Order*, at *85-87 (adopting 60 basis point adjustment); *Pa. Pub. Util. Comm'n v. PPL Electric Utilities Corp.*, Docket No. R-00049255 (Order dated Dec. 6, 2004) (approving 45 basis point adjustment).

Parties to this proceeding incorrectly argue that the Commission has fundamentally rejected leverage adjustments by citing two cases. First, in *Aqua 2008*, the Commission declined to use a leverage adjustment in arriving at the DCF cost of equity because the unadjusted DCF results presented by Aqua adequately captured the perceived risk associated with Aqua's market-to-book ratio. The Commission explained:

> Based upon our analysis and review of the record, the Recommended Decision, and the Exceptions and Replies thereto, we reject the ALJ's recommendation to add a 65 basis point risk adjustment. The award of such an adjustment is not precedential but discretionary with the Commission. In fact, in *Met Ed/Penelec* (*Pa. P.U.C. v. Metropolitan Edison Co./Pennsylvania Electric Co.* Order of Jan. 11, 2007, at R-000161366 and R-00061367), we specifically approved the removal of any risk adders from the cost of equity calculations. *Met Ed/Penelec* at 136.
>
> In the cases cited by Aqua in support of its leverage adjustment, it is obvious that the DCF results in those cases were not as high as the unadjusted DCF result we have in this proceeding, since the final cost of equity in those cases was no higher than 10.6% with the leverage adjustment. The unadjusted DCF results presented by the Parties in this case are generally higher than the DCF recommendations from the earlier cases cited by Aqua. When viewed in the context of the other methodologies, we conclude that there is no need to have an upwards adjustment to compensate for any perceived risk related to Aqua's market-to-book ratio. Accordingly, we reject the ALJ's recommendation to allow a 65 basis point leverage adjustment.

Aqua 2008, pp. 38-39. Importantly, while the Commission declined to adopt Aqua's proposed leverage adjustment, it ultimately approved an 11.0% cost of common equity, which was also inclusive of a 22 basis point adjustment for managerial performance. *Aqua 2008*, pp. 53-54.

As noted in the above quote, the Commission has applied the leverage adjustment in cases where it believes market conditions have resulted in an understated DCF cost rate. Such conditions appear in this case. The DCF result for Mr. Moul's Electric Group is 9.48%, well below the average allowed ROE in 2017, without the leverage adjustment of 107 basis points. Mr. Moul cautioned that the use of an unadjusted DCF alone significantly understates the cost of common equity, because the proportion of market value of common equity in the Electric Group's capitalization was significantly higher than its proportion measure at book value. UGI Electric St. No. 5, pp. 27-29. Indeed, "[t]he company's risk-adjusted return associated with a higher market-value capitalization is different than and generally lower than its risk-adjusted return associated with a book-value capitalization. Therefore, in order to apply a measurement of a return measured based on a firm's market-value capitalization to a book-value capitalization, the return measurement must be adjusted before it is applied to the firm's capitalization measured based on book value." UGI Electric St. No. 5-R, p. 25. As such, the leverage adjustment is necessary to reflect the difference between market prices, which are assumed to drive investors' expectations in the DCF analysis, and book values, which are used in the ratemaking process. Without this adjustment, market-derived DCF results would be inapplicable in the ratemaking context. *See* UGI Electric St. No. 5-R, p. 23.

Second, in *Pa. Pub. Util. Comm'n, v. City of Lancaster Bureau of Water,* Docket Nos. R-2010-2179103 et al. (Order dated July 14, 2011) the Commission declined to adopted a leverage adjustment. However, this order does not foreclose the adoption of a leverage adjustment.

Rather, the Commission simply exercised its discretion in that proceeding not to adopt a leverage adjustment, citing the *Aqua 2008* case that it was unnecessary to adopt the leverage adjustment in that proceeding. *Id.*, p. 79. This is consistent with the Commission's actions in other proceedings where it has reviewed the entire record and either chose to adopt or chose not to adopt a leverage adjustment based upon the specific circumstances of each case. As explained above, it is especially appropriate to adopt the leverage adjustment in this proceeding to address understated DCF results and account for the mismatch between market and book values of the Company's capitalization. Further, as noted previously, the Commonwealth Court in *PA American* specifically affirmed the Commission's authority to include the leverage adjustment in the DCF analysis.

Moreover, the *City of Lancaster* decision is clearly distinguishable. The City is not an investor owned utility, such as UGI Electric. In its Order, the Commission specifically recognized that the City did not have the same financial risk profile as an investor owned utility, stating as follows:

> We note that the City's debt cost rate in this proceeding is at 4.66%, which reflects the City's ability to tax. This illustrates that the City's taxing power lowers the City's financial risk when compared to an investor-owned utility. Since Lancaster's status as a municipally owned utility provides it with the opportunity to obtain debt at this low cost rate as a result of the City's ability to tax, this low cost debt should not be shifted to higher cost equity at the expense of the City's customers. <u>As a result, we do not find that the City has to be treated like an investor owned utility for ratemaking purposes.</u>

City of Lancaster, p. 54 (emphasis added). It is clear from the Order that this lower risk profile impacted the Commission's decision in that proceeding.

Finally, OCA and I&E may attempt to rely upon the *PPL 2012 RC Order*, to further bolster their suggestion that UGI Electric's proposed leverage adjustment be disallowed.

However, it is important to recognize that the Commission did not approve the requested leverage adjustment in the *PPL 2012 RC Order* because the Commission approved a cost of common equity at the higher-end of the ranges proposed by the parties. *See PPL 2012 RC Order*, p. 82 (noting range of reasonableness from 9.0% to 11.25% and adopting a 10.28% cost of common equity). The Commission went on to explain:

> …in the context of our determination, *supra*, of a reasonable return on equity for PPL of 10.28%, we conclude that there is no need to have an artificial upwards adjustment to compensate for any perceived risk related to PPL's market-to-book ratio.

PPL 2012 RC Order, p. 91. Clearly, the Commission elected not to approve the leverage adjustment because the approved cost of common equity adequately recognized the risks associated with investment.

b. Risk Premium.

UGI Electric witness Mr. Moul also performed a risk premium analysis to determine the cost of common equity. The risk premium analysis is based upon the fundamental principle that an equity investor in a given company has a greater risk than a bond holder in the same company because interest on bonds are paid before any return is received by the equity investor, and the bond holder receives a return of its capital before an equity investor receives any return of capital in the event of bankruptcy or the dissolution of the subject company.

Furthermore, the risk premium analysis has common sense appeal to investors, who expect to earn equity return in excess of bond returns as compensation for the increased risk associated with equity investments. UGI Electric St. No. 5-R, p. 32. Accordingly, the risk premium method determines the cost of equity by summing the expected public utility bond yield and the return of equities over bond returns (*i.e.* the "equity premium") over an historic period, as adjusted to reflect lower risk of utilities compared to the common equity of all corporations. UGI Electric St. 5, pp. 31-33.

Mr. Moul determined the risk premium cost of common equity to be 11.25% as follows:

Interest Rate	Risk Premium		Cost Rate
4.75%	6.50%	=	11.25%

The interest rate used in Mr. Moul's calculation is an estimated interest rate for A-rated public utility bonds. UGI Electric St. No. 5, pp. 31-32. Mr. Moul specifically notes that longer-term forecasts strongly suggest that interest rates will increase from the levels revealed in near-term forecasts, which supports his use of a prospective yield above the historical and near team yields for A-rated public utility bonds. UGI Electric St. No. 5, p. 32.

The risk premium used by Mr. Moul is the average of historical risk premiums over long-term corporate bonds. UGI Electric St. No. 5, pp. 32-33. Importantly, Mr. Moul highlighted the fact that the equity risk premium bears an inverse relationship to the interest rates of long-term corporate bonds (*i.e.* when long term interest rates are low, the equity risk premium is high and vice versa). As the current investing climate involves interest rates that are increasing significantly from historic lows in the aftermath of the recession, Mr. Moul utilized a 6.50% equity risk premium, which is between the average risk premiums associated with low interest rates and average interest rates. UGI Electric St. No. 5, p. 33.

c. CAPM.

UGI Electric witness Mr. Moul also performed a capital asset pricing model ("CAPM") analysis to estimate the cost of common equity for the Electric Group. The CAPM analysis is similar in concept to the risk premium analysis in that it determines a "risk-free" interest rate based on U.S. Treasury obligations and an equity risk premium that is proportional to the systematic (*i.e.* "beta value") risk of a stock, which are summed to produce the cost rate of equity. UGI Electric St. No. 5, pp. 34-38.

Mr. Moul determined the risk free rate to be 3.75% based on current and forecasted Treasury notes and bonds yields. UGI Electric St. No. 5, pp. 35-36. In his analysis, Mr. Moul highlighted the importance of the longer-term forecasts of Treasury notes and bonds yields, which reflect the FOMC's clear decision to address historically low interest rates in the wake of the Great Recession. UGI Electric St. No. 5, pp. 35-36. Specifically, Mr. Moul explained:

> At its December 16, 2015 meeting, the FOMC increased the federal funds rate range by 0.25 percentage points. On December 14, 2016, the FOMC acted again by raising the Fed Funds rate by one-quarter percentage point. The FOMC also used this occasion to express a more aggressive approach to future increases in interest rates. In addition, the Fed has indicated that it will reduce the size of its balance sheet. FOMC has increased the fed funds rate on three occasions in 2017 (i.e., March 15, 2017, June 14, 2017 and December 13, 2017) by one-quarter percentage point each. The Wall Street Journal has also reported that three one-quarter percentage point rate increases are anticipated for 2018 and two one-quarter percentage point rate increases will likely follow in each of the years 2019 and 2020. This buttresses the prospect that higher interest rates are on the horizon.
>
> As shown on page 2 of Schedule 13, forecasts published by Blue Chip on November 1, 2017 indicate that the yields on long-term Treasury bonds are expected to be in the range of 3.0% to 3.6% during the next six quarters. The longer-term forecasts described previously show that the yields on 30-year Treasury bonds will average 4.3% from 2019 through 2023 and 4.5% from 2024 to 2028.

UGI Electric St. No. 5, p. 36.

For the risk/market premium component of the CAPM analysis, Mr. Moul calculated an 8.03% premium based upon the average historical data and forecasted returns. UGI Electric St. No. 5, p. 37. Mr. Moul further gave additional weight to the more recent historical data, to recognize the fact that interest rates are forecasted to trend upwards in the future. The forecasted returns are based upon the 11.87% DCF return for the S&P 500. UGI Electric St. No. 5, p. 37.

Finally, Mr. Moul included a 1.02% size adjustment to his CAPM analysis to recognize the Company's smaller size and resultant increased risk profile. This adjustment is based upon generally accepted and widely recognized literature that states smaller firms have higher capital costs than larger firms. UGI Electric St. No. 5, p. 37.

The results of Mr. Moul's CAPM analysis are 11.03% for the Electric Group.

d. Comparable Earnings.

UGI Electric witness Moul also performed a comparable earnings analysis based on the principle set forth by the United States Supreme Court that a utility should be afforded an opportunity to earn a return on its property equal to that being earned on investments in other businesses with corresponding risks and uncertainties. *Bluefield Water Works v. Public Service Commission*, 262 U.S. 668 (1982). The analysis identifies non-regulated companies with comparable risk and produces a cost rate of 12.55%. UGI Electric St. 5, pp. 38-41.

e. UGI's Evidence Of The Current Financial Climate And Its Effects On Attracting Common Equity Capital Investments.

The current financial climate, as demonstrated by rising interest rates on risk-free investments (*i.e.* U.S. Treasury notes and bonds) and investors' expectations in the wake of the TCJA, further demonstrate that the Commission should adopt the Company's proposed cost of common equity of 11.25%. The basic effect of these fundamental changes in the financial marketplace is to increase the risk associated with common equity investments and the increase in the return on common equity necessary to attract capital investments under these circumstances.

As noted above, Mr. Moul emphasized the importance of the FOMC's current and expected policy of increasing interest rates from the historical lows in the wake of the Great Recession. It is undisputed that in order to attract common equity capital investments, an investor must be offered a sufficient premium over a risk free investment. Moreover, neither I&E nor OCA dispute Mr. Moul's testimony that economists and forecasters expect long-term interest rates to increase. *See* I&E St. No. 2, p. 26 (noting the yield on the 10-year Treasury Bond is expected to range between 2.90%-3.20% from Q3 2018 to Q2 2019, and is forecasted to increase to 3.60% from 2019-2023); OCA St. No. 3, p. 16 (citing March 21, 2018 Federal Reserve press release stating that "economic conditions will…warrant further gradual increases in the federal funds rate."). As the interest rate on risk-free investments increases, so too must the return on common equity in order to attract sufficient capital investments of this class.

Furthermore, Mr. Moul explained that the TCJA significantly impacts the Company's risk profile. In particular, the TCJA will significantly decrease the Company's pre-tax interest coverage, thereby reducing its credit quality, and will significantly increase the amount of investor-supplied capital to fund infrastructure programs, thereby further reducing the Company's credit quality. UGI Electric St. No. 5-SD, pp. 3-4.[19] As the Company's risk profile increases in the wake of the TCJA, so too must the return on common equity in order to attract sufficient capital investments of this class.

In addition, Mr. Moul explained that the volatility rating of common stock investments as measured by the Volatility Index ("VIX") markedly increased from an average of 11.09 in 2017 to an average of 17.52 in 2018. Specifically, the average VIX for the period February 1 to May 3, 2018, was 19.65. UGI Electric St. No. 5-R, pp. 6-7. As the current level of volatility risk associated with common stocks is markedly higher than in prior periods, so too must the return

[19] As explained by Mr. Moul, another consequence of the TCJA is the elimination of deferred income taxes. UGI Electric St. No. 5-SD, p. 4. While deferred income taxes are a deduction from rate base, these amounts provide an essential capital source for public utilities to fund infrastructure projects, which need not be raised from investors. *Id.* The significant reductions and/or eliminations of this capital source will negatively impact the credit quality of public utilities, which in turn increases the risk associated with common equity investments and the return investors will expect in making common equity investments.

on common equity be higher than in prior periods to attract sufficient capital investments of this class.

Mr. Moul explained that adopting the position of either I&E or the OCA would signal to the investment community that financial strength of Pennsylvania public utilities may be faltering. He explained:

> The investment community would be very concerned if the Commission were to adopt either of the positions of the I&E or OCA. If it were to do so, investors would see Pennsylvania regulation as less supportive of the Company at a time of high levels of capital investment, rising interest rates, and the cash-flow consequences of TCJA. At present, Pennsylvania regulation is currently ranked Above Average/3 by Regulatory Research Associates ("RRA"), which reflects an upgrade that occurred on May 10, 2017. The rating system used by RRA includes three principal categories (i.e., Above Average, Average and Below Average with more refined positions within the categories designated by the numbers 1, 2 and 3). If the Commission were to follow the proposals of I&E or the OCA, the regulatory ranking of Pennsylvania would certainly be jeopardized. <u>The return on equity used by the Commission to set rates embodies in a single numerical value a clear signal of regulatory support for the financial strength of the utilities that it regulates.</u> Although cost allocations, rate design issues, and regulatory policies relative to the cost of service are important considerations, the opportunity to achieve a reasonable return on equity represents a direct signal to the investment community of regulatory support (or lack thereof) for the utility's financial strength. <u>In a single figure, the return on equity utilized to set rates provides a common and widely understood benchmark that can be compared from one company to another and is the basis by which returns on all financial assets (stocks – both utility and non-regulated, bonds, money market instruments, and so forth) can be measured. So, while varying degrees of sophistication are required to interpret the meaning of specific Commission policies on technical matters, the return on equity figure is universally understood and communicates to investors the types of returns that they can reasonably expect from an investment in utilities operating in Pennsylvania.</u>

UGI Electric St. No. 5-R, pp. 4-5 (emphasis added).

Moreover, Mr. Moul explained that the proposals of I&E and the OCA completely ignored the returns that investors can expect to earn on investments of comparable risk, *e.g.*, other electric utilities. He explained:

> According to RRA, the average authorized equity return for electric utilities was 9.75% in the first quarter of 2018, as compared to the average authorized equity return of 9.74% for all of 2017. Moreover, for DSIC purposes the Commission has set a 9.55% equity return for electric utilities. In addition, the projected return on equity for the Electric Group is 11.00% according to Mr. Rothschild, which represents a benchmark for the types of returns that investors expect for electric utilities.
>
> The rates of return on common equity of 8.50% proposed by Mr. Rothschild and 8.62% proposed by Mr. Spadaccio are seriously deficient and will not provide UGI Electric with the opportunity to earn its investor required cost of capital for the fully projected future test year. As explained below, this is not the time for the Commission to be reducing the Company's authorized return when there is a compelling need for capital investment to rehabilitate aging infrastructures.

UGI Electric St. No. 5, pp. 5-6. By failing to recognize the average equity returns authorized by electric utilities across the country, I&E and OCA's analyses are fundamentally flawed and represent poor public policy. Indeed, without supportive regulation from this Commission, investors will be left to assume that "Pennsylvania is pulling away from its prior support for accelerated infrastructure replacement," and public utilities will be unable to attract sufficient capital to support such accelerated infrastructure replacement. UGI Electric St. No. 5-R, p. 8.

f. The Cost of Equity Should Include An Increment For Management Performance.

UGI Electric has demonstrated strong performance in the area of management effectiveness, which should be recognized by the Commission through a 20 basis point addition to the cost of common equity. *See* Section VII.E *infra*. Furthermore, I&E's and OCA's attempts to dispute the Company's proposed addition recognizing its management effectiveness are without merit, unprecedented and should be rejected. *See* Section VII.D.2. *infra*. Therefore, the cost of common equity proposed in this proceeding should include UGI Electric's proposed 20 basis point addition, in recognition of its outstanding management performance.

g. Summary Of UGI Electric's Cost Of Equity Presentation.

UGI Electric witness Mr. Moul has demonstrated that the cost of equity for the Electric Group is between 10.15% and 12.55%. UGI Electric St. No. 5, p. 41. Based upon the Company's risk profile, the general condition of the capital markets, the Company's strong management performance, rising interest rates and cost of capital and the negative impacts of the TCJA, Mr. Moul recommended that the Commission adopt an 11.25% cost of common equity. *See* UGI Electric St. No. 5, pp. 41-42; *see also* UGI Electric St. No. 5-SD, p. 7.

2. The Opposing Parties' Unprecedented And Unreasonable Common Equity Recommendations Must Be Rejected.

I&E and OCA both advance cost of common equity recommendations (8.62% and 8.50% respectively) that ignore the basic characteristics of the financial climate in which UGI Electric operates. I&E St. No. 2, pp. 21-23; OCA St. No. 3, p. 3. These recommendations ignore clear evidence of rising interest rates, the negative consequences of the TCJA on the credit quality and ability of utilities to attract equity capital, and the Commission's well-recognized policy of supporting capital investments to replace aging infrastructure. They also attempt to ignore, without disputing, UGI Electric's implementation of programs that significantly benefit its ratepayers and evidence strong management performance.

These recommendations are also unprecedented, even in the context of fully-litigated rate cases before this Commission. In the most recent recent fully-litigated rate cases, the Commission has approved cost of common equity amounts of 10.4% and 11.0%. *See PPL 2012 RC*, p. 101 (adopting 10.4% cost of common equity); *see also Aqua 2008*, pp. 53-54 (adopting

11.0% cost of common equity). Moreover the Commission has not awarded a single digit return for a major public utility since the adoption of original cost ratemaking, and has not awarded a cost of common equity below 9.0% since at least 2004.

a. I&E's Return On Common Equity Recommendation Is Flawed And Should Be Rejected.

I&E witness Spadaccio uses a DCF model to derive his recommended cost of common equity of 8.62%. I&E St. No. 2, pp. 21-23. Mr. Spadaccio then employs a CAPM analysis, which yielded a result of 8.98%. I&E St. No. 2, pp. 24-28.

The fundamental flaw in Mr. Spadaccio's cost of common equity analysis is that he has performed a flawed DCF analysis. Mr. Spadaccio then compounded this error by not performing any analysis that can be considered a reasonable check on the reliability of his DCF results. To this point, Mr. Spadaccio stated that "the CAPM's relevance to the investment decision making process does not carry over into the regulatory rate setting process" (I&E St. No. 2, p. 19) and that "it is inappropriate to give the CAPM and RP models similar weight to the DCF…" I&E St. No. 2, p. 29.

The numerous flaws in Mr. Spadaccio's calculation of the DCF cost rate were explained in detail in Mr. Moul's Rebuttal Testimony. *See* UGI Electric St. No. 5-R, pp. 12-25. The principal errors in Mr. Spadaccio's analysis are that he arbitrarily includes low growth rates for several companies that should have been excluded from his Electric Group and that he fails to employ a leverage adjustment in his DCF analysis. *Id.*

Mr. Spadaccio's failure to exclude companies with arbitrarily low growth rates from his Electric Group renders his analysis unreliable. Mr. Moul explained that a fundamental tenet of finance is that the cost of equity must be higher than the cost of debt by a meaningful margin to compensate for the higher risk associated with a common equity investment. UGI Electric St.

No. 5-R, p. 14. Yet, Mr. Spadaccio included the growth rates of five companies in his DCF analysis that do not satisfy this fundamental requirement. *See id.* (table summarizing DCF results). As the spread between the cost of debt and cost of common equity in this market environment was demonstrated to be 6.50%, the returns of these five companies are unreasonable and should have been excluded from Mr. Spadaccio's barometer group. *Id.*, pp. 14-15 (citing UGI Electric St. No. 5, p. 38). If Mr. Spadaccio had properly excluded these companies from his analysis, his group average growth rate would have been 5.73%, thereby producing a 9.47% DCF return. UGI Electric St. No. 5-R, p. 17.

UGI Electric has previously addressed the propriety of the leverage adjustment in the DCF analysis proposed by Mr. Moul. *See* Section VII.D.1.a.iii. *supra*; *see also* UGI Electric St. No. 5-R, pp. 20-22. Mr. Spadaccio's failure to include the leverage adjustment is also a significant error in his DCF analysis.

While Mr. Spadaccio attempts to use a CAPM analysis as a check on his flawed DCF result, his CAPM analysis is also unreliable. As explained by UGI Electric witness Mr. Moul, Mr. Spadaccio's CAPM analysis understates the cost of equity by: (i) his use of the yield on 10-year Treasury notes in lieu of longer-term Treasury bonds; (ii) his use of historical geometric means to calculate total market return; (iii) his use of out of date measures of the total market return; (iv) his failure to use leveraged adjusted betas; and (v) his failure to make a size adjustment. *See* UGI Electric St. No. 5-R, pp. 25-30.

Significant among these errors, Mr. Spadaccio's use of the yield on 10-year U.S. Treasury notes, which are shorter-term and more susceptible to policy initiatives, instead of 30-year Treasury notes results in a systematic understatement of returns in the CAPM analysis. *Id.*, pp. 25-26. Mr. Spadaccio further compounds this understatement by giving the same weight to the yield on 10-year Treasury notes for the third quarter of 2018 as he does for the entire five-year period 2019 through 2023. *Id.*, p. 26. By understating the risk-free rate of return, Mr. Spadaccio's CAPM analysis does not appear to operate as an independent check on his DCF analysis. Rather, it appears to be designed to minimize current and forecasted increases in the risk-free rate of return to confirm the flawed results of an improper DCF analysis.

For the reasons explained above, Mr. Spadaccio's DCF is flawed and his CAPM analysis does not act as a reliable check on the reasonableness of the DCF result. Moreover, Mr. Spadaccio recommends an ROE allowance well below the average ROE's approved by other state regulatory commission's around the country in 2017 (9.74%) and the first quarter of 2018 (9.75%). UGI Electric St. No. 5, pp. 5-6. Therefore, as well as the other evidence of the flaws in Mr. Spadaccio's DCF analysis, require rejection of his recommendation as to the cost of common equity.

b. OCA's Recommended Cost of Equity Is Flawed And Should Be Rejected.

The many errors and flaws in Mr. Rothschild's testimony and exhibits are detailed below. As an initial matter, OCA witness Mr. Rothschild's cost of common equity data demonstrates that his own proposed return is flawed and that the return for the Electric Group is, in fact, 11.0%. UGI Electric St. No. 5-R, pp. 18-19. This fact alone render's Mr. Rothschild's analysis untrustworthy; it is simply not credible to conclude that 8.50% return is reasonable, as Mr. Rothschild does, when the data that forms the foundation for this recommendation demonstrates that other utilities are earning an 11.0% return.

OCA witness Mr. Rothschild also primarily relies on both a constant growth and non-constant growth DCF analysis in arriving at his recommended cost of common equity. OCA St. No. 3, p. 25. He also employs a CAPM analysis as a check on his DCF results. *Id.*, p. 3. He arrives at a cost of equity range between 7.10% and 8.31% for the Electric Group under his constant growth and non-constant growth models, and a cost of equity of only 7.08% under his CAPM analysis. Mr. Rothschild ultimately recommends a cost of equity of 8.50%, which is above the results of all of his analyses. *Id.* This, by itself, demonstrates the flaw in Mr Rothschild's analysis, as he is left only with a subjective judgement as to how much to increase his recommendation above his own results.

The principal errors in Mr. Rothschild's DCF analysis are that: (1) he understates the DCF growth rate; and (2) he declines to include the leverage adjustment.

Regarding Mr. Rothschild's proposed growth rate, UGI Electric witness Mr. Moul explained that Mr. Rothschild use a special form of the constant growth DCF model, *i.e.* the retention growth method, to adjust his assumed return on book common equity by the difference between the dividend yield on book value and the dividend yield on market value. UGI Electric St. No. 5-R, pp. 18-20. Mr. Moul explained that Mr. Rothschild's use of the retention growth method is anchored in his erroneous contention that when stock prices are considerably higher than their book value, then a company is earning a return in excess of the cost of equity. Not only does Mr. Rothschild's contention contravene the Commission's prior decisions that it does not make ROE determinations to produce any particular market-to-book ratios,[20] it ignores the fact that nearly all stocks prices have exceeded book value for an extended period of time. If Mr. Rothschild's premise were correct, then stock prices would gravitate toward book value. Mr. Moul explained that the basic history of the market for electric utility stocks over a lengthy period of time demonstrates this contention is not valid. UGI Electric St. No. 5-R, pp. 15-16.

[20] *Pa. P.U.C. v. Blue Mountain Consolidated Water Company*, Docket No. R-78100686, 55 Pa. PUC 502, 1982 Pa. PUC LEXIS 160 *2, *11, (Order entered January 14, 1982); *Pa. P.U.C. v. The York Water Co.*, Docket No. R-850268 *et al.*, 62 Pa. PUC 459 1986 Pa. PUC LEXIS 26, *103, n. 24, (Order entered November 25, 1986).

Indeed, as adjusted by Mr. Moul, Mr. Rothschild's DCF analysis demonstrated that the investor expected return on common equity for the Electric Group is actually 11.0%. UGI Electric St. No. 5-R, p. 19. If 11.0% is an appropriate projected return on common equity, which matches investor expectations for the barometer group, Mr. Rothschild's attempt to artificially reduce this return by trying to force stock prices down to book value should be rejected.

Mr. Moul further highlighted that Mr. Rothschild's non-constant growth DCF result cannot be given serious consideration because it is between 211 and 264 basis points *below the average* of authorized returns for electric utilities in 2017 and the first quarter of 2018. UGI Electric St. No. 5-R, p. 20. If one were to correct Mr. Rothschild's flaws in the non-constant growth DCF analysis, the two stage result would instead be 9.23%, which, while inadequate, is far more reasonable than his 7.63% number. *Id.*

The second error in Mr. Rothschild's analysis is his failure to employ a leverage adjustment. *See* Section VII.D.1.a.iii. *supra*; *see also* UGI Electric St. No. 5-R, pp. 20-22. As explained by Mr. Rothschild's critiques are primarily based on his contention that the market value capital structure and book value capital structure of a company are two completely different ways of measuring the same thing.

Mr. Moul's common sense summary of this error bears repeating. He explained:

> Mr. Rothschild's analogy to the measurement of weight on two scales is no analogy at all. Unlike weight, there is only one scale for measuring financial risk and that is the proportion of leverage in a firm's capital structure. A firm's financial risk changes when the quantities of debt and equity capital, on which the proportion is based, are changed…A measurement of financial risk that is based on a market-value capitalization cannot be applied directly to book-value capitalization if there is a material difference attributed to a change in financial risk between the two. <u>Unlike weight, where the relationship between the scales of measurement are fixed (i.e., one-pound equals 0.45359 kilograms), the financial risk associated with a market-value capitalization can be higher or</u>

> lower than the financial risk associated with a book-value capitalization, depending on the quantities, stated in dollars, of debt and equity measured and their relative proportion to the total capitalization. Financial risk is measured as a percent of fixed-cost (i.e., senior) capital. That is to say, the quantities that are used to measure financial risk account for the different quantities of debt and equity that result from market and book valuations of capital.
>
> According to Mr. Rothschild's analogy one loses weight by merely changing the calibration of the scale from pounds to kilograms. Mr. Rothschild's position that a cost of equity derived from market-value capitalizations may be applied to a book-value capitalization is just like saying one kilogram is the same as one pound. This is, of course, incorrect, just as it is indisputable that there is more financial risk associated with a 45.44% common equity ratio than there is with a 56.99% common equity ratio. The company's risk-adjusted return associated with a higher market-value capitalization is different than and generally lower than its risk-adjusted return associated with a book-value capitalization. Therefore, in order to apply a measurement of a return measured based on a firm's market-value capitalization to a book-value capitalization, the return measurement must be adjusted before it is applied to the firm's capitalization measured based on book value.

UGI Electric St. No. 5-R, pp. 24-25. It is clear that Mr. Rothschild's critique of the leverage adjustment is based on a fundamentally flawed assumption and, therefore, cannot be given serious consideration.

Mr. Rothschild employs a CAPM analysis to support his DCF result. Curiously, the CAPM result of 7.08% produces a result well below his constant growth rate DCF result. *See* OCA St. No. 3, p. 3. Mr. Moul explained the variety of problems with Mr. Rothschild's CAPM analysis in his Rebuttal Testimony. UGI Electric St. No. 5-R, pp. 31-32. Chief among these, Mr. Rothschild uses "phantom betas," which are not based upon betas available to or used by investors, that invalidate his CAPM. *Id.* As such, Mr. Rothschild's CAPM analysis is no check at all of his already unreliable and unreasonable DCF analysis.

For the reasons explained above, OCA's proposed cost of common equity is unsupported and unreasonable and, therefore, should be rejected.

E. MANAGEMENT PERFORMANCE

UGI Electric has demonstrated strong performance in the area of management effectiveness, which should be recognized by the Commission through a 20 basis point addition to the cost of common equity. *See* Section VII.D.1.f.i. *supra*. Furthermore, I&E's and OCA's attempts to dispute the Company's proposed addition recognizing its management effectiveness are without merit, unprecedented and should be rejected. *See* Section VII.D.1.f.ii. *supra*.

Under the Public Utility Code, the Commission is required to consider management effectiveness in setting rates. Section 523 states:

> The commission <u>shall consider</u>, in addition to all other relevant evidence of record, <u>the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title</u>. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.

66 Pa. C.S. § 523(a) (emphasis added). In addition, the Commission has, where appropriate, included an incremental upward adjustment to the cost of common equity to reflect management effectiveness. *See, e.g.*, *PPL 2012 RC Order*, pp. 98-99; *Aqua 2008*, at *63; *Pa. P.U.C. v. West Penn Power Co.*, Docket Nos. R-00942986, *et al.*, 1994 Pa. PUC LEXIS 144, *147 (Order dated Dec. 29, 1994). In the *PPL 2012 RC Order*, the Commission specifically recognized PPL's operating initiatives, customer contact center, and energy efficiency programs as laudable and warranting consideration as a factor in its common equity analysis. *PPL 2012 RC Order*, p. 98.

In this proceeding, UGI Electric has presented extensive evidence as to its management effectiveness. On the basis of this evidence, UGI Electric's rate of return witness recommended a 20 basis point addition to the cost of common equity for management effectiveness. UGI

Electric St. No. 5, p. 1. I&E and OCA oppose any allowance for management effectiveness. As explained below, these arguments are meritless, unprecedented and, therefore, should be rejected.

1. Evidence Of UGI Electric's Management Effectiveness.

UGI Electric has presented extensive evidence as to its management effectiveness, summarized below.

UGI Electric has focused on a number of areas and programs to enhance and improve the quality and effectiveness of the service it provides to its customers. As detailed in the Direct Testimony of UGI Electric witness Paul J. Szykman and the Statement of reasons, the Company has taken substantial efforts to improve the quality and effectiveness of its management performance, including, but not limited to: (1) a Commission-approved Long Term Infrastructure Improvement Plan to accelerate the replacement and repair of aged and aging infrastructure; (2) high standards for electric reliability that rank UGI electric first in Customer Average Interruption Duration Index ("CAIDI"), third in System Average Interruption Frequency Index ("SAIFI") and second in System Average Interruption Duration Index ("SAIDI") among all Pennsylvania electric distribution companies; (3) a voluntary EE&C Plan designed to educate and encourage the efficient use of electricity and smart appliance purchase decisions by UGI Electric customers; (4) a new, state of the art CIS to provide customers with greater levels of service quality, information availability and around the clock accessibility; (5) improvements to aged and outdated financial systems to provide improved system capability related to capital activity tracking and recording, as well as financial system support; (6) top-tier customer satisfaction; (7) implementation of the UGI-1 initiative to drive additional efficiencies and effectiveness across the organization, including the implementation of new state-of-the-art CIS,, work management and other supportive systems; and (8) expansive customer assistance and support under its Universal Service offerings. UGI Electric Book I, Statement of Reasons; *see also* UGI Electric St. No. 1, pp. 12-17. UGI Electric also plays an essential role in the communities it serves, supporting education programs and a number of community initiatives. UGI Electric St. No. 1, p. 18. Importantly, UGI Electric has implemented these projects and programs while maintaining some of the lowest rates in Pennsylvania. *Id*.

While UGI Electric is not required to submit an EE&C Plan or LTIIP for Commission approval, it has elected to do so in order to address the needs of its customers. *See* UGI Electric St. No. 1-R, p. 15. These <u>voluntary</u> programs by the Company reflect management's support and commitment to the Company and its customers; management oversight and execution of these voluntary programs are required for successful execution. *Id.*

In addition, the UGI-1 and related UNITE technology improvement represent substantial distribution system optimization initiatives employed by UGI Electric to drive efficiencies that benefit its customers. In particular, the UNITE technology improvement project standardizes and adopts common industry-leading electric and gas modern processes; automating certain manual, time consuming processes; and retiring legacy mainframe equipment. It also includes a replacement of UGI Electric's CIS to improve its customers' experience interfacing with UGI Electric. UGI Electric St. No. 1, pp. 18-21. UGI Electric's ability to be more efficient and effective under the UNITE program provides significant customer and operational benefits. UGI Electric St. No. 1, pp. 21-23.

UGI has also developed and implemented numerous safety improvement initiatives designed to reduce or prevent injuries and motor vehicle accidents. These initiatives include pursuing Occupational Safety and Health Administration verification of a Voluntary Protection Program, a First Move Forward policy, a 360-degree "cone" policy, a "Making a Difference" safety program, use of dash-cams to record and review incidents or close-calls, Smith Driving School training, an annual Safety Summit involving all employees, establishing safety committees for accident analysis and review, and Company-wide education and appropriate employee coaching and engagement tracks. UGI Electric St. No. 1, pp. 15-16; *see also* UGI Electric St. No. 3, pp. 7-11.

Finally, UGI Electric is also consistently recognized for high customer satisfaction. UGI has finished in first or second place in the J.D. Power award for customer satisfaction among utilities in each of the last 5 years, and has won the award a total of 7 times (2003-2007, 2013, 2014) since UGI was first included in the survey in 2003 by J.D. Power. UGI Electric's customers receive the same call center customer service experience as the other regulated UGI affiliates. UGI Electric St. No. 1, p. 15.

The foregoing clearly demonstrates UGI Electric's efforts to improve its operations in ways that strengthen reliability, enhance customer satisfaction, respond to customer needs, and reinforce public and employee safety, beyond what it is required to do under the Public Utility Code. Importantly, UGI Electric's voluntary operating initiatives, programs focusing on enhancing customer satisfaction, and workforce safety and training initiatives are extremely similar to the types of utility programs and initiatives that the Commission has previously deemed laudable and deserving recognition through an addition to the cost of common equity. *See PPL 2012 RC Order*, p. 98 (recognizing PPL's operating initiatives, customer contact center, and energy efficiency programs justified a twelve basis point recognition for management performance). For these reasons, the cost of common equity should include an increment for management performance.

2. I&E's And OCA's Arguments Against Any Allowance for Management Effectiveness Should Be Rejected.

I&E and OCA oppose any allowance for management effectiveness. As explained below, their arguments are without merit, unprecedented and, therefore, should be rejected.

I&E clearly recognize, and does not dispute, that UGI Electric has engaged in many voluntary programs and initiatives that benefit its customers. *See* I&E St. No. 2, pp. 47-48. However, I&E argues that UGI Electric should not be recognized for implementing these programs, because they are either funded by ratepayers, required under 66 Pa. C.S. § 1501, or are required for purposes of a DSIC mechanism. *Id.*, p. 48. I&E witness Mr. Spadaccio boldly claims:

> Ultimately, for any company, true management effectiveness is earning a higher return through its efficient use of resources and cost cutting measures. The greater net income resulting from cost savings and true efficiency in management and operations is available to be passed on to shareholders. <u>I do not feel that UGI electric, or any utility should be gifted additional basis points for doing what they are required to do to provide adequate, efficient, safe, and reasonable service under 66 Pa. C.S.A. § 1501.</u>

I&E St. No. 2, p. 49 (emphasis added).

Relatedly, OCA argues that charging customers an additional return for management performance is inconsistent with the United States Supreme Court's decision in the *Hope* and *Bluefield* cases. OCA St. No. 3, p. 45. OCA witness Rothschild further suggests that Mr. Moul presented no analysis of how UGI Electric's superior performance translated to 20 basis points, and that UGI Electric did not evaluate whether it is superior to or more efficient than other companies in the Electric Group. *Id.*

I&E's and OCA's arguments simply miss the mark for several reasons. First, under Section 523 of the Public Utility Code, the Commission may reward utilities through rates, particularly by way of rate of return premiums, for their performance. Section 523 states in relevant part:

> (a) Considerations. -- The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. <u>On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate</u>. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.
>
> (b) Fixed utilities. -- As part of its duties pursuant to subsection (a), the commission shall set forth criteria by which it will evaluate future fixed utility performance and in assessing the performance of a fixed utility pursuant to subsection (a), the commission shall consider specifically the following:
>
>> (1) Management effectiveness and operating efficiency as measured by an audit pursuant to section 516 (relating to audits of certain utilities) to the extent that the audit or portions of the audit have been properly introduced by a party into the record of the proceeding in accordance with applicable rules of evidence and procedure.
>>
>> * * *
>>
>> (4) Action or failure to act to encourage development of cost-effective energy supply alternatives such as conservation or load management, cogeneration or small power production for electric and gas utilities.
>>
>> * * *
>>
>> (7) Any other relevant and material evidence of efficiency, effectiveness and adequacy of service.

66 Pa. C.S. § 523 (emphasis added). Nothing in Section 523 requires a finding that a utility must outperform all other utilities in the Commonwealth or that the utility’s programs not be funded

by ratepayers before it is eligible for an increment to the rate of return for management effectiveness.

Indeed, the issue is not whether UGI Electric's practices, processes, or programs are superior to other electric utilities, or whether the programs and initiatives are funded by ratepayers. Rather, the principal issue is the broad scope of UGI Electric's efforts to improve its operations in ways that strengthen reliability, enhance customer satisfaction, respond to customer needs, and reinforce public and employee safety. It involves a commitment to customer services, effective leadership, operational excellence, and a culture of continuous improvement.

Nonetheless, I&E and OCA simply attempt to ignore undisputed record evidence where UGI Electric enacted programs beyond what it is required to by the Public Utility Code, and where UGI Electric has, in fact, outperformed other Pennsylvania EDCs. For instance, neither I&E nor OCA disputes that UGI Electric's EE&C Program and LTIIP are voluntary; UGI Electric is not mandated to adopt either of these programs by the Public Utility Code or other statute. Rather, UGI Electric has voluntarily adopted these programs to provide better, more efficient, and more reliable service to its customers. UGI Electric St. No. 1-R, pp. 14-15. In addition, UGI Electric's internal programs and initiatives have caused it to exceed Commission benchmark levels for service reliability. In fact, UGI Electric has outperformed the vast majority of all Pennsylvania EDCs in each category used to measure system reliability. UGI Electric St. No. 1, p. 13.

Essentially, I&E and OCA both advance arguments that render Section 523 of the Public Utility Code a nullity. If any action that a public utility takes to strengthen reliability, enhance customer satisfaction, respond to customer needs, and/or reinforce public and employee safety must be voluntary, funded exclusively by the utility's shareholders, and be implemented better than similar programs by all other public utilities, then no utility would ever be granted an increment for management effectiveness under Section 523. For these reasons, the arguments advanced by I&E and OCA are contrary to the law and must be rejected.

F. CONCLUSION AS TO RATE OF RETURN

As explained above, UGI Electric is attempting to attract common equity capital investments in a financial climate marked by rising interest rates, greater stock market volatility, and the negative impacts of the TCJA on companies' credit profiles. Faced with these realities, capital investors' expect to earn increased returns on common equity that are sufficient to justify the risks attendant to equity investments. The Commission cannot and should not adopt an equity cost rate that is dramatically lower than rates previously adopted in the face of rising capital costs and the negative effects of the TCJA on utilities. Doing so would fail to recognize these increased costs and signal to investors that the Commission is pulling away from its prior support of infrastructure replacement projects and that the financial strength of Pennsylvania public utilities. To the contrary, with interest rates and capital costs having passed their trough and continuing to rise, the Commission should increase ROE allowances to continue to show capital markets that the Commission will continue to support the funding of accelerated replacement of aging infrastructure and continued provision of excellent utility service by UGI Electric. For these reason the Commission should adopt the Company's proposed cost of common equity of 11.25%.

VIII. <u>TAXES</u>

The Company's initial claim for federal income taxes was $3,291,000. UGI Electric Exhibit A – Fully Projected, Schedule D-33, Line 32. On December 22, 2017, roughly one month before the Company's January 26, 2018 rate filing, Congress enacted the TCJA. Among other things, the TJCA reduced the federal corporate income tax rate from 35% to 21% and eliminated bonus depreciation, both effective January 1, 2018. *See* 26 U.S.C. § 11(b) (establishing 21% federal corporate income tax rate); *see also id.* § 168(k)(9) (disqualifying public utility property from the definition of the term "qualified property" under Section 168).

On March 12, 2018, the Company filed Supplemental Direct Testimony specifying the impacts of the TCJA. In summary, the TCJA reduced the Company's federal income tax expense by $1,734,000 to $1,557,000 and also reduced the Company's ADIT balance by $11,213,000 to $16,572,000. The Company's Supplemental Direct Testimony also explained the substantial negative impacts of the TCJA on the cost of common equity, as explained in Section VII.D.1.e. *supra*, and its proposed upward adjustment to its claimed cost of equity from 10.95% to 11.25%. *See* UGI Electric St. No. 5-SD, p. 7. The Company's revised filing reflects all impacts of the TCJA for the FPFTY.

The Commission also has taken certain statewide action regarding the TCJA. By Secretarial Letter dated February 12, 2018, at Docket No. M-2018-2641242, the Commission directed major jurisdictional utilities to file certain data concerning the effects of TCJA. The jurisdictional public utilities that did not have pending rate cases before the Commission submitted comments and data in response to the February 12, 2018 Secretarial Letter on or before March 9, 2018. Thereafter, the Commission issued an Order dated March 15, 2018, that established temporary rates for all public utilities not currently involved in a pending Section 1308(d) general rate increase proceeding. *See Tax Cuts and Jobs Act of 2017*, Docket No. M-2018-2641242, p. 19 (Order entered March 15, 2018) ("*Temporary Rates Order*"). However, the Commission noted that public utilities and parties involved in pending Section 1308(d) general rate proceedings should address the effect of the new federal tax rate on the justness and reasonableness of the customer rates charged during the term of the suspension period established by the *Temporary Rates Order*.

The Company has fully reflected all prospective impacts of the TCJA for ratemaking purposes. Despite this fact, I&E and OCA propose two additional adjustments associated with the TCJA: (1) a reduction in rates through a surcharge to reflect the impact of the TCJA in 2018; and (2) a reduction in rate base to reflect the Excess Accumulated Deferred Income Taxes ("EADIT") resulting from the change in the federal income tax rate from a 35% to a 21%. In addition, OCA witness Morgan proposes a rate base adjustment related to Act 40, which ended the so-called consolidated tax savings adjustment in Pennsylvania. For the reasons set forth below, each of these adjustments should be rejected.

A. 2018 TAX ADJUSTMENT

As noted above, the Company's supplemental filing fully reflects all impacts of the TCJA on a prospective basis. Despite this fact, I&E and OCA propose an additional reduction in rates to reflect the 2018 impacts of the TCJA. Specifically, I&E and OCA propose a reduction in tax expense of $212,000 to be refunded to customers outside of base rates. I&E proposes that this amount be flowed back to ratepayers through a Section 1307 surcharge mechanism, similar to a mechanism proposed by PECO Electric. I&E St. No. 1, pp. 33-35. OCA proposes that this amount also be passed through to ratepayers through a mechanism similar to a surcharge. OCA St. No. 1, p. 14. As explained below, such a further reduction in rates violates long-standing rules against single issue and retroactive ratemaking, is unwarranted given that the Company's current rate of return is not excessive or unreasonable, and would be extraordinarily poor public policy.

1. The 2018 Rate Reductions Proposed By I&E And OCA Violate Long-Standing Rules Against Single Issue And Retroactive Ratemaking.

The "general rule" under Pennsylvania law is that "there may be no line by line examination" of "particular items of expense or revenue," and variations in "an isolated item of revenue or expense" may not, "without more," support "a Commission order of refund or recovery." *See Phila. Elec. Co. v. Pa. Pub. Util. Comm'n*, 502 A.2d 722, 727-728 (Pa. Cmwlth. 1985). Single-issue ratemaking occurs "when only one element of the general ratemaking equation is examined between rate cases and the customers' rates are adjusted to reflect a change in that element." *See Petition of UGI Utilities, Inc. – Elec. Div. For Approval Of Its Energy Efficiency And Conservation Plan*, Docket No. M-2010-2210316, 2011 Pa. PUC LEXIS 1690 at *28 (Recommended Decision issue July 13, 2011). As such, single issue ratemaking is generally prohibited where it impacts on a matter normally considered in a base rate case,[21] such as federal income tax expense.

Pennsylvania law also prohibits retroactive ratemaking. It is a fundamental precept of public utility law that "a commission-made rate furnishes the applicable law for the utility and its customers until a change is made by the Commission." *Cheltenham & Abington Sewerage Co. v. Pa. Pub. Util. Comm'n*, 25 A.2d 334, 337 (Pa. 1942). Furthermore, the Commission cannot give "retroactive effect" to a rate determination and "direct refunds to consumers" for charges billed pursuant to "previously approved" rates. *West Penn Power Co. v. Pa. Pub. Util. Comm'n*, 100 A.2d 110, 114 (Pa. Super. 1953).

In the seminal case of *Cheltenham v. Abington Sewerage Co. v. Pa. Pub. Util. Comm'n*, the Pennsylvania Supreme Court reversed the decisions of the Superior Court and the Commission that would have required the utility to refund amounts collected pursuant to a final

[21] *See Pa. Indus. Energy Coal. v. Pa. Pub. Util. Comm'n*, 653 A.2d 1336 (Pa. Cmwlth. 1995).

order establishing rates. Both the Superior Court and Commission based this decision on a subsequent order, which purported to find, retroactively, the rates charged were unjust and unreasonable. *Cheltenham*, 25 A.2d at 336. The Pennsylvania Supreme Court announced the following, enduring prescription:

> Rates having in other respects the attributes of commission-made rates do not lose their effect as such by an indefinite expression of opinion that some of the factors on which they are based are variable and may not stand a pragmatic test, a situation which is always implied.
>
> To sustain the position of the Superior Court would be to give a retroactive effect to the order of August 30, 1935, without notice to the utility. The mere institution of an inquiry did not constitute notice that a departure would be made from the tariff established by the commission in its quasi legislative capacity.

Id. at 337.

This principle was subsequently applied and further refined in *West Penn Power Co. v. Pa. Pub. Util. Comm'n*, where the Pennsylvania Superior Court articulated further that:

> …the Commission, having approved the rates under tariff No. 30, could not summarily reverse its order of approval and apply such reversal retroactively by ordering refunds for the period between October 29, 1951, and April 14, 1953. The order of October 26, 1951, amounted in law to formal Commission approval of the new rates filed by the Company under tariff No. 30, and rendered the rates in effect commission-made rates. <u>Consequently, after it had previously approved the rates, the Commission could not give retroactive effect to its order of February 16, 1953, and direct refunds to consumers for charges made beginning October 29, 1951.</u>

West Penn Power, 100 A.2d at 114. The court did note, however, that the Commission "is of course free to take <u>prospective action</u> on the reasonableness of the Company's rates now being charged and collected…" *Id.* (emphasis added). In short, the weight of Pennsylvania law embodied in the well-established prohibition against retroactive ratemaking bars the Commission from ordering utilities by surcharge or other methodology to provide refunds to customers based upon amounts collected pursuant to Commission-made rates. Any adjustment to the Company's rates can only be made prospectively.

The I&E and OCA 2018 adjustments clearly violate the rules against single issue and retroactive ratemaking. The proposed base rate increase in this proceeding will be effective in October 2018 for service rendered on and after October 27, 2018, and are based on data and information for a FPFTY ending September 30, 2019. This test year and the rates developed from it reflect a full year's impact of all aspects of the TCJA. The additional adjustment proposed by I&E and OCA would impermissibly reduce rates for a single issue, *i.e.* the 2018 tax impact of TCJA, without any examination of any other elements of the ratemaking formula. This adjustment also would retroactively reduce UGI Electric's rates. Current rates were set in 1996 as a result of a base rate proceeding filed at that time. Those rates can only be changed prospectively, which will occur in October 2018, at the conclusion of this base rate case. I&E and OCA improperly seek to retroactively reduce current rates through a surcharge outside of a base rate proceeding.

I&E and OCA will likely cite Commission and court precedent where single issue/retroactive ratemaking can take place for certain extraordinary and non-recurring items and events between rate cases. However, these precedents are inapplicable as their proposed adjustment fails to qualify for this exception.

First, a change in the tax law is not extraordinary. Changes in tax law occur all the time. Congress regularly amends, extends, and adds to existing tax laws and regulations. UGI Electric St. No. 5-RJ, pp. 2-3. In fact, the 2016 Annual Report to Congress published by the Taxpayer Advocate service, stated that from 2001 – 2016, there have been more than 5,900 changes to the

Internal Revenue Code which equates to more than 1 change per day. *See* 2016 Annual Report to Congress, Volume 1, Legislative Recommendation #1, p. 305.

Second, and perhaps more importantly, a change in tax rates is not a non-recurring item. The tax law changed effective January 1, 2018, and will remain permanently in effect unless and until changed by Congress. There is no "sunset" provision or other expiration of this tax cut. It is a recurring and ongoing expense reduction that clearly does not qualify for any exception to single issue/retroactive ratemaking. Notably, OCA witness Mr. Morgan agreed with this conclusion. Tr. 150:3-20. ("I would say it's an ongoing - - it's a new tax rate that is ongoing.")

The Commission has previously determined that expenses traditionally claimed in base rate proceeding are not extraordinary and non-recurring. *See Aqua 2004 Order*, at *48. In the *Aqua 2004 Order*, the Commission declined Aqua's claimed annual amortization of deferred pension costs, which was based upon a substantial decline in the value of the equity investments made by the pension plan. *Id.*, at *47. The Commission explained:

> [T]he legal standard for any such deferred claim as an exception to the prohibition against retroactive ratemaking is that it must be both 'extraordinary' and nonrecurring, not simply one or the other. AP alleges that the reduction in the value of its stock portfolio used for investment of its pension fund assets constitutes an "extraordinary" event. However, we are not convinced that the fact that such publicly traded stocks went down in value is extraordinary. As noted by the ALJ, the stock market has historically gone up and down.
>
> AP has also failed to meet the second requirement for an exemption from the retroactive ratemaking prohibition, namely, that the relevant event is nonrecurring. It is an axiom of ratemaking that pension fund costs are recurring and are a traditionally claimed expense item in any and all base rate filings made by jurisdictional utilities which provide such pension benefits. If, on the other hand, AP is actually asserting that it was the drop, or the level of the drop, in the value of the publicly traded stocks that is the nonrecurring event, then that argument is easily refutable since such stocks, and stock markets by their nature

continually rise and fall in value, and those events will continue to recur.

Aqua 2004 Order, pp. *47-48 (emphasis added).

The increase in pension expense resulting from a decline in the stock market at issue in the *Aqua 2004 Order* provides an apt analogy to the instant dispute over 2018 federal income tax expense. Like the adverse impact of the stock market on pension expense, the federal income tax law changes on a regular basis; Congress regularly amends, extends, and adds to existing tax laws and regulations. *See* UGI Electric St. No. 5-RJ, pp. 2-3. Moreover, federal income taxes, just like pension expense, are a recurring expense item that are traditionally addressed in every base rate filing made by every public utility. I&E's and OCA's suggestion that a change in federal income tax expense is extraordinary and non-recurring (and therefore an exception to the prohibitions against single-issue and retroactive ratemaking) is simply wrong and should be rejected.

The Commission reached a similar conclusion in *Pa. Pub. Util. Comm'n v. Mechanicsburg Water Co.*, when it denied a water utility's request to amortize expenses related to sludge removal. *Pa. Pub. Util. Comm'n v. Mechanicsburg Water Co.*¸80 Pa. PUC 212, 232 (Order dated July 22, 1993). Therein, the company had proposed to amortize prior expenses related to the dredging of a lagoon. *Id.* The Commission explained however that "[t]he existence of the <u>unchallenged ongoing expense</u>, however, is proof positive that the cost for removal of the sludge … is not extraordinary, non-recurring expense which should be amortized in current rates." *Id.* (emphasis added). Indeed, where an expense is <u>ongoing</u> in nature, it is inherently <u>recurring</u> and, therefore, is not subject to the extraordinary and non-recurring expense exception to the prohibition against retroactive ratemaking.

Perhaps recognizing that a change in tax law is neither extraordinary nor non-recurring, OCA witness Mr. Morgan contends that single-issue ratemaking in this instance is appropriate simply because the reduction in taxes was substantial in amount. OCA St. No. 1-S, p. 6. Of course, there is no exception to the rule against single issue/retroactive ratemaking due to the size of the change. And, even if there were, Mr. Morgan's comparison of the impact of the TCJA to extraordinary storm damage expense (Tr. 147:10-18) is unavailing. In March 2018, a major storm crossed UGI Electric's service territory resulting in approximately $309,708 in damage. UGI Electric St. No. 3-RJ, p. 10. This substantially exceeds the 2018 impact of the TCJA ($212,000). *See* I&E St. No. 1, p. 34; OCA St. No. 1, p. 14.

Further, even where an item qualifies for an exception to the rule against single issue ratemaking, the Commonwealth Court has held that the Commission must conduct some examination of whether the utility is currently earning an excessive rate of return. *See Popowsky v. Pa. Pub. Util. Comm'n*, 683 A.2d 958 (Pa. Cmwlth. 1996) ("*Equitable*"); *see also Pa. Ind. Energy Coal. v. Pa. Pub. Util. Comm'n*, 653 A.2d 1336 (Pa. Cmwlth. 1995). In *Equitable*, the Commonwealth Court reiterated the principle that when examining a change in rates, "[t]he PUC must make all findings necessary to determine whether the rates are just and reasonable." *Equitable*, 683 A.2d at 962. This includes a showing that the utility's current rate of return is excessive and unreasonable. *See id.* at 962-963 (analyzing Equitable's claim that its current rate of return was inadequate). The opposing parties have presented absolutely no evidence that UGI Electric is currently earning more than a fair rate of return in 2018. Indeed, all available evidence is to the contrary. *See* Revised UGI Electric Exhibit A – Future, Schedule A-1, Line 19 (demonstrating that UGI Electric's rate of return at present rates for the FTY, *i.e.* the year ending September 30, 2018, is 4.94%).[22]

In summary, there is simply no basis for proposed adjustment from I&E and OCA. It is plainly unlawful and would undoubtedly be reversed on appeal if it were to be adopted.

2. Adoption Of The Proposed 2018 TCJA Adjustment Would Be Extraordinarily Poor Public Policy And Is Not In The Public Interest.

In addition to being flatly illegal, the proposed adjustment would be poor public policy. As explained by UGI Electric witness Mr. Moul, the TCJA will have several highly negative effects on all utilities and UGI Electric in particular. In his Direct Testimony, Mr. Moul stated:

> There are several major financial consequences arising from the changes in the federal income tax law that will negatively impact the Company. First, a lower federal income tax rate will lower the Company's pre-tax interest coverage that will reduce credit quality and increase risk. For example, with the marginal federal corporate income tax rate change from 35% to 21%, the pre-tax interest coverage shown on page 1 of Schedule 1 declines from 5.32 times to 4.56 times. This assumes no other changes in tax provisions that may also impact the Company's financial condition and credit quality. Second, with a lower marginal federal corporate income tax rate, the Company's return variability will increase, thereby increasing its business risk. When the federal corporate income tax rate was formerly 35%, investors only needed to absorb 65% of any changes in revenues and expenses. At a 21% federal corporate income tax rate, investors will need to absorb 79% of changes in revenues and expenses. That is to say, the reduced federal income taxes will make investor returns more variable than formerly, thereby increasing the Company's risk. Third, utilities will require more investor supplied capital to fund their construction program because the level of deferred taxes will decline and because the tax code reform eliminates bonus depreciation. This will also impact another credit metric revealed by the percentage of internally generated funds to construction.

[22] Furthermore, where the Commission ordered companies not currently in a rate case to implement surcharges effective July 1, 2018, to flow back the TCJA impacts, each such order included a specific finding that the utility was currently over earning. *See, e.g., Tax Cuts and Jobs Act of 2017 – PPL Electric Utilities Corporation,* Docket No. R 2018 3000775, at p. 3 (Order entered May 17, 2018) ("Based on this review, and a comprehensive analysis of the effects of the TCJA upon Respondent's operations, the Commission finds that the Respondent's existing rates are producing a return in excess of a fair return upon the fair value of the Respondent's used and useful utility property…"). No such finding was made for UGI Electric, nor could one be.

> This percentage will decline with the new lower income tax rate. In response to these financial challenges caused by the new lower federal corporate income tax rate, there may be the need to reduce the percentage of debt in a utility's capital structure to respond to higher business risk and weaker credit quality measures.

UGI Electric St. No. 5, pp. 8-9. Mr. Moul reiterated and further detailed the effects of these impacts on UGI Electric's credit quality and ability to attract common equity capital in his Supplemental Direct Testimony. UGI Electric St. No. 5-SD, pp. 2-8.

UGI Electric's comments in the Commission's generic docket applicable to the TCJA raised similar concerns. In particular, UGI explained the potential negative cash flow consequences of the TCJA as follows:

> The negative cash flow consequences described above can be a matter of serious concern for certain public utilities with large ongoing construction programs. In recent reports, FitchRatings ("Fitch"), Moody's Investor Services ("Moody's") and Standard & Poors ("S&P") have expressed concern about the impact of the TCJA on the credit metrics of public utilities, including natural gas utilities. According to Fitch, to the extent that utilities are required to reduce rates to flow through the tax rate reduction in rates, "[a]bsent mitigating strategies on the regulatory front, this is expected to lead to weaker credit metrics and negative rating actions for those issuers that have limited headroom to absorb the leverage creep." FitchRatings, "Tax Reform Impact on the U.S. Utilities, Power & Gas Sector (Tax Reform Creates Near-Term Credit Pressure for Regulated Utilities and Holding Companies)", issued January 24, 2018, page 1. This impact is attributed to reduced funds from operations affecting cash flow used to support construction and other activity in the event a utility commission required a utility to pass back the revenue requirement associated with the tax reduction to its customers, and to the loss of bonus depreciation. *Id.* at pages 2-4. Moody's and S&P expressed similar views. Moody's Investors Services, Regulated Utilities – US, Tax reform is credit negative for sector but impact varies by company", issued January 24, 2018, pages, 1-4; S&P Global, "Ratings agencies warn tax reform could drag US utility sector credit quality", issued January 25, 2018. The three ratings services also agree that the regulatory outcome in various TCJA-based investigations such as the one initiated by the Commission in this proceeding is key to whether a public utility's credit metrics will be negatively affected by the TCJA. In evaluating potential

> regulatory outcomes, Fitch offered various tools for regulatory commissions to consider, among others, an increase in authorized equity ratio and/or return on equity, return of the EDFIT over a long-term horizon, and accelerated depreciation on certain assets.

Tax Cuts and Jobs Act of 2017, Comments of UGI Utilities, Inc., UGI Penn Natural Gas, Inc., and UGI Central Penn Gas, Inc., Docket No. M-2018-2641242 (filed March 9, 2018).

UGI Electric has already reflected a full year's impact of the TCJA in prospective rates, has demonstrated that it is not overearning its allowed rate of return in 2018, and is in the midst of a major infrastructure improvement program and needs full and reasonable access to the capital markets. Even if the 2018 TCJA adjustment proposed by I&E and the OCA were lawful, and it is not, the Commission should exercise its discretion and reject this adjustment on policy grounds.

B. EXCESS ACCUMULATED DEFERRED INCOME TAXES

The Company's revenue requirement in this proceeding includes the amortization of a regulatory liability for EADIT, which represent the change in the Company's ADIT balance resulting from the TCJA's change in the corporate income tax rate from 35% to 21%. UGI Electric St. No. 9-SD, pp. 2-3. I&E and OCA support the Company's proposed amortization, but contend that the unamortized balance should be deducted from rate base. *See* I&E St. No. 1, pp. 37-39; *see also* OCA St. No. 1, p. 11. As explained below, the proposed rate base adjustment is unprecedented, factually wrong, patently inconsistent and not in the public interest. Before turning to the merits, a brief discussion of deferred taxes and regulatory assets/liabilities is provided.

1. Deferred Income Taxes.

It is well-established that income tax expense is recoverable in rates. *See, e.g., Pittsburgh v. Pa. Pub. Util. Comm'n*, 128 A.2d 372, 384 (Pa. Super. 1956); *Chambersburg Gas Company v.*

Pub. Serv. Comm'n, 176 A. 794, 805 (Pa. Super. 1934) ("In fixing rates and setting up a tariff prescribing the rates which the company should receive, it is required that allowance be made for income tax paid…"); *see also Galveston Electric Co. v. Galveston*, 258 U.S. 388 (1922)*; Georgia Ry. v. R.R. Comm.*, 262 U.S. 625 (1922). There can be a substantial difference, however, in taxes recorded on a utility's books and taxes paid to the government. The principal cause of this difference is the depreciation expense deduction. For book purposes, a utility calculates its depreciation expense deduction based on straight line book depreciation, *i.e.* the asset in question is depreciated ratably over its depreciable life. For federal income tax purposes, however, utilities, for certain qualifying investments, are permitted to use accelerated depreciation to calculate their depreciation expense deduction. This results in lower taxes paid to the government in the early years of an asset's life (when the tax deduction is higher than the book deduction) and higher taxes paid to the government in the later years of an asset's life (when the tax deduction is lower than the book deduction). The point at which tax depreciation no longer exceeds book depreciation is sometimes called the reversal point. This is shown graphically in the following table:

Example:

Asset Cost:	1,000,000
Book Life:	10 years
Tax Life:	5 years
Tax Convention:	Half Year

Year	Tax Depreciation	Book Depreciation	
1	200,000	100,000	
2	320,000	100,000	
3	192,000	100,000	
4	115,200	100,000	
5	115,200	100,000	
6	**57,600**	**100,000**	**Reversal Point**
7		100,000	
8		100,000	
9		100,000	
10		100,000	
Total Depreciation	1,000,000	1,000,000	

For ratemaking purposes, utilities calculate their tax expense per books, including the use of book depreciation. This calculation results in two categories of tax expense: (1) current tax expense, which is the tax paid to the government using accelerated depreciation, and (2) deferred tax expense, which is the difference between book tax expense and taxes paid to the government. They are called "deferred" taxes because they will be paid to the government in the future when, as explained above, tax depreciation "reverses" and is less than book depreciation. Rates include both annual current and annual deferred income taxes. In addition, the annual accumulated deferred taxes are deducted from rate base as they are viewed as an "interest free" loan from the government and non-investor supplied capital. They are treated as a "loan" because the capital provided in the early years of an asset's life when tax depreciation exceeds book depreciation is paid back in the later years of an asset's life when book depreciation exceeds tax depreciation. The net accumulated balance of deferred taxes is recorded in FERC Account 282 – ADIT and deducted from rate base.

2. Regulatory Assets And Liabilities.

Under generally accepted accounting principles, operating revenues and expenses, including taxes, are recorded on the income statement, and capital investments are recorded on the balance sheet. Under certain circumstances, utilities are allowed to defer and record on the balance sheet items of revenue and expense, which would otherwise be recorded on the income statement. One example is storm damage expense where, for major storms, utilities are permitted, through accounting authorization granted by their regulatory commission, to defer expenses from the income statement in the year they are incurred and record the expense on the balance sheet (which is normally reserved for capital items) as a "regulatory asset" reflecting an amount that may be recovered from customers in future rates. For regulatory liabilities, the opposite occurs. An item that would normally flow through the income statement as income (or a contra expense) is deferred to the balance sheet as a "regulatory liability" reflecting an amount that may be refunded to customers in future rates.

3. Excess ADIT / EADIT.

As explained above, the TCJA, *inter alia*, reduced the federal corporate income tax rate from 35% to 21%. This impacted both annual current taxes and annual deferred taxes, but also impacted ADIT. Deferred taxes are calculated using the currently applicable tax rate. The reduction in the federal corporate income tax rate from 35% to 21% substantially reduced the value of ADIT on the Company's books. For example, ADIT on a $1,000,000 book-tax depreciation difference would have been $350,000 under the old 35% federal tax rate ($1,000,000 x 35%). Now, that same ADIT item is $210,000 at the new federal tax rate of 21%

($1,000,000 x 21%). This amount is removed from the ADIT account (FERC Account 282) and recorded in Account 254 – Other Regulatory Liabilities. In accordance with accounting and IRS requirements, this "excess" ADIT is recorded as regulatory liability on the Company's balance sheet and amortized to the income statement and/or returned to customers over time using the IRS approved Average Rate Assumption Method ("ARAM"). The amortization begins at the reversal point when book depreciation exceeds tax depreciation.

All parties agree with the Company's proposed treatment of EADIT to this point. I&E and OCA, however, propose an additional adjustment to deduct the unamortized portion of EADIT from rate base. For the reasons set forth below, this further adjustment should be rejected.

a. The Proposed Adjustment Is Legally Flawed And Unprecedented.

The fundamental flaw in the I&E and OCA proposals is that they seek to treat an expense item (federal corporate income taxes) as a capital expense and provide customers a return thereon. This violates basic ratemaking principles and should be rejected. The basic ratemaking formula employed by this Commission and other regulatory commissions throughout the country provides a utility a fair opportunity to recover all reasonable operating expenses and taxes, and to earn a fair rate of return on its capital investment employed in the public service. *See* A Guide to Utility Ratemaking, James H. Cawley and Norman J. Kennard, at p. 112 (Ed. 2018). Under this formula, operating expenses, including taxes, are recovered on a dollar for dollar basis without profit, and capital expenditures are included in rates and the utility earns a return of (depreciation) and a return on these investments. No return or profit is permitted on expenses, only on capital investments. *See, e.g., Pennsylvania Power & Light Co. v. Pa. Pub. Util. Comm'n*, 311 A.2d 151, 149 (Pa. Cmwlth. 1972) ("The common sense of our holding in this case is realized when one again takes note of two basic principles: (1) a public utility only earns money on its rate base, and (2) it earns no money on its expenses."); *Pa. Pub. Util. Comm'n v. Phila. Elec. Co.*, Docket No. R-891364, 1990 Pa. PUC LEXIS 115 at *133 (Order dated May 16, 1990) ("It is an established regulatory principle that a public utility is not entitled to earn a return on its expenses…") The proposal of I&E and OCA violates this cardinal principal by deducting the unamortized balance of an operating expense (taxes) from rate base.

The fact that EADIT has been deferred to the balance sheet should not affect this analysis. The liability in question, a tax expense credit, which through amortization using the ARAM method, runs through the operating income statement to effectively reduce the annual provision for deferred income taxes below the 21% statutory rate (to the benefit of customers) is still an expense item even though it has been deferred to the balance sheet. Deferral simply affects the timing of rate recovery/refund. It does not and cannot magically transform an expense item into a capital item for ratemaking purposes.

The proposed adjustment also is unprecedented. The last change in the federal corporate income tax rate occurred in 1986. In temporary orders, the Commission required utilities to reduce rates to reflect the reduction in current and deferred taxes, but did not require a flow black/refund of EADIT. *See Re: Proceeding Upon the Commission's Own Motion With Respect to the Effect of the Tax Reform Act of 1986*, Docket No. M-86015, 1986 Pa. PUC LEXIS 4 (Order dated Dec., 19, 1986) (establishing temporary rates effective Jan. 1, 1987, but not ordering the flow back/refund of EADIT). This approach is also consistent with the Commission's ratemaking practice over the last 40 years where it has consistently denied a return on the unamortized balance of regulatory assets. *See, e.g., Butler Township*, 473 A.2d at 223 (affirming Commission order which disallowed water company's claim for "carrying charges" related to rate case, flood and freeze-up damage expenses as a part of rate base "for want of legal basis."); *Pennsylvania Electric Co. v. Pa. Pub. Util. Comm'n*, 417 A.2d 819 (Pa. Commw. 1980) (affirming the Commission's decision to disallow a return on unamortized portions of a rate case and flood expenses, and deferred energy costs, because a utility cannot capitalize an item in its rate base and at the same time recover the item as an expense); *Pa. Pub. Util. Comm'n v. Pennsylvania Electric Company*, 1978 Pa. PUC LEXIS 211, 51 Pa. PUC 649 (Order dated Feb. 24, 1978) (adopting staff proposal rejecting a utility's proposed return on the unamortized balance of certain rate case expenses).

The Commonwealth Court specifically affirmed the Commission's decision to reject a utility's request to earn a return on the unamortized balance of a regulatory asset in *Pennsylvania Electric Co. v. Pa. Pub. Util. Comm'n*, 417 A.2d 819 (Pa. Commw. 1980). In *Pennsylvania Electric Co.*, Penelec argued that the PUC erred in excluding from rate base the unamortized balances of rate case expense, flood expense, and deferred energy costs, where the company also recovered certain amounts of these deferred expenses through amortization. *Id.* at 823. The Commonwealth Court upheld the Commission's decision to disallow recovery of these items, both as an item of rate base (the unamortized balance) and as an expense (the amounts amortized on a yearly basis); it explained:

> At issue is whether the PUC must, in addition to allowing the amortized portions as expenses, include in rate base that portion of each expense that has not yet been recovered. We faced a similar question recently in UGI Corp. v. Pennsylvania Public Utility Commission, 49 Pa. Commonwealth Ct. 69, 77, 410 A.2d 923, 928 (1980), wherein we observed that a utility could not "<u>capitalize an item in its rate base and at the same time recover the item as an expense from ratepayers.</u>" In UGI the utility attempted to amortize the expense of its gas exploration program over a period of 28 years and to include in rate base a portion of that expense which represented net unsuccessful well costs. The PUC excluded the rate

> base claim and we affirmed. We find our reasoning there to be equally applicable here.

Id. (emphasis added).

The Commonwealth Court reached this decision by relying on the long-standing and repeatedly affirmed standard that a public utility may not capitalize an item in its rate base and at the same time recover the item as an expense from rate payers. *Id*; *see also UGI Corp. v. Pa. Pub. Util. Comm'n*, 410 A.2d 923, 928 (Pa. Cmwlth. 1980); *Pittsburgh v. Pa. Pub. Util. Comm'n*, 144 A.2d 648, 655 (Pa. Super. 1958); *Wall v. Pa. Pub.Util. Comm'n*, 125 A.2d 630, 635 (Pa. Super 1956) (reasoning that this standard "…is essentially a rule of logic; it prohibits a double allowance for the same item merely by placing it in two categories. To express it otherwise, a utility should not receive credit for the same deduction by treating it as an ordinary expense on one occasion and by capitalizing it on another."). As a public utility may not receive double credit for the same deduction through capitalization and expensing, so too may ratepayers not benefit twice through a rate base deduction and refund of the unamortized balance of a regulatory liability—in this case, the impacts of the TCJA.

Applying EADIT as a deduction from rate base is completely unprecedented and should therefore be rejected.

b. The Proposed Adjustment Is Factually Wrong.

I&E and OCA also may contend that Excess ADIT was once ADIT and should continue to be deducted from rate base. UGI Electric disagrees. Excess ADIT was once ADIT, but it is no longer ADIT and should not be deducted from rate base in setting prospective rates. It is not recorded in the ADIT account and by definition it is not ADIT, it is "excess" ADIT. This amount should be returned to customers, but customers should not receive a return on the amortized balance of an expense item and should not receive a prospective rate base deduction for deferred taxes that no longer exist.

I&E and OCA also appear to argue that customers paid these Excess ADIT balances in rates as part of the deferred taxes included in rates. This argument is factually wrong. UGI Electric's rates were last set in 1996 based on operating and financial conditions at that time, including tax expense. *See generally Pa. Pub. Util. Comm'n, et al. v. UGI Utilities, Inc. (Electric Division),* Docket No. R-00953534 (Filing Submitted Jan. 26, 1996). Thus, deferred taxes in UGI Electric's rates reflect 1996 deferred income taxes. Any deferred taxes recorded on the Company's books since 1996 were not reflected in rates and have not been paid by customers. It would be highly inappropriate and confiscatory to deduct from rate base deferred taxes that were never paid by customers. Indeed, the entire concept of a rate base deduction for deferred taxes is that customers paid the deferred taxes in current rates and that this provided an interest free "loan" to the utility. If deferred taxes were not reflected in rates, then there is no "loan" and no basis for a rate base deduction.

c. The Proposed Adjustment For EADIT Is Patently Inconsistent With Other I&E And OCA Tax Adjustments.

An important principle of ratemaking is that rates should be set on a consistent basis. I&E and OCA have clearly violated this principle in their proposed tax adjustments associated with the TCJA. There are three adjustments at issue regarding the TCJA: (1) effect on 2018 taxes; (2) ongoing prospective impact on taxes, inclusive of (a) the reduction of the tax rate to 21% and (b) the amortization of the EADIT as a deduction to tax expense, thereby reducing ratemaking federal income tax expense below the 21% level; and (3) effect on the ADIT rate base deduction. The first two adjustments, if adopted, would substantially reduce customers' rates to reflect the impact of the reduction in tax rate from 35% to 21% and, with the EADIT amortization, even below 21%. The third adjustment would reduce ADIT, which has the effect of increasing rate base and increasing rates as ADIT is a deduction from rate base. I&E and OCA, perhaps not surprisingly, advocate for the two effects which reduce rates, but oppose the one effect that would increase rates. This sort of "cherry picking" or "have your cake and eat it too" ratemaking is not appropriate. If the impacts of the TCJA are to be reflected in rates, then all of the impacts should be included, not just the ones that reduce rates. There is no basis for I&E's and OCA's opportunistic approach to ratemaking, and it should be rejected.

d. The Proposed Adjustment Is Not In The Public Interest.

The purpose of the TCJA was to encourage businesses to invest new capital and increase employment. *See* Pub. L. 115-97, 131 Stat. 2054 (stating purpose of TCJA). For public utilities, this purpose will not be achieved because all of the benefits will flow back to customers through reduced rates. As explained above, UGI Electric's supplemental direct testimony and exhibits recalculated its rate increase request based on the new 21% rate and this amount will reduce revenue requirement accordingly. The adjustment required by the TCJA reduced the Revenue Requirement for the FPFTY by $0.763 million from the as filed amount of $9.254 million to $8.491 million. In addition, UGI Electric and all utilities as of January 1, 2018, will begin accruing deferred taxes at a 21% rate. This will substantially reduce deferred taxes and the resulting "interest free loan" from the government will be similarly reduced and will require UGI Electric to rely more heavily on outside financing to fund its capital projects. This is particularly difficult for a company like UGI Electric, in the midst of a major capital program to replace aging infrastructure to provide safe and reliable service to customers. This problem is exacerbated by the rising interest rate market, which will further increase UGI Electric's cost of capital. *See* Section VII.D.1. *infra*. To further reduce rate base for EADIT would add "insult to injury," and clearly is not in the best interests of customers or the Commonwealth. UGI Electric has fully reflected the benefits of the TCJA in its prospective rates. The proposals to reduce rate base for deferred taxes that no longer exist and were, for the most part, never paid for customers is simply wrong and should be rejected.

C. ACT 40

In 2016, the General Assembly enacted Act 40 of 2016, Pub. L. 332 (“Act 40”), which added Section 1301.1 to the Public Utility Code. The purpose of Act 40 was to eliminate the so-called “consolidated tax savings adjustment” (“CTA”) from Pennsylvania ratemaking. Prior to Act 40, long-standing decisions of the Commonwealth Court required the Commission to adjust rates to reflect “savings” achieved from a utility’s participation in its parent company’s consolidated tax return. *See, e.g., Pa. Pub. Util. Comm’n, et al., v. PPL Gas Utilities Corporation*, Docket Nos. R-0061398 et al., 2007 Pa. PUC LEXIS 779 at *128-133 (Order entered Feb. 8, 2007) (litigating consolidated tax savings adjustment); *see also Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge*, Docket Nos. P-2015-2508942, et al., 2018 Pa. PUC LEXIS 147 (Order entered April 19, 2018) (“…the intended purpose of Section 1301.1 was to move away from Pennsylvania's past practice of requiring a consolidated tax adjustment to a public utility's tax expenses when setting rates in a base rate proceeding.”). Act 40, however, requires utilities to compute a hypothetical CTA (which would apply in the absence of Act 40), and to certify that 50% of the differential shall be used to support reliability or infrastructure related to the rate-base eligible capital investment as determined by the Commission and 50% shall be used for general corporate purposes. 66 Pa. C.S. § 1301.1(b).

OCA witness Morgan, in less than 3 pages of testimony, contends that the Company has not adequately demonstrated its proposed use of the additional income generated from not making a CTA and that the hypothetical CTA should therefore be deducted from rate base as "ratepayer supplied capital." OCA St. No. 1, pp. 23-25. Mr. Morgan's proposed adjustment is fundamentally flawed and should be rejected. Act 40 eliminated the CTA, and the Company has fully complied with the Act's use of funds requirements. Mr. Morgan's adjustment is nothing more than a blatant attempt to continue the CTA, although in a different form. This transparent effort to thwart the plain language of the statute and clear legislative intent must be rejected. The OCA should accept the fact that the Pennsylvania General Assembly has joined 46 other states and eliminated the CTA.

Section 1301.1(a) specifies how the Commission is to compute income tax expense for ratemaking purposes in base rate cases. Section 1301.1(b) describes how incremental utility operating income produced by the operation of Section 1301.1(a) should be used by affected utilities until the sunset of Section 1301.1(b) on December 31, 2025. Simply stated, subsection (a) deals with ratemaking, while subsection (b) deals with the use of utility operating income generated by the ratemaking change made by subsection (a).

Subsection (a)—the ratemaking provision—requires that the Commission employ a "stand-alone" computation whereby a utility's allowable income tax expense for ratemaking purposes is calculated without regard to the taxable income, deductions or credits of other companies that may join with the utility in filing a consolidated federal income tax return. There is no dispute—and the legislative record is clear—that Section 1301.1(a) terminates the practice of making a CTA when calculating a utility's federal income taxes for ratemaking purposes in Pennsylvania.

Under the Modified Effective Tax Rate Method, as it was used by the Commission, a CTA captured a portion of the deductions—including taxable losses—of unregulated affiliates of public utilities and gave those benefits to the utilities' customers in the form of a lower income tax expense allowance than the utilities would bear on a "stand-alone" basis. That expense reduction was appropriated for the benefit of customers despite the fact that a utility's customers paid none of the expenses that generated the tax benefits they received from the CTA. With the enactment of Act 40, Pennsylvania joined the other 46 jurisdictions (45 states and the Federal Energy Regulatory Commission) that do not recognize any CTAs for ratemaking purposes.

Subsection (b), relied on by Mr. Morgan is not a ratemaking provision. *See* OCA St. No. 1, pp. 22-23. Instead it specifies how the additional utility operating income that subsection (a) may produce (the "differential" between making and not making a CTA for ratemaking purposes) should be "used." *See* 66 Pa. C.S. § 1301.1(b).

Thus, by correcting the historic unfairness that forced utilities to absorb the income tax expense they were denied by a CTA, subsection (a)—the ratemaking provision—freed up funds that utilities otherwise have to use to pay their unrecovered income tax expense. The legislature, recognizing that subsection (a) would increase utility operating income and, therefore, provide additional internally-generated funds that could be reinvested in critical infrastructure, added subsection (b), which directs how a portion of that income should be invested. Specifically, subsection (b)(1) imposes an obligation (until 2025) on affected utilities to reinvest a portion (50%) of that incremental utility operating income in vital infrastructure and reliability, while subsection (b)(2) makes clear there are no corresponding restrictions on the balance of the "differential," which may be used for "general corporate purposes."

UGI Electric witness Mr. Anzaldo has fully explained the Company's compliance with this provision in both his Direct and Rebuttal Testimony. In his Direct Testimony, Mr. Anzaldo explained that the Company's *pro forma* capital additions for reliability or infrastructure projects in the FTY are $10.950 million and for the FPFTY are $11.770 million, which is greater than

50% of the amount of what would have been the CTA under prior ratemaking principles, and that the Company's general corporate purpose expense will also exceed 50% of the tax benefit resulting from elimination of the CTA. UGI Electric St. No. 2, p. 25. Mr. Anzaldo further responded to the criticisms of OCA witness Mr. Morgan in his Rebuttal Testimony, and explained "[i]n the case of UGI Electric, both its capital expenditure expense and general corporate purpose expense exceed the fifty percent thresholds referenced in 66 Pa. C.S. §1301(b) by wide margins, and thus UGI Electric is fully entitled to recover tax expense in the manor authorized by Act 40 without reduction. As quantified in UGI Electric St. No. 9, the Act 40 impact is $75,400." UGI Electric St. No. 2-R, p. 13.

Mr. Morgan proposes to treat the entire amount of the hypothetical CTA, as customer supplied funds, similar to a contribution in aid of construction ("CIAC"), and deduct it from rate base. There is no merit in this position

First, there is no requirement in Section 1301.1 that 50% of the "differential" be treated like a CIAC. It should, therefore, be treated as what it is—utility operating income reinvested in utility plant and equipment. The plant and equipment represented by that reinvestment is no different from any other utility plant financed with a utility's internally-generated funds, which is entitled to be included in rate base at its full value. In fact, Section 1301.1(b)(1) expressly refers to the utility's use of 50% of the "differential" as "rate-base eligible capital investment."

Second, notwithstanding Section 1301.1(a), Mr. Morgan clings to his view that all of the traditional arguments for a CTA—which the Legislature rejected by enacting Act 40—have some continuing validity and, therefore, should control the way the Commission implements Act 40 in this case. This is illustrated by his assertion that the represented "differential" "should be used to offset rate base," simply to reduce the burden on ratepayers. OCA St No. 1, p. 24. Those arguments, however, have now definitively been put to rest in Pennsylvania by the passage of Act 40.

Third, and related to the prior point, Mr. Morgan simply refuses to acknowledge what the Legislature did—and said it was doing—by enacting Act 40. Specifically, Act 40 eliminates the use of CTAs in setting base rates in order to assure that a utility's income tax expense for ratemaking is not reduced by the tax attributes of separate, affiliated companies, none of whose costs or investments are borne by the utilities' customers.

Fourth, Mr. Morgan tries improperly to blend the separate and distinct subsections of Section 1301.1 in order to apply Section 1301.1 in a manner that is contrary to the purposes for which Act 40 was enacted. As explained previously, Section 1301.1(a) deals with ratemaking, while Section 1301.1(b), which only addresses "uses," specifies how a portion of the income provided by subsection (a) must be reinvested between now and the end of 2025. The implicit assumption underlying Mr. Morgan's interpretation is that Section 1301.1(b) requires the Commission to treat the "differential" as if it were a contribution to capital—similar to CIAC—and, therefore, it should be deducted from the utility's rate base. *See* OCA St. No. 1, p. 24.

Mr. Morgan's approach is wrong on several levels. As explained before, subsection (a) is the ratemaking provision of Section 1301.1. It says nothing about deducting any part of the "differential" from rate base. To the contrary, subsection (a) specifically anticipates and rejects Mr. Morgan's rate base deduction by providing as follows:

> The deferred income taxes used to determine the rate base of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity.

66 Pa. C.S. § 1301.1(a). This provision clearly prohibits deductions from rate base to attempt to avoid the prohibition of reducing tax recoveries for deductions and credits of affiliate companies.

Therefore, Mr Morgan's proposed adjustment is contrary to the express provisions of law and must be rejected.

Subsection (b), in turn, deals with the "uses" of the differential, and embodies the Legislature's decision that fifty percent of those funds are to be invested in vital infrastructure and reliability and the other fifty percent may be devoted to general corporate purposes. Subsection (b) has nothing to do with ratemaking and does not even purport to address any ratemaking issue. And, as discussed previously, subsection (b) does not deal with ratemaking but focuses solely on the use of the funds by the utility. If the form of ratemaking treatment proposed Mr. Morgan's recommendation was contemplated, it was contemplated and expressly prohibited by Section 1301.1(a).

Fifth, Mr. Morgan's proposed adjustments would undo what Act 40 was enacted to accomplish. The net result of Mr. Morgan's adjustments would simply substitute one form of CTA for another. In that regard, while this Commission has used the Modified Effective Tax Rate Method to calculate CTAs for Pennsylvania utilities, the very few commissions that still recognize CTAs have used other methods. In particular, the method historically used by the New Jersey Board of Public Utilities ("BPU") aggregated annual CTAs and deducted the aggregate amount from utilities' rate bases,[23] as did the New York Public Service Commission.[24] Given the express prohibition in subsection (a) against rate base deductions to accomplish the CTA, it is reasonable to conclude that the Pennsylvania General Assembly knew of this practice in other jurisdictions and intended to prohibit it in Pennsylvania. This is fundamentally the very

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[23] *See In the matter of the Verified Petition of New Jersey Central Power & Light Company*, 2015 N.J. AGEN LEXIS 24, at *19-31 (Order dated Jan. 8, 2015) (explaining historical methods for calculating a CTA used by the BPU).

[24] *See Proceeding on motion of the Commission as to the rates and charges of New York Water Service Corporation for water service*, 1987 N.Y. PUC LEXIS 20, at *41-42 (Order dated July 17, 1987) (detailing the pass-through of consolidated tax savings through a rate base adjustment used by the New York Public Service Commission).

same thing Mr. Morgan is recommending in this case. Act 40 was enacted to separate Pennsylvania from the small and dwindling number of jurisdictions that cling to some form of CTA for utility ratemaking. Applying Act 40 as Mr. Morgan recommends would be antithetical to that purpose and contrary to the express provisions of the law. Mr. Morgan's proposed method for implementing Act 40 would substitute one form of CTA for another.

Sixth, as the plain language of Section 1301.1(b)(1) shows, it is designed to increase investment in critical infrastructure and reliability. In fact, the remarks on the floor of the House of Representatives by the lead sponsor of the bill (HB 1436) that became Act 40 underscores this point. Representative Godshall, explaining HB 1436, made it clear that subsection (b)(1) deals with the targeted reinvestment of funds, not unmentioned rate base deductions: "[I]f there is any gain, 50 percent of that gain must go to infrastructure." House Journal, 2016-117 (Rep. Godshall). However, Mr. Morgan's approach ignores this purpose; in fact, it is contrary to that broader purpose. It treats both subsection (a) and subsection (b) as if they relate to ratemaking – ignoring the fact that subsection (b) explicitly states it pertains to "uses." More importantly, deducting any part of the CTA "differential" from a utility's rate base undermines the goal of spurring increase infrastructure investment.

For these reasons, Mr. Morgan's adjustment should be rejected.

IX. RATE STRUCTURE

A. ALLOCATED CLASS COST OF SERVICE STUDY

1. Introduction.

The fundamental purpose of a class cost allocation study is to aid in the accurate and reasonable design of rates by identifying all the capital and operating costs incurred by the utility in serving its customers, and then directly assigning or allocating these costs to each individual rate class based on established principles of cost causation to calculate the rate of return provided by each class. UGI Electric St. No. 6, p. 5. The rate of return for each class is then compared to a system average rate of return to determine if each rate class is either under-paying or over-paying its allocated cost of service. This information is then used to determine how the proposed rate increase should be allocated among the rate classes. The goal is to move each rate class towards the system rate of return. This can be accomplished by assigning a greater than system average increase to classes paying less than their cost of service, and assigning a less than average increase to classes paying more than the system average rate of return. As explained below, other factors may be considered in revenue allocation, such as value of service and gradualism.

Although class cost of service studies may appear to have great precision, the Commission has repeatedly recognized that the cost of service study is only a guide to designing rates and is only one factor, albeit an important one, to be considered in the rate setting process. *See, e.g., Aqua 2008*, 2008 Pa. PUC LEXIS 50; *Pa. P.U.C. v. West Penn Power Co.,* Docket Nos. R-901609, et al., 1990 Pa. PUC LEXIS 142, 73 Pa. PUC 454, 119 P.U.R.4th 110 (Order dated Dec. 13, 1990); *Pa. P.U.C. v. Pennsylvania Power & Light Co.,* 55 PUR 4th 185, 249 (Order dated Aug. 19, 1983). Cost allocation studies require a considerable amount of judgment and are described as more of an accounting/engineering art rather than science. *Application of Metropolitan Edison Co.,* R-00974008 (Order dated June 30, 1998); *Pa. P.U.C. v. Pennsylvania Power & Light Co.,* 55 PUR 4th 185 (Order dated Aug. 19, 1983).

The Commonwealth Court has, however, concluded that the class cost of service is the "polestar" of utility ratemaking. *See Lloyd*, 904 A.2d at 1020. Despite its heightened importance in the ratemaking process, cost allocation remains an inexact science, and there is no single "correct" cost allocation methodology. There are, however, two fundamental principles—

cost causation and consistency. Cost causation means that costs should be allocated based on what causes a cost to be incurred or what causes a cost to vary. Consistency means that once a reasonable cost allocation methodology is established, it should not be changed without a compelling reason.

The Company's allocated class cost of service study ("ACOSS") is consistent with prior studies approved by the Commission and consistent with the approach taken by all other electric utilities in Pennsylvania. Most recently, in the last fully litigated electric rate proceeding before this Commission, OCA aggressively challenged PPL Electric's cost of service study and was rejected by the Commission. *PPL 2012 RC Order*, p. 113. Therein, the Commission stated:

> We have reviewed the OCA's position and Exceptions on this issue and are not persuaded by the arguments it presented in support of its recommended COSS methodology. The position presented by the OCA was considered and rejected by the Commission in the litigation of PPL's 2010 base rate proceeding. We conclude that OCA has not presented convincing arguments in this proceeding that would cause us to re-evaluate our determination in PPL's prior proceeding. PPL's proposed COSS in the instant proceeding is virtually identical to the COSS approved in 2010, <u>is consistent with the NARUC Manual and more accurately reflects cost-causation principles</u> than the COSS methodology the Company utilized prior to the 2010 base rate case.

Id. (emphasis added) (internal citations omitted). On all major issues, UGI Electric's cost of service study was performed in accordance with PPL Electric's cost of service study methodology, which was approved by the Commission in the *PPL 2012 RC Order*. Indeed, the same expert, John Taylor, performed both the PPL Electric and UGI Electric cost of service studies.[25]

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[25] John Taylor is involved in a variety of energy and utility related projects regarding matters pertaining to economics, finance, and public policy including: asset divestitures, allocated class cost of service studies, rate of return, cash working capital, tax litigation, rate design analysis, auction analysis, and affiliate cost allocation. Part of his role within these projects is to conduct various analyses which take into account both accounting and financial

OCA seeks to re-litigate the PPL Electric case and proposes a cost of service methodology that is fundamentally inconsistent with how the Commission evaluates cost allocation for all other electric utilities in the state. Consistency is an important factor in cost allocation, and OCA's proposals are inconsistent with Pennsylvania electric base rate case history. Additionally, in assuming that there is no customer allocation component to the primary and secondary distribution system, OCA's approach is fundamentally at odds with basic principles of cost causation. This assumption that the size and design of the distribution system would be exactly the same, regardless of the number of customers, is demonstrably false and should be rejected as it has been previously and recently rejected by the Commission.

In addition, it is worth noting that I&E has not challenged the Company's ACOSS and that OSBA largely agrees with the Company's ACOSS approach, but offered minor refinements, most of which were adopted by the Company as explained by UGI Electric witness Mr. Taylor in his Rebuttal and Rejoinder testimonies. UGI Electric St. No. 6-R; UGI Electric St. No. 6-RJ. Simply put, the OCA again stands alone in opposing UGI Electric's cost of service study.

2. UGI Electric's Cost of Service Study Is Reasonable And Should Be Adopted.

UGI Electric's witness, Mr. John D. Taylor, a principal consultant at Black & Veatch, prepared the Company's ACOSS. He utilized the Black & Veatch Model which has been used in over a dozen jurisdictions on numerous occasions to develop electric and natural gas allocated class cost of service studies. UGI Electric St. No. 6, p. 4. His ACOSS was originally submitted as UGI Electric Exhibit D – Cost of Service Study, for the FPFTY ending September 30, 2019,

considerations and the particular operational configuration of a company's assets. He has presented expert testimony in Indiana, Maine, Minnesota, Illinois, Delaware, Pennsylvania, British Columbia, and the Federal Energy Regulatory Commission. He began his education studying electrical and mechanical engineering and worked for an industrial inspection company which provided him with hands on experience with electric utility assets and equipment. In addition, he received an undergraduate degree in Environmental Economics, with an emphasis in econometrics and regulatory policy as well as a Masters in Economics from American University in Washington, DC. UGI Electric St. No. 6, pp. 1-2.

and updated to reflect the impacts of the TCJA as Revised UGI Electric Exhibit D – Cost of Service Study.

Mr. Taylor's cost of service study conducted in this proceeding is consistent with general ratemaking principals and Commission precedent. UGI Electric St. No. 6, pp. 9-10; *see also PPL 2012 RC Order*, pp. 113-114. Therefore and, for the reasons more fully explained below, it should be adopted by the Commission in this proceeding.

a. The Company's Cost Of Service Study Methodology Reflects A Reasonable And Accepted Functionalization, Classification and Allocation Of Costs.

The cost of service study prepared by Mr. Taylor includes three familiar steps: (1) cost functionalization, (2) cost classification, (3) cost allocation. UGI Electric St. No. 6, p. 6. First, the Company's total cost of service (plant and expenses) are identified and separated into specific cost categories associated with the electric distribution service including: Primary Distribution, Secondary Distribution, and Customer Accounts and Services. Next, the costs in each category are further classified and then allocated and assigned to the responsible rate classes, in accordance with their classification. Calculating the costs assigned to each rate class by their individual contribution to the Company's revenue provides the rate of return for each rate class. Those rates of return for each class are compared to a system average rate of return to determine if each rate class is either under-paying or over-paying its allocated cost of service. UGI Electric St. No. 6, pp. 6-10. As explained below, UGI Electric properly performed each of these steps, consistent with Commission precedent and general ratemaking practice.

As to cost functionalization and classification, Mr. Taylor explained his methodology starts with the FERC accounts used by the Company to record its Pennsylvania-jurisdictional assets. UGI Electric St. No. 6, p. 14. These accounts were split into separate functions (*i.e.* primary distribution, secondary distribution, or customer accounts and services), and thereafter were classified as customer or demand costs[26] based on the portion of those costs required to serve a customer with minimum or no load (customer cost); the remaining portion of the costs is allocated based on each rate class' maximum non-coincident peak ("NCP") demand (demand costs). This process is known as the "minimum system" method, and is generally favored because it is "based on the specific design and operating characteristics of the Company's distribution system, and provides a more accurate and consistent measure of class cost responsibility than other approaches for the provision of distribution service to its customers." UGI Electric St. No. 6, p. 9.

The above-described methodology adheres to the generally accepted methods of preparing a cost allocation study set out in the National Association of Regulatory Utility Commissioners ("NARUC") Manual. UGI Electric St. No. 6, p. 8. The NARUC Manual states that distribution costs should be either customer-related, demand-related, or, as the Company has elected to do in this proceeding, a combination of both. UGI Electric St. No. 6, p. 8. As explained by Mr. Taylor, the methodology employed by the Company in this case is consistent with these generally accepted principles.

Moreover, the above-described methodology is based on the same methods and criteria approved in the *PPL 2012 RC Order*. UGI Electric St. No. 6, pp. 9-10. Therein, the Commission approved a cost of service study utilizing the same functionalization and classification methods as the Company has used here. *See PPL 2012 RC Order*, p. 106 (noting PPL Electric's study functionalized costs based on primary and secondary voltage levels, and

[26] Customer-related costs are those that relate to the number of customers served by the Company, e.g.¸ meters. Demand-related costs are those that relate to the peak load/demand imposed on the Company's facilities, e.g., primary and secondary substation. Energy costs are those costs that related to the total amount of electricity consumed during a given period of time, e.g., purchased generation supply. In general, however, no electric distribution costs are caused by average or annual amounts of energy delivered by UGI Electric. UGI Electric's approach to not classify any electric distribution costs as energy related is consistent with the NARUC Manual. UGI Electric St. No. 6, p. 7.

thereafter classified into customer and demand components). This methodology was also accepted in PPL Electric's 2010 base rate case (*see PPL 2012 RC Order*, p. 113), and is the same methodology used by other Pennsylvania electric utilities. As such, UGI Electric's cost of service study is consistent with Commission precedent in base rate proceedings.

b. The Refinements To The ACOSS Set Forth In UGI Electric's Rebuttal Testimony Are Reasonable And Should Be Accepted.

Even though the ACOSS submitted with its initial filing accurately determined the cost to serve each customer class, UGI Electric included certain minor modifications to this study in its Rebuttal Testimony. *See* UGI Electric St. No. 6-R, pp. 18-29. OSBA witness Mr. Knecht generally accepted the Company's ACOSS methodology, but proposed eleven technical corrections (OSBA St. No. 1, pp. 9-10) and six additional modifications (OSBA St. No. 1, p. 11) to the ACOSS.

The technical corrections included four corrections related to the allocation of taxes among the various rate classes, and seven other technical corrections. UGI Electric St. No. 6-R, pp. 19-21. In addition, OSBA proposed additional modifications related to: (a) the separate allocation of Rate GS-1 and Rate GS-4 classes; (b) the classification of pole costs; (c) the classification of transformer costs; (d) the allocation of line transformer costs to secondary customers; and (e) the reallocation of meters for the lighting class. *See* UGI Electric St. No. 8-R, pp. 22-27.

The above-described modifications and refinements were incorporated into UGI Electric Exhibit D – Cost of Service Study (REBUTTAL), because they were minor, reasonable modifications that did not change the underlying methodology of the ACOSS. UGI Electric St. No. 6-R, pp. 18, 28-29. As such, these modifications did not have a material impact on the results of the ACOSS. A comparison of the results of the Company's and OSBA's proposed cost of service studies and the ultimate results of the above-described refinements from Mr. Taylor's Rebuttal Testimony is reproduced below:

Table 1 – ACOSS Comparison – Supplemental Revenue Requirement

	UGI Supplemental ACOSS	Knecht Supplemental ACOSS	UGI Rebuttal ACOSS @ Supplemental Revenue Requirement
Residential	9,782	10,372	10,886
GS-1	(708)	805	823
GS-4		(1,592)	(1,832)
Large Power	(374)	(785)	(1,136)
Lighting	(208)	(308)	(250)
System	**8,492**	**8,492**	**8,492**

UGI Electric St. No. 6-R, p. 29, Table 2.

Based on the forgoing, the Company submits that the ACOSS set forth in UGI Electric Exhibit D – Cost of Service Study (REBUTTAL) is reasonable and should be approved by the Commission in this proceeding.

3. OCA's Allocated Class Cost of Service Study Should Be Rejected As It Was Designed To Reduce The Costs Allocated To The Residential Class And Is Inconsistent With Basic Principles Of Cost Allocation and Cost Causation.

OCA takes issue with the Company's ACOSS and its witness, Mr. Mierzwa, has prepared and submitted an alternative cost of service study. OCA St. No. 4, pp. 3, 6-19. Mr. Mierzwa: (a) criticizes the Company's proposed classification of primary and secondary upstream distribution plant; (b) criticizes the use of NCP demand rather than Peak Load Carrying Capability ("PLCC"); and (c) proposed modifications to allocations in specific O&M accounts. *Id.*

As an initial matter, it should be noted that the OCA raised very similar, if not identical, criticisms of the cost of service study methodology employed by an electric utility in *PPL 2010*

RC Order and *PPL 2012 RC Order*. In each instance, the OCA's criticisms were rejected by the Commission, and so too should they be rejected here.

As explained below, each of these criticisms is fundamentally flawed and appears specifically designed to improperly and unreasonably decrease the costs attributed and allocated to the residential class.

a. UGI Electric's Classification Of Primary And Secondary Upstream Distribution Plant Is Appropriate.

OCA witness Mr. Mierzwa recommends that the primary and secondary portion of upstream distribution plant should be classified as 100% demand related. OCA St. No. 4, pp. 3, 9, 16. As noted by UGI Electric witness Mr. Taylor, this recommendation is inconsistent with the practices of all public utilities in Pennsylvania and past Commission precedent addressing this recommendation by OCA. *See* UGI Electric St. No. 6-R, pp. 4-5. OCA's arguments have been extensively debated before the Commission and rejected in every instance. *See, e.g., PPL 2012 RC Order*, p. 113 (noting that OCA's arguments were the same as those rejected in prior PPL proceedings). UGI Electric's classification of upstream distribution plant is both customer- and demand-related, and using a minimum system study is entirely reasonable and appropriate.

In addition, Mr. Mierzwa's attempt to justify his recommendation by relying on Principles of Public Utility Rates[27] is misleading at best. OCA St. No. 4, pp. 10-11. As noted by Mr. Taylor, the quote used by Mr. Mierzwa omits a material sentence that makes clear it is referring to the zero-intercept method, which was not used by UGI Electric in its ACOSS. UGI Electric St. No. 8-R, pp. 5-6. As such, Mr. Mierzwa's critique and reliance on literature has no applicability here.

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[27] Principles of Public Utility Rates, Second Edition, Page 491 James C. Bonbright, Albert L. Danielson, David R. Kamerschen, Public Utility Reports, Inc., 1988.

Mr. Mierzwa also argues that customer density should be taken into account to allocate upstream distribution facilities on a customer basis. OCA St. No. 4, pp. 11-13. In doing so, however, Mr. Mierzwa fails to acknowledge that the cost of installing distribution facilities varies by location for a myriad of reasons. UGI Electric St. No. 6-R, p. 8. These cost variances would effectively offset any differences associated with customer density. *Id.* In addition, class average costs are the standard for cost of service studies; geographic intra-class costs are not, because intra-class rates do not vary based on geography. *Id.*

Finally, Mr. Mierzwa included analyses of the average footage of primary conductor allocated to each customer. OCA St. No. 4, p. 13. However, this analysis is inaccurate and unnecessary because the minimum system study does not allocate a specific footage of distribution conductor to each customer; it determines what the total costs would be if the minimum conductor size were installed across the system. UGI Electric St. No. 6-R, p. 12.

UGI Electric witness Mr. Taylor also demonstrated that Mr. Mierzwa's proposal to remove the customer component of upstream distribution facilities costs is inconsistent with public utility accounting theory, the cost allocation process as developed by NARUC, cost causation, and the economics of efficient rates for a utility that is experiencing declining costs. UGI Electric St. No. 6-R, pp. 9-12. Mr. Taylor explained that fundamental utility accounting practices recognize that upstream distribution plant (*e.g.*, transformers, conductors, poles and towers) all contain customer costs and that the NARUC Manual fully supports the use of the minimum system method to make this classification. *Id.*, p. 9. In addition, Mr. Taylor explained that OCA's proposed allocation would result in more costs being attributed to large customers who may not even use any of the smaller facilities. *Id.*, pp. 10-11. Moreover, using a demand allocation factor alone, as proposed by Mr. Mierzwa, assumes that transformer and conductor capacity is the same for all classes; it is not. *Id.*, p. 11-12. In summary, absent the use of the minimum system, the distribution costs are incorrectly allocated to each class resulting in costs being under-allocated to smaller customers are and over-allocated to serve larger load customers.

b. UGI Electric's Use Of NCP Demand Rather Than PLCC Is Reasonable And Should Be Accepted.

OCA witness Mr. Mierzwa also argues that the minimum system approach fails to account for the portion of each class' NCP[28] demand that can be met by the minimum system, *i.e.* the PLCC of the minimum system. OCA St. No. 4, pp. 14-15. This, Mr. Mierzwa claims, results in a "double allocation" of primary and secondary upstream distribution costs to residential and other small customers. *Id.*

UGI Electric witness Mr. Taylor demonstrated that OCA's claims regarding NCP ignore two critical facts. First, the fact that some equipment in the Company's minimum size system has some nominal capability to carry load does not prevent the study from providing a reasonable approximation of customer and demand related costs. UGI Electric St. No. 6-R, p. 13. Second, the Company's ACOSS only classifies the no-load portion of transformers as customer related through an adjustment made to the unit cost of transformers. This method fulfills the requirements to consider the load carrying capacity of the transformers requested by Mr. Mierzwa. Conversely, minimum size poles do not have load carrying capacity; so, the minimum used for the customer portion of poles costs is the no-load portion. *Id.*, pp. 13-14. This reality is recognized by all other electric utilities, and was specifically approved in PPL Electric's and Duquesne Light Company's last rate filings, as explained by Mr. Taylor. *Id.*, p. 14.

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[28] The non-coincident peak (NCP) is the class's maximum energy demand during the year in a given hour; regardless of whether that hour of time corresponds to the system (coincidental) peak. UGI Electric St. No. 6, pg. 9.

c. OCA's Proposed Modifications To The Allocation Of Costs In Specific O&M Accounts Are Without Merit.

The OCA further argues that the Company's method of determining customer cost components of O&M Accounts 364, 365, and 367 results in "a mismatch" and "over states" the customer component. OCA St. No. 4, p. 17-18. Mr. Mierzwa proposes that 50% of the costs in these accounts be classified as energy-related.

The OCA's argument is counterintuitive and violates cost causation principles. The maintenance of the facilities recorded in Accounts 364, 365 and 367 is not driven by the amount of energy consumed by each rate class. In his Rebuttal Testimony, Mr. Taylor provided data demonstrating that there is no correlation between these O&M expenses and the amount of energy consumed by customers. UGI Electric St. No. 6-R, p. 16. More specifically, for the maintenance of overhead and underground transmission lines, there is no correlation between the level of conductor maintenance costs and total sales of electricity. UGI Electric St. No. 6-R, p. 15. Therefore, Mr. Mierzwa's recommendation to classify 50% of these costs as energy-related should be rejected.

Similarly, the OCA recommends 50% of Outside Service expenses in Accounts 539, 594, and 923 be classified and allocated as energy-related rather than customer related because they are organizational costs for UGI Electric's holding company for shared services where some of the allocation is dependent on purchased power costs and purchased power revenues. OCA St. No. 4, p. 17-18.

However, outside services costs are general in nature, do not vary with energy consumed, and are best allocated based on the labor costs of the electric distribution utility. UGI Electric St. No. 6-R, p. 17. Account 923 in total represents only 2.2% of the total budget and the fact that there may be a de minimus portion of affiliated costs should not inform the allocation choices within the ACOSS. As such, Mr. Mierzwa's recommendations to classify half of the O&M and outside service account costs as energy related are baseless, inconsistent with the principle of cost causation, and should be rejected.

4. Summary As To The Cost Of Service Study.

UGI Electric's ACOSS is consistent with fundamental principles of utility ratemaking and consistent with Commission precedent. In contrast, the adjustments and alternatives proposed by the OCA attempt to ignore cost causation and are contrary to Commission precedent. In this proceeding, the Commission should continue to be guided by cost-causation principles that it has repeatedly recognized in prior electric base rate proceeding, and should not depart from this precedent for reasons it has previously stated were insufficient. Therefore, the ACOSS proposed by UGI Electric should be adopted.

B. REVENUE ALLOCATION

1. Introduction.

UGI Electric's proposed allocation of revenue among the rate classes is primarily driven by the cost to serve each class. As indicated by the Commonwealth Court in *Lloyd*, cost of service is the "polestar" of utility rates. *Lloyd*, 904 A.2d at 1020. While other factors, such as gradualism, may be considered, these factors are not permitted to "trump" cost of service as the primary basis for allocating the revenue increase. *Id.* at 1020-21.

Consistent with the Commonwealth Court's directive in *Lloyd*, a proposed revenue allocation will only be found to be reasonable where it moves distribution rates for each class closer to the full cost of providing service. *Pa. Publ. Util. Comm'n, et al. v. PPL Electric Utilities Corporation*, Docket Nos. R-00049255, et al., 2007 Pa. PUC LEXIS 55 (Order On Remand entered July 25, 2007).

Even prior to *Lloyd*, the importance of properly allocating a proposed revenue increase among a utility's rate classes was recognized by Pennsylvania appellate courts. In *Philadelphia Suburban Water Company v. Pa. Pub. Util. Comm'n*, the court has stated that:

> in order for a rate differential to survive a challenge brought under Section 1304 of the Public Utility Code [bar against rate discrimination], the utility must show that the differential [different rates among the classes] can be justified by the difference in costs required to deliver service to each class. The rate cannot be illegally high for one class and illegally low for another.

808 A.2d 1044, 1060 (Pa Cmwlth. 2002). Indeed, any significant departure from the results of a cost of service study requires the proponent to fully justify the deviation.

As explained below, UGI Electric's proposed revenue allocation is consistent with regulatory practice and precedent, including the *Lloyd* decision. Contrary to UGI Electric's proposal to neutrally allocate revenues consistent with the cost to serve each class, OCA attempts to allocate revenues in a manner that ignores the cost to serve each class solely to allocate less of the proposed revenue increase to the residential class. Therefore, and for the reasons more fully explained below, OCA's improper allocation should be rejected and the Commission should adopt the Company's proposed allocation.

2. UGI Electric's Revenue Allocation Is Reasonable And Consistent With Controlling Precedent.

The cost of service study performed by UGI Electric witness Taylor demonstrated that the residential class currently pays far less than its cost of service, while all other classes pay significantly more than their cost of service. *See* UGI Electric St. No. 6-SD, pp. 2-3. Given the significant disparity between the cost to serve the residential class and the revenues the class contributes under current rates, the Company reasonably decided to allocate the proposed increase to the residential class. *Id.* In addition, the Company proposed no net change for all other rate classes, because their relative rates of return were significantly above the system average. *Id.* (proposing no increase to the GS, Rate LP, and Lighting classes). Importantly, even under this revenue allocation, the residential class would remain well below the system average rate of return. Nevertheless, the Company's proposal properly moves the rate of returns for all classes closer to the overall system average rate of return. *See* UGI Electric St. No. 8, pp. 17.

UGI Electric's proposed allocation follows the results of UGI Electric witness Mr. Taylor's cost of service study, UGI Exhibit D – Allocated Class Cost of Service Study. As a result of the stark disparities in the customer classes' rate of returns revealed by the cost of service study, the Company originally proposed a revenue allocation that would significantly move all rate groups, except for the Lighting class, approximately 80-92% closer to the system average rate of return. UGI Electric St. No. 8, p. 15.

The Company's proposal was altered after company witness Taylor revised his ACOSS to reflect the new tax law, as well as other adjustments adopted throughout the proceeding, and UGI Electric's revenue requirement decreased from $9,254,354 to $8,092,000. UGI Electric Exhibit A – Fully Projected (REBUTTAL). As mentioned above, Mr. Lahoff's revenue allocation study was primarily based off of Mr. Taylor's cost of service study. Due to the cost of service study revisions aimed at addressing the impacts of the TCJA, Mr. Lahoff provided a table including the revised proposed revenue increases and relative rate of returns by customer class shown in Revised UGI Electric Exhibit D - Cost of Service[29] as a part of his Supplemental Direct Testimony. UGI Electric St. No. 8-SD, pp. 3-4. UGI Electric again updated the table showing the revised proposed revenue increases and relative rates of return by customer class as showing in UGI Electric Exhibit D – Cost of Service (REBUTTAL).

[29] The $8.491 million proposed increase for the residential class in the table includes $15,254 allocated to Rate GS5, which is a general service rate that is served under residential rates. This rate applies to volunteer fire companies, non-profit senior centers, non-profit rescue squads and non-profit ambulance services.

The Company's revised proposed revenue allocation results in substantial movement of all rate classes toward the system average rate of return, as shown by the chart below.

UGI Electric's Proposed Relative Rate of Returns

	Total Company	Residential	General Service - 1	General Service - 4	Large Power	Lighting
Total Revenue Increase as Proposed	$8,092	$7,987	$620	$(515)	$0	$0
Percent Total Revenue Change	9.08%	13.30%	19.35%	-3.31%	0.00%	0.00%
Proposed Rate of Return	8.24%	6.13%	6.12%	17.30%	14.50%	18.91%
Proposed Relative Rate of Return	100%	75%	74%	210%	176	230
Current Rate of Return	3.75%	-0.54%	-0.59%	23.23%	16.20%	21.02%
Current Relative Rate of Return	100%	-14%	-16%	619%	431%	560%

See UGI Electric Exhibit D – Cost of Service Study (REBUTTAL), pp. 6-7.[30]

As this table illustrates, UGI Electric's proposed allocation of revenue requirement among the rate classes is reasonable and achieves substantial progress in moving rate classes toward the system average relative rate of return.

3. Certain Modifications To The Company's Proposed Revenue Allocation By OSBA Are Reasonable And Appropriate.

OSBA witness Mr. Knecht offered several modifications to the Company's proposed cost of service study, discussed in Section IX.A.2. *supra*, which affected the proposed allocation of revenue. OSBA St. No. 1, pp. 8-10. As noted in the Rebuttal Testimony of UGI Electric witness Mr. Taylor, the Company has elected to incorporate many of these modifications. UGI Electric St. No. 6-R, pp. 19-22. As a result, the revenue originally allocated to the GS class has been segmented between Rates GS-1 and GS-4, as proposed by OSBA witness Mr. Knecht. UGI Electric St. No. 8-R, p. 5; *see also* OSBA St. No. 1-SD, pp. 4-5. Examined independently, Rate GS-1, which is below system average rate of return, has been allocated a portion of the

[30] The Company submits that its final proposed revenue requirement of $7.705 million, inclusive of all adjustments resulting from the Company's Rejoinder Testimony, should be allocated according to the same principles and in the same manner set forth in UGI Electric Exhibit D – Cost of Service Study (REBUTTAL).

Company's proposed revenue increase of $621,000. UGI Electric St. No. 8-R, pp. 5-6, 12. Similarly, Rate GS-4, which is significantly above the system average rate of return, has been allocated a $515,000 revenue decrease. *Id.* These reasonable modifications result in an overall General Service class increase of $106,000, subsequently providing for a $106,000 reduction in the allocation to the Rate R class. *See,* UGI Electric St. No. 8-R, pp. 5-6. While this adjustment does not bring those rate classes as close to the system average as the Company originally proposed, these propose allocations of revenue are fair and reasonable and reduce the items of contention in this case by addressing the concerns raised by OSBA, without ignoring the cost to serve the residential class. For the reasons more fully explained above, the revenue allocation proposal set forth in the Company's Rebuttal Testimony (UGI Electric St. No. 8-R) is reasonable and should be approved.

4. OSBA's Modifications To The Company's Proposed Revenue Allocation For Large Power and Lighting Customer Groups Were Not Adopted By The Company Because There Is No Reasonable Basis For Increasing The Revenue Allocation For Those Customer Groups.

Considering the relative rate of return for Large Power is 431% and 560% for Lighting, the Company finds no reasonable basis for adopting proposed revenue allocation revisions for these rate classes as suggested by OSBA witness Knecht. *See* UGI Electric Exhibit D – Cost of Service Study (REBUTTAL). Therefore, the OSBA's proposal to allocate a portion of the revenue increase to the Rate LP and Lighting classes should be rejected.

5. OCA's Proposed Revenue Allocation Should Be Rejected Because It Is Based on A Cost of Service Study That Ignores the Actual Cost to Serve the Residential Class.

OCA's revenue allocation is set forth in the following table.

Table 5. OCA Proposed Revenue Distribution ($000)				
Rate Class	**Present Rates**	**Proposed Rates**	**Increase**	**Percent**
Residential	$22,373	$28,887	$6,514	29%
General Service	7,443	8,196	753	10
Large Power	5,927	7,152	1,225	21
Lighting	1,021	1,021	0	0
Total:	**$36,764**	**$45,256**	**$8,492**	**23%**

OCA St. No. 4, p. 21.

The stark contrast in results is primarily attributed to the OCA's improper and unreasonable cost of service study method, which attempts to attribute less revenue to the residential customer class. As discussed above, OCA's cost of service study should be rejected because it incorporates assumptions that are contrary to the NARUC Manual, general industry practices, and the decisions of this Commission in prior electric base rate proceedings. *See* Section IX.A.3. *supra*.

Once Mr. Mierzwa's erroneous cost of service study is rejected, consistent with prior Commission treatment for this methodology, Mr. Mierzwa's proposed revenue allocation must also fail because it does not to properly reflect the cost of service, in violation of controlling precedent. *See PPL 2012 RC Order*, p. 113 (rejecting OCA cost of service methodology); *see also Lloyd*, 904 A.2d at 1020.

C. RATE DESIGN

1. Summary of Proposed Rate Design.

In order to properly reflect the fixed and variable costs of service associated with its proposed revenue allocation, UGI Electric has proposed the following customer, demand and energy charges:[31]

Rate Class	Customer Charge	Demand Charge	Volumetric Energy Charge(s)
Rate R – Residential[32]	$14.00	N/A	$0.03077/kWh
Rate GS-1 – General Service[33]	$14.00	N/A	$0.04707/kWh
Rate GS-4 – General Service[34]	$15.00	$3.59/kWh/month $2.20/kWh/month	$0.02222-0.01261/kWh
Rate GS-5 – General Service[35]	$14.00	N/A	$0.03077/kWh
Rate LP – Large Power[36]	N/A	$135.80 (≤ 100 kW) $0.94/kWh (101-400 kW) $0.69/kWh (> 500 kW)	$0.01672 (first 100 hours of demand) $0.01518/kWh (next 200 hours of demand, not to exceed 200,000 kWh) $0.01383/kWh (next 200 hours of demand, not to exceed 200,000 kWh) $0.01295/kWh (excess)

The rate design reflected in the table above accounts for the impacts of the TCJA, as well as the revisions to the Company's cost of service study and revenue allocation discussed in Sections IX.A. and IX.B. *supra*.

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[31] The Company notes that the following table does not include the Lighting class as this class is charged a flat fee, because it is unmetered.
[32] UGI Electric St. No. 8, p. 17; *see also* UGI Electric St. No. 8-SD, p. 4 (noting changes to volumetric charges caused by the TCJA).
[33] UGI Electric St. No. 8-R, p. 11 (noting modifications to Rate GS-1, due to the acceptance of certain modifications to the Company's proposed cost of service study).
[34] UGI Electric St. No. 8-R, pp. 11-12 (noting modifications to Rate GS-4, due to the acceptance of certain modifications to the Company's proposed cost of service study).
[35] UGI Electric St. No. 8, p. 18 (noting that Rate GS5 is served under residential rates, which are identical to those proposed for Rate R in this proceeding).
[36] UGI Electric Book XI – Proposed Tariff, Rate Schedule LP, Page Nos. 66-67.

The Company also proposed several revisions and additions to its tariff. UGI Electric witness David Lahoff summarized the Company's proposed rate schedule revisions in his direct testimony, whereby the Company sought to simplify its rate design and eliminate certain rate schedules that are no longer necessary or appropriate. UGI Electric St. No. 8, pp. 9-11. These tariff revisions were not opposed by any party and, therefore, should be approved. In addition, Mr. Lahoff described the Company's proposal to: (1) adopt a reconcilable USP Rider ("Rider C"); (2) adopt a reconcilable Storm Expense Rider ("SER"); and (3) adopt a new electric vehicle service rate (*i.e.* "Rate EV"). As discussed in Section III *supra*, the Partial Stipulation in Settlement resolved all issues with respect to the Rider C, SER and Rate EV schedules.

The opposing parties generally agree with or do not oppose the Company's proposed rate design. The opposing parties, however, take issue with specific customer, demand and energy charges applicable to the various rate classes. As discussed below: (1) I&E and OCA propose adjustments to the Residential Customer Charge;[37] (2) OSBA recommended changes to Rate GS-1 and Rate GS-4; and (3) OSBA recommended rate design changes for Rate LP and Lighting classes. Except for the recommended changes to the design of Rate GS-1 and Rate GS-4 proposed by OSBA, the rate designs for the Residential, Large Power, and Lighting classes submitted by the other parties in this proceeding are unreasonable and should be rejected.

2. Residential Charges.

a. The Company's Proposed Residential Customer Charge Is Reasonable And Should Be Approved.

Based on the results of its class cost of service study and proposed revenue allocation, UGI Electric proposed to increase the Rate R customer charge from $5.50 per month to $14.00 per month. UGI Electric St. No. 8, p. 17. UGI Electric witness Mr. Taylor's ACOSS, which

[37] The proposed changes to Rate R by I&E and OCA would similarly affect Rate GS5, as customers paying this rate take service under residential rates.

allows for the development of the total revenue requirement by functions and classifications, demonstrated that residential customers have a monthly customer cost of $31.84. UGI Electric St. No. 6, pp. 15-16. In addition, this analysis showed that the PA PUC Customer Cost Function, which includes only those fixed costs historically allowed by the PA PUC in a customer charge, resulted in a monthly customer charge of $19.01. *Id.*, p. 16. UGI Electric's proposed monthly customer charge of $14.00 is reasonable in light of the amount justified by Mr. Taylor's analysis.

In addition, UGI Electric's current residential customer charge is far below the residential customer charges currently in effect for other Pennsylvania electric utilities, as well as Pennsylvania electrical cooperatives. For example, UGI Electric's service territory is surrounded by PPL Electric; PPL Electric, which serves a geographically comparable region to UGI Electric, currently has a $17.34 per month customer charge. PPL Electric Utilities Corporation, Tariff Electric Pa. P.U.C. No. 201, Supplement No. 249, Page No. 20 ("PPL Electric Customer Charge"). Indeed, UGI Electric's proposed customer charge is approximately $3.34 less than the customer charge implemented by PPL Electric, and UGI Electric's current customer charge is <u>less than one third</u> of the PPL Electric Customer Charge.

In addition, UGI Electric's proposed customer charge is far lower than the customer charges currently in effect for every non-PUC-jurisdictional electrical cooperative in the Commonwealth. UGI Electric St. No. 6-R, p. 36. Table 6 in Mr. Taylor's Rebuttal Testimony is reproduced below:

Table 2 - PA Electric Cooperatives' Monthly Customer Charge[38]

Adams Electric Cooperative	$33.75
Sullivan County Rural Electric Cooperative, Inc.	$30.00
REA Energy Cooperative, Inc.	$30.00
Northwestern Rural Electric Cooperative Association, Inc.	$30.00
United Electric Cooperative, Inc.	$29.60
Valley Rural Electric Cooperative, Inc.	$28.00
Claverack Rural Electric Cooperative	$27.70
Bedford Rural Electric Cooperative	$26.00
Warren Electric Cooperative, Inc.	$24.84
Central Electric Cooperative	$23.00
Somerset Rural Electric Cooperative, Inc	$20.50
New Enterprise Rural Electric Cooperative	$20.00
Tri-County Rural Electric Cooperative, Inc.	$20.00

UGI Electric's customer charge substantially addresses the cost to serve the residential class at an amount that is less than comparable charges for other utilities. Therefore, UGI Electric's proposed rate design for the residential customer class should be approved.

b. I&E's And OCA's Proposed Residential Customer Charge Are Flawed And Should Be Rejected.

Both I&E and OCA criticize the proposed residential customer charge. I&E St. No. 3, pp. 33-38; OCA St. No. 4 pp. 22-25. I&E recommends a customer charge of $10.00 (I&E St. No. 3, p. 37)[39] and OCA recommends a customer charge of $8.00 (OCA St. No. 4, p. 8). Both parties relatedly propose increases to the energy charge. *See* I&E St. No. 3, p. 37; *see also* OCA St. No. 4, p. 24.

The primary thrust of I&E's and OCA's argument against the proposed residential rate design is that the proposed $14.00 customer charge is inconsistent with the concept of

[38] Three co-ops did not have their rate schedule posted on line: (1) REA Energy Cooperative, Inc., (2) Somerset Rural Electric Cooperative, Inc and (3) United Electric Cooperative, Inc.

[39] As noted previously, I&E also recommended a $10.00 customer charge for Rate GS-5, as these are general service customers taking service under the residential schedule. I&E St. No. 3, p. 37. I&E's recommendation regarding the Rate GS-5 customer charge should be rejected for the same reasons as its recommendation regarding the Rate R customer charge, discussed herein.

gradualism. I&E St. No. 3, p. 36; OCA St. No. 4, p. 23. In addition, OCA witness Mr. Mierzwa argues that the Company has inappropriately included certain Universal Service and Uncollectible Accounts costs in the proposed customer charge, and that increasing the fixed monthly charge does not send meaningful price signals to UGI Electric's customers regarding energy usage and conservation. OCA St. No. 4, pp. 23-24. Each of these arguments should be rejected.

As explained above, I&E and OCA ignore controlling precedent by attempting to advance gradualism considerations ahead of the cost to serve the residential class. *See* Section IX.B.5. *supra*. Importantly, both I&E and OCA admit that, even after any proposed adjustments or criticisms of the Company's cost of service study, a residential charge that reflects the cost to serve the residential rate class substantially <u>exceeds</u> their own proposed customer charges. *See* I&E St. No. 3, pp. 35-36 (acknowledging the cost of service study reflects a customer charge of $17.70, but proposing a customer charge of $10.00); *see* OCA St. No. 4, pp. 24-25 (acknowledging, with adjustments, that the cost of serving residential customers reflects a $10.29 customer charge, but proposing a customer charge of $8.00).

While I&E and OCA may attempt to justify these recommendations by arguing that they account for gradualism, this argument is contrary to precedent and ignores the fact that UGI Electric's proposed customer charge is less than PPL Electric's current customer charge and less than the customer charges of every Pennsylvania electric cooperative. Gradualism concerns cannot be considered a valid reason for UGI Electric to adopt an $8.00 or $10.00 customer charge that is far below and bears little or no relationship to the "polestar" of cost of service.

In addition, these gradualism concerns improperly focus on one aspect of the rate applicable to the residential class, *i.e.* the monthly customer charge. The concept of gradualism should be applied to the entire rate increase, and not individual components of the rate design. Customers do not pay just the customer charge, just the demand charge or just the energy charge. They pay the entire rate. For example, in this case, UGI Electric proposes an increase in the customer charge and a decrease in the energy charge. In this context, focusing solely on the customer charge is obviously an inappropriate test for gradualism. UGI Electric St. No. 8-R, p. 8. As shown in UGI Electric Exhibit E – Proof of Revenue (Rebuttal), the Company's proposal results in a total Rate R revenue increase of just 13.6%. Given UGI Electric's last base rate increase was 22 years ago, a 13.6% change or approximately 0.6% annually over the course of 22 years is quite gradual under any reasonable standard.

OCA's proposed $8.00 per month customer charge should also be rejected because it is based on improper adjustments to the ACOSS. As explained by UGI Electric witnesses Mr. Taylor (UGI Electric St. No. 6-R, pp. 3-18) and Mr. Lahoff (UGI Electric St. No. 8-R, p. 10), OCA witness Mr. Mierzwa's attempt to remove certain costs from the customer cost analysis are inconsistent with public utility accounting, theory, cost-causation principles, and the economics of efficient rates for a utility that is a declining cost firm, and are contrary to precedent with respect to electric utilities in Pennsylvania. UGI Electric St. No. 6-R, p. 18; *see also* Section IX.A.3. *supra*. In addition, Mr. Mierzwa's claim that the volumetric charge should be prioritized to reflect the demand-varying costs of the Company's distribution system overlooks the fact that a material part of the operation and capital costs of a utility business is more directly and closely related to the number of customers than to energy consumption, and that such costs are incurred to serve customers regardless of whether the customer uses the service. UGI Electric St. No. 6-R, pp. 6-7.

In addition, Mr. Mierzwa's arguments regarding proper price signals and the supposed effects of the Company's proposed residential customer charge miss the mark. Mr. Mierzwa ignores the fact that residential customers pay for electric service through a customer charge, designed to collect the fixed costs of providing service, and an energy charge, which is designed to collect the variable costs associated with a customer's usage patterns. Indeed, the percentage of revenue collected from a residential customer through the proposed customer charge, which does not vary with usage, is only 38% of the total revenue. Moreover, Mr. Mierzwa's criticism of the customer charge ignores the other riders in UGI Electric's tariff applicable to residential customers that are, in fact, energy charges. These riders include: the STAS, the GSR, Rider C, and an EE&C Rider. In light of these facts, it is clear that UGI Electric's entire proposed rate design for the residential customer class provides appropriate price signals regarding usage and conservation.

OCA's argument that energy charges provide better price signals to customers is further undermined by the fact that every Pennsylvania electric cooperative uses a monthly customer charge that significantly exceeds the customer charge proposed by UGI Electric. UGI Electric St. No. 6-R, p. 36. This data is instructive for the Commission as to the correct level for a customer charge, because it represents the customer charge that citizens of Pennsylvania who <u>own and operate their own utility</u> view as appropriate. Moreover, the current residential customer charge for PPL Electric exceeds the Company's proposed customer charge. *See* PPL Electric Customer Charge.

c. OCA's Argument That The Proposed Residential Customer Charge Negatively Impacts Low-Income Customers Is Flawed.

In addition to the concerns discussed above, OCA claims that the Company's proposed $14.00 residential customer charge would negatively impact low-income customers. OCA St.

No. 5, p. 8. OCA principally claims that low-income customers are low-usage customers. OCA St. No. 5, pp. 16-21. Based upon this claim, OCA witness Mr. Colton argues that the proposed charge will increase CAP bills to customers using the average monthly bill component of CAP, will reduce the buying power of LIHEAP for UGI Electric customers, and will increase bills for low-income customers that do not participate in UGI Electric bill affordability programs. *See* OCA St. No. 5, pp. 8-21. Mr. Colton submits that these concerns justify the adoption of the $8.00 customer charge proposed by OCA. OCA St. No. 5, p. 21.

UGI Electric witness Mr. Taylor showed that the OCA's concerns regarding the impact of the $14.00 customer charge on low-income customers are meritless. As to OCA's principal claim, Mr. Taylor showed that Mr. Colton's assumptions regarding the usage patterns of low-income customers are incorrect; low-income customers are not necessarily low-usage customers. UGI Electric St. No. 6-R, pp. 31-33. Further, housing unit size is only one variable affecting energy usage and, alone, cannot serve as a credible basis for drawing conclusions about usage. *Id*., pp. 33-34. Indeed, the Company's actual usage data conclusively demonstrates that OCA's assumptions and concerns are meritless.

More importantly, actual UGI Electric usage data demonstrates that low-income customers, in fact, use more electricity than the average residential customer. *See* UGI Electric St. No. 6-R, p. 33; *see also* UGI Electric St. No. 10-R, p. 4. As a result, UGI Electric's proposed $14.00 per month customer charge and associated energy charge benefits low-income residential customers, regardless of their participation in CAP, in comparison to the OCA's proposed $8.00 per month customer charge and associated energy charge.

In his Rejoinder Testimony, Mr. Taylor further refined this table into two separate figures that broke out the impact of UGI Electric's customer charge proposal on Low-Income Non-CAP customers and CAP Participants. UGI Electric St. No. 6-RJ, p. 10. Those tables show:

Figure 2 – Low Income Non-CAP Bill Impact

	$8/Month Charge	$14/Month Charge
Customer Charge	$8.00	$14.00
Variable Charge	$0.03808	$0.03077
Average Monthly Usage	993	993
Usage Charge	$37.79	$30.54
Total Distribution Charges	$45.79	$44.54
Monthly Difference		($1.26)
Annual Difference		($15.06)

Figure 3 – CAP Participants Bill Impact

	$8/Month Charge	$14/Month Charge
Customer Charge	$ 8.00	$ 14.00
Variable Charge	0.03808	0.03077
Average Monthly Usage	1,293	1,293
Usage Charge	49.24	39.79
Total Distribution Charges	$57.24	$53.79
Monthly Difference		($3.45)
Annual Difference		($41.42)

Id.

As shown in the above table, with UGI Electric's proposed $14.00 customer charge low-income non-CAP customers will pay $1.26 per month and $15.06 per year <u>less</u> than if they were subject to the OCA's $8.00 per month customer charge. UGI Electric St. No. 6-RJ, p. 10, Figure 2. Similarly, low-income CAP customers will pay $3.45 per month and $41.42 per year <u>less</u> under UGI Electric's proposal. UGI Electric St. No. 6-RJ, p. 10, Figure 3. Contrary to OCA's assertions, UGI Electric's low-income customers will <u>benefit</u> from the Company's proposed $14.00 per month customer charge, in comparison to the OCA's proposal.

For these reasons, the OCA's concerns regarding the impact of the $14.00 customer charge on low-income customers should be rejected.

d. Conclusion As To The Residential Charges.

UGI Electric's proposed residential class rate design properly reflects the cost to serve the residential class and results in monthly and annual bill decreases for its low-income residential customers.

3. Non-Residential Charges.

a. The Company's Proposed Rate Design For Rate GS-1 And Rate GS-4 Is Reasonable And Should Be Approved.

In its Direct Testimony, the Company proposed no allocation of the proposed revenue increase to the General Service class and, therefore, proposed to maintain the existing rate design for this class. UGI Electric St. No. 8, pp. 17-18. OSBA recommended splitting this class into two rates. OSBA St. No. 1, pp. 11-12. In its Rebuttal Testimony, the Company adopted certain minor modifications to its cost of service study, which ultimately necessitated certain minor changes to its proposed rate design for Rates GS-1 and GS-4. *See* UGI Electric St. No. 8-R, pp. 5-6, 12-13 (explaining proposed adjustments for Rates GS-1 and GS-4). As seen in UGI Electric Exhibit E – Proof of Revenue (REBUTTAL), UGI Electric adopted a total revenue increase of $606,680 for Rate GS-1 along with a customer charge of $14.00 per month, which results in a revised distribution rate of $0.04707/kWh. *See* UGI Electric Exhibit E – Proof of Revenue (REBUTTAL). In addition, the Company adopted the OSBA's proposal for a total revenue decrease of $520,672 for Rate GS-4 along with a customer charge of $15.00 per month which results in revised energy rates of $0.02222/kWh for the first block (first 200 hours of demand), $0.01533/kWh for the second block (next 300 hours of demand) and $0.01261/kWh for the third block (all hours over 500). UGI Electric Exhibit E – Proof of Revenue (REBUTTAL). Demand charges for the first 20 kWh would be $3.59/kWh and the second block (over 20 kWh) would be

$2.20/kW. Mr. Lahoff explained these changes in his Rebuttal Testimony. *See* UGI Electric St. No. 8-R, pp. 12-13.

Given that these changes in rate design are the result of the Company's proposal to adopt reasonable modifications to its cost of service study (*see* Section IX.A.2.b. *supra*), which have influenced the revenue to be allocated to each customer class, and which are aligned with OSBA's proposal (*see* Section IX.B.2-3. *supra*), the Company submits that the proposed rate design for Rates GS-1 and GS-4 presented in its Rebuttal Testimony is reasonable and should be approved.

b. Rate LP.

i. The Company's Current Rate LP Design Should Be Maintained.

UGI Electric witness Mr. Lahoff explained in his Direct Testimony that the Company proposed no changes to the rate design for Rate LP, because no portion of the revenue increase was allocated to the Large Power class. UGI Electric St. No. 8, pp. 18-19.

ii. OSBA's Proposed Modifications To Rate LP Design Should Be Rejected.

OSBA witness Mr. Knect proposed certain "directional" changes to the Rate LP design, as indicated in his Surrebuttal Testimony. OSBA St. No. 1-S, p. 3, Table IEc-SD6: CORRECTED (reflecting OSBA's proposed Rate LP design and correcting errors contained in the proposal in OSBA St. No. 1-SD). Mr. Knecht indicated that he was concerned the Rate LP eligibility cutoff is too low, at 100 kW. OSBA St. No. 1, p. 24. In addition, Mr. Knecht recommended including a customer charge or retaining a two block demand charge, reducing the demand charge block differentials, and reducing the Wright energy charge. OSBA St. No. 1-SD, pp. 8-9.

As Mr. Knecht's proposed Rate LP design is reflective of no revenue increase being allocated to Rate LP, the Company submits that Mr. Knecht's proposed rate design changes are unnecessary. UGI Electric St. No. 8-R, p. 14. In addition, it is important to note that the Company has not proposed a change to Rate LP's design in this proceeding; OSBA is the proponent of these changes. As such, OSBA bears the burden of proof with respect to this proposal. *See Pa. P.U.C. v. Philadelphia Gas Works*, Docket Nos. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 45 at *165-68 (Order entered Sept. 28, 2007) (adopting the ALJ's discussion on burden of proof).

Mr. Knecht provided no evidence that the Rate LP eligibility cutoff was unjust or unreasonable. In addition, he provided no analysis regarding the bill impacts for Rate LP customers that would occur if his alternative rate design proposal were adopted and no evidence that the current rate design, without these changes, is unreasonable. The Company submits that Mr. Knecht has not supported his proposed changes to the Rate LP design and, therefore, those changes should be rejected.

c. Lighting Customer Class.

UGI Electric witness Mr. Lahoff explained in his Direct Testimony that the Company proposed no changes to the rate design for the Lighting customer class, because no portion of the revenue increase was allocated to the Lighting class. UGI Electric St. No. 8, p. 19. No parties contested the Company's proposed rate design for the Lighting customer class. The Company's proposal results in substantial movement towards the system average return for the Lighting customer class and, therefore, warrants no alteration to the applicable rate design.

For these reasons, the Company's proposed rate design for the Lighting customer class should be approved.

d. Rate HTP.

UGI Electric witness Mr. Lahoff also indicated that Rate HTP would be updated to solely reflect a two-component customer charge. UGI Electric St. No. 8, pp. 19-20. The two components of the customer charge are associated with Primary Metered Service and Secondary Metered Service. *Id.* No customers currently take service under this schedule, and no costs or revenues were assigned to it as a part of the Company's filing. In addition, no party contested the Company's proposed Rate HTP design.

For these reasons, the Company's proposed rate design for Rate HTP should be approved.

e. Merchant Function Charge ("MFC").

In its Direct Testimony, OSBA recommended that the Company include an MFC to recover supply-related uncollectibles for default service. OSBA St. No. 1, p. 25. OSBA proposed this revision to the Company's rate design based upon his concern that shopping customers may be required to pay for uncollectible expenses associated with default service. *Id.*

The Company explained that it is not feasible or reasonable to implement an MFC at this time. UGI Electric St. No. 8-R, pp. 15-16. Very few residential customers currently participate in the Company's Choice program, approximately 0.5%, and implementing the MFC would be cost-prohibitive given the current focus on implementing high impact IT projects such as the UNITE Phase 1 and Phase 2, CIS, and ERM projects. *Id.* As such, it would not be prudent to implement this charge at this time.

OSBA did not attempt to rebut these facts in its Surrebuttal Testimony. As such, the Company notes that OSBA, as the proponent of this tariff revision, bears the burden of proof. *See Pa. P.U.C. v. Philadelphia Gas Works*, Docket Nos. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 45 at *165-68 (Order entered Sept. 28, 2007) (adopting the ALJ's discussion on burden of proof). The Company submits that the OSBA has not met its burden to demonstrate this proposed charge is just and reasonable, and that significant reasons exist to not implement the charge at this time.

For these reasons, the Commission should reject OSBA's proposal to require the Company to implement an MFC.

D. SCALE BACK

As explained throughout this brief, the Company's proposed rate increase is just and reasonable and, therefore, should be approved. However, to the extent the Commission approves a rate increase less than that proposed by the Company, the scale back should be applied proportionally based on the Company's proposed revenue allocation. UGI Electric St. No. 8-R, p. 24. This proportional scale back would apply to both the proposed increases and proposed decreases. As to rate design, the scale back should first be applied to any proposed increase to any energy charges, and then to any proposed increase to demand charges. *Id*. The Company also submits that any scale back should be based on the Company's proposed rates and not the reduced customer charge proposed by I&E and OCA. *Id.*, p. 25.

I&E witness Cline recommends that the Rate GS-5 usage rate first be scaled back to produce $29,078 in revenue, and then the Rate R usage rate be scaled back to produce $14,297,208 in revenue. I&E St. No. 3, p. 39. Additionally, I&E recommends a proportional scale back from the $10.00/month usage rate occur for classes GS-5 and R equally to produce the revenue increase granted by the Commission. *Id*. These recommendations, however, should not be adopted. Any scale back should be conducted consistent with the reasonable revenue allocation proposed by the Company.

E. SUMMARY

The Company's proposed ACOSS and revenue allocation are guided by the current rate of returns for each customer class and consistent with the Commonwealth Court's directives in *Lloyd*. The result of these proposals is to move the distribution rates for each class closer to the full cost of providing service to those classes. Despite the claims by OCA and I&E that the proposed Residential customer rate violates the principle of gradualism, the Commonwealth court in *Lloyd* explicitly stated that gradualism may not "trump" cost of service as the primary basis for allocating an increase in revenue. *Lloyd*, 904 A.2d at 1020-21. The result of the Company's revenue allocation is a just and reasonable rate design that, in particular, would result in residential customers paying less for their electric service than under the alternative proposal advanced by OCA. For these and the above reasons, the Company's proposed rate structure is just and reasonable and should be adopted in this proceeding.

X. UNIVERSAL SERVICE

As explained in Section III.F *supra*, the Joint Stipulation resolved the Universal Service Programs issues raised in this proceeding. Joint Stipulation ¶ 11. The Joint Stipulation regarding these issues is, therefore, reasonable and should be approved.

XI. MISCELLANEOUS ISSUES

A. QUARTERLY EARNINGS REPORTS

I&E has challenged the Company's method of calculating its QER, which is filed on a quarterly basis when UGI Electric is not in a base rate proceeding. *See* 52 Pa. Code § 71.1 *et. seq.* Specifically, I&E's witness Joseph Kubas has challenged UGI Electric's use of FPFTY ratemaking adjustments in the calculation of past QERs—the last of which was filed on November 30, 2017. His requested relief is that the Company not be allowed to use FPFTY ratemaking adjustments in future QERs—the next of which will not be filed until May 31, 2019. I&E St. No. 5, pp. 8, 15.

UGI Electric opposes I&E's recommendation for three primary reasons. First, the challenge to the QER calculation is outside the scope of a base rate proceeding conducted pursuant to Chapter 53 of the Pennsylvania Code as the method of reporting QER calculations has in base rate proceedings. *See* 52 Pa. Code § 53.53. Therefore, it should be excluded from this proceeding.

Second, I&E's recommendation raises a policy issue concerning the appropriate method of making QER filings that would impact other utilities, many of which also reflect the FPFTY adjustments in their QERs consistent with the provisions of Act 11. These affected utilities will be deprived procedural due process if they have no opportunity to comment on this important policy recommendation. A UGI Electric base rate case is simply not an appropriate forum for addressing I&E's QER recommendation.

Finally, should the Commission elect to address this policy recommendation in this case, I&Es position should be rejected.

Chapter 71 of the Commission's regulations seeks "[f]inancial data which specifies actual per book amounts," and also requires utilities to report adjustments to financial data to "reflect current Commission ratemaking policy and practices" so that the Commission can obtain a clearer picture of the likely results of a base rate investigation. *See* 52 Pa. Code §71.5(a)(2) and §71.6(d). This purpose was not altered by the provisions of Act 11 which, amongst other things, overturned existing Commission precedent by amending Section 315 of the Public Utility Code to allow utilities to use a FPFTY in ratemaking. As a result of this statutory change the adjusted financial data presented in QERs needs to be adjusted to reflect this ratemaking practice for those utilities electing to use FPFTYs for ratemaking so that the Commission would continue to have a clear picture of the likely results of a base rate investigation of such utilities. I&E's recommendation would undermine the explicit use of FPFTY ratemaking adjustments afforded to utilities by Act 11 by requiring QERs to be adjusted in ways that would not be reflective of how base rates would be determined or reviewed, and I&E's recommendation should thus be rejected.

For the reasons further explained in this section, the QER issue should either be excluded from this proceeding, or, in the alternative, the recommendation of I&E should be rejected as inconsistent with current ratemaking practice established by Act 11.

1. The QER Issue Should Be Excluded From This Proceeding.

The Commission's Order suspending this proceeding and setting it for hearing, which was entered on March 1, 2018, provides the scope of the proceeding. In that Order, the Commission stated as follows:

> 1. That an investigation on Commission motion be, and hereby is, instituted to determine the lawfulness, justness, and reasonableness of the rates, rules, and regulations contained in the proposed Tariff Electric PA P.U.C. Nos. 6 and 2S
>
> ….
>
> 4. That this investigation shall include consideration of the lawfulness, justness, and reasonableness of the UGI Utilities, Inc. - Electric Division's existing rates, rules, and regulations.

Suspension Order at p. 2. Further, base rate proceedings are governed by Chapter 53 of the Pennsylvania Code. In relevant part, 52 Pa. Code § 53.53 provides:

> (a) When a public utility…files a tariff or tariff supplement seeking a general rate increase within the meaning of 66 Pa.C.S. § 1308(d) (relating to voluntary changes in rates), and the general rate increase exceeds $1 million in gross annual revenues, in addition to the data required by other provisions of this chapter, the

> tariff or tariff supplement shall be accompanied by responses to the data requests contained in the following exhibits which apply to the utility types indicated.
>
> …
>
> (3) Exhibit C—Electric utilities.
>
> …
>
> (c) Initial utility direct testimony of a witness who shall testify in support of the utility's position shall be provided as part of the filing materials. The testimony of the filing utility shall include a complete explanation and justification of claims which depart from the unadjusted test year results of operations, including the methodology and rationale. The testimony shall be accompanied by supporting worksheets, if necessary, and shall refer to supporting exhibits to which the testimony relates. The explanation and documentation of the proposed adjustments shall enable a reasonably informed party to determine how the amount was calculated and to understand why the amount is being claimed.

As reflected in Chapter 53 and the Suspension Order, the appropriate scope of the 2018 Base Rate Case is all issues that are related to the justness and reasonableness of the Company's proposed rates, rules, and regulations <u>currently reflected in its tariffs, or proposed in the tariffs</u> to be adopted as part of this proceeding.

The QER does not fall into either of these categories and therefore should be excluded from this proceeding. Importantly, this conclusion is fully supported by the testimony of I&E's own witness. Mr. Kubas unequivocally states: "A base rate case and a QER are two different filings with two different filing requirements." I&E St. No. 5-SR, p. 7. Despite this clear statement, I&E has continued to argue that the calculation methods used in QERs is an appropriate issue to be decided in a base rate case. *See, e.g.*, Tr. 82. I&E provides no rational basis for concluding that the QER is related to this proceeding, aside from a broad assertion that because the rate of return is determined in a 1308(d) base rate proceeding and reported in a QER, they are therefore, somehow, inextricably linked. Tr. 82:10-16 (statement by counsel for I&E).

This is not a reasonable conclusion to draw, and it does not comport with the Commission's regulations governing these two separate proceedings.

As described previously, Chapter 53 governs base rate proceedings. However, an entirely separate chapter of the Pennsylvania Code, Chapter 71, governs the calculation and filing of the QERs. QERs are only filed when a utility is not involved in a base rate proceeding. 52 Pa. Code § 71.4(c). This shows that the legislature and Commission do not find QERs to add value to the rigorous analytical process occurring in a base rate proceeding, and that the two filings are materially unrelated in form, content, and purpose. Indeed, the Company's QER filing is less than ten pages in length, while its 2018 Base Rate Case is supported by thousands of pages of detailed materials.

Not only is it clear that the analysis involved in the QER has no relevance or relationship to a base rate proceeding, the relief requested by I&E regarding the QER clearly has no relationship to this proceeding. I&E has requested that the Commission order UGI Electric not to use the FPFTY adjustments in future QERs. However, the Company will not file another QER until May 31, 2019 – months after the Commission enters its order in this proceeding.

Critically, I&E is not without remedy if the QER issue is struck from this base rate proceeding. I&E has numerous other avenues that are readily available to address its concerns, and which would be much more appropriate. The most appropriate venue for the determination on the appropriate calculation of the QER, would be for I&E to petition the Commission to initiate an industry-wide rulemaking proceeding. *See e.g. Pa. P.U.C. v. Pennsylvania-American Water Co.*, Docket No. R-00932670 *et al*., 1994 Pa. PUC LEXIS 120 at *158 (Final Order entered July 26, 1994) (adopting the ALJ's conclusion that the issues raised by OCA were outside the scope of rate case and would be better addressed in a statewide rulemaking proceeding). An industry-wide rulemaking proceeding would allow all interested participants to provide the Commission with comments on the impact of adopting I&E's recommendations for QER reporting, and provide feedback related to the impacts on different parts of the industry, if such recommendation were adopted. UGI Electric provides a comprehensive discussion on the need for an industry-wide proceeding below.

2. This Issue Should Not Be Decided Without Input from Other Impacted Members of the Industry.

I&E's adjustment to the calculation of the QER should not be adopted in this proceeding, where the full impact of its proposal cannot be properly assessed. The full implications of this policy change on other industry actors cannot be known and weighed on the evidence presented by UGI Electric, alone, or within the shortened time span of this base rate case. While I&E's witness spends a significant amount of testimony opining on the fact that there are other utilities who do not use the FPFTY in their QER calculations, he provides no information on the operational circumstances that may lead one utility to use or not use the FPFTY in its calculation of the QER. Section 315 of the Public Utility Code clearly authorizes, at the utility's election, the use of a HTY, FTY, or FPFTY for ratemaking. Varied approaches are utilized across the industry, and the Commission should certainly be afforded the opportunity to hear and understand the circumstances of these different approaches from the utilities that would be impacted, before it adopts any wide-ranging policy.

Many utilities in Pennsylvania do appear to be including FPFTY ratemaking adjustments in the calculation of the QER. A non-comprehensive review indicates that PECO Electric, York Water, Superior Water, Aqua PA and Pennsylvania American Water Company, National Fuel Gas Distribution Company, PECO Gas, Peoples Gas, Peoples Equitable Gas, Peoples TWP, as well as the other UGI distribution utilities: UGI Utilities – Gas Division, UGI Penn Natural Gas, UGI Central Penn Gas, all include adjustments for future plant additions. UGI Electric St. No. 1-R, p. 10. Despite Mr. Kubas' disregard of non-electric utilities in his surrebuttal testimony, I&E St. No. 5-SR, p. 20, it is clear that any determination on this issue may hold significant policy implications for many other utilities. It would be a deprivation of due process to exclude these impacted utilities from presenting their positions. Further, it would be unfair to target UGI Electric, alone, where there is substantial evidence that other utilities are engaging in the same behavior. The widespread nature of this behavior clearly suggests that it is not prohibited by the Commission's regulations. The Commission's decision-making is subject to the requirement that there be adherence to the fundamental principles of fairness and to the constitutional guarantees of due process. *West Penn Power Company v. Pennsylvania Public Utility Commission*, 174 Pa. Superior Ct. 123, 131, 100 A.2d 110 (Pa. Super. 1953). Simply put, determination of this issue in this proceeding would be manifestly unfair to both UGI Electric and the rest of the industry.

I&E has proclaimed in this proceeding that one of its primary concerns is that there should be uniformity across the industry. I&E St. No. 5, p. 4; I&E St. No. 5-SR, p. 15. However, no uniformity can be achieved through one-off proceedings, such as this one. Not only would industry uniformity not be served by addressing this issue in one small electric utility's base rate proceeding, judicial scrutiny will not be well-served, either. Base rate proceedings constrain the Commission's time for consideration, due to statutory time constraints. By raising this QER issue in a base rate proceeding, I&E will prevent this issue from receiving the thorough examination it deserves. This constrained review, in combination with the exclusion of all other members of the industry, will thwart a complete and adequate examination of Chapter 71 filing requirements for QERs under the ratemaking landscape created by Act 11.

Rather, the appropriate forum would be a statewide proceeding involving all public utilities and stakeholders that was not subject to the time constraints of a base rate proceeding. Only in this way could a unified industry-wide approach be determined and implemented, as desired by I&E.

Finally, I&E may petition the Commission at any time to pursue its proposed policy alteration in a separate proceeding. A separate proceeding would provide all interested industry participants with the opportunity to comment on any proposed rulemaking. UGI Electric St. No. 1-R, p. 11. Further, if the Commission believes that modifications are necessary in order to update Chapter 71 QER reporting requirements to more clearly comport with Act 11 and any other Commission objectives, the Commission may open a generic rulemaking proceeding at any time to begin that process.[40] UGI Electric St. No. 1-R, p. 11. However, it is clearly not appropriate to make a determination on an issue that will impact many utilities without giving them the opportunity to comment on the methodology being used.

3. The Company's Calculation Of The QER Is Consistent With Ratemaking Practices In Pennsylvania And Does Not Need To Be Altered.

If the QER issue is not struck from this proceeding, then a review of the evidence produced in this proceeding shows that the Company's calculation is fully consistent with the Commission's current ratemaking practices and the intention of the legislature in passing Act 11. Further, the concerns I&E has raised in its testimony are inconsistent with positions previously taken by the Commission in other proceedings.

[40] Moreover, the FPFTY is authorized by statute as a ratemaking policy. The regulation at issue specifically allows ratemaking adjustments in accordance with current PUC ratemaking policy, which as the Company indicated in Section IV.A.1., above, as well as in Section X.A.3., below, was already acted upon by the Commission. Adoption of I&E's position is inconsistent with a clear PUC regulation, and can only be adopted as part of a statewide proceeding to change or waive the regulation.

a. The Company's Calculation Of The QER Is Necessary In Order To Facilitate The Mandates Of Act 11.

As described previously in Section IV.A.1., Act 11 amended Chapters 3, 13 and 33 of Title 66 of the Code. One of the key amendments was to provide Pennsylvania utilities with the ability to use a FPFTY for ratemaking purposes. Indeed, as part of this proceeding, UGI Electric has adopted the FPFTY in its ratemaking calculation. As of 2018, a majority of Pennsylvania utilities now utilize the FPFTY in the calculation of their base rates. Both the Company's witness and I&E's witness agree that the FPFTY reflects current ratemaking practice in Pennsylvania. UGI Electric St. No. 1-R, pp. 3-4; I&E St. No. 5, p. 11. There is seemingly no dispute in this proceeding that the FPFTY reflects the ratemaking methodology currently employed by the Commission.

Chapter 71, on its face, requires utilities to calculate their QERs on a "ratemaking basis." In relevant part, Chapter 71 provides as follows:

> (a) A public utility shall make annualization, normalization and ratemaking adjustments to its intrastate data to reflect, to the extent practicable, its results of operations on a ratemaking basis. <u>These adjustments shall be consistent with current Commission policy and practices.</u>

52 Pa. Code § 71.6(a) (emphasis added). Despite this directive, I&E's exhaustive testimony in this proceeding insists on a pre-Act 11 Chapter 71 analysis, where the QER would not include FPFTY adjustments. However, the Commission operates in a post Act-11 regulatory environment, and calculation of the QER must reflect that reality. I&E's recommendation in this proceeding is to ignore the impact of Act 11 on ratemaking for the purposes of calculating the QER, which is directly contrary to the plain language of Chapter 71. Chapter 71 "requires" utilities to calculate their QERs on a "ratemaking basis." The Legislature and the Commission have spoken on what constitutes ratemaking in Pennsylvania. Both parties' witnesses agree that

FPFTY adjustments may be reflected in rate base as authorized by Act 11, and that the FPFTY reflects current ratemaking practice in Pennsylvania. UGI Electric's inclusion of FPFTY ratemaking adjustments in the calculation of its QER therefore is fully consistent with Act 11 and the plain language of Chapter 71 and should be allowed to continue.

The language of Act 11 itself clearly contemplates that the FPFTY will be included in the calculation of the QER. Act 11 states, in relevant part:

> The distribution system improvement charge shall be reset at zero if, in any quarter, data filed with the commission in the utility's most recent annual or quarterly earnings report show that the utility ***will*** earn a rate of return that would exceed the allowable rate of return used to calculate its fixed costs under the distribution system improvement charge.

66 Pa. C.S. §1358(b)(3) (emphasis added). Critically, this section clearly states the criteria that the QER "…show that the utility ***will*** earn …" UGI Electric St. No. 1-R, pp. 8-9. The forward looking context of this language in regard to rate of return is quite clear. I&E, however, argues that the purpose of the QERs is to provide the Commission with a snapshot of the utility's ***current*** financial performance and earnings. I&E St. No. 5, p. 9; I&E St. No. 5-SR, p. 5. Moreover, the QERs are filed quarterly with two months' lag in the data (*e.g.*, the Company's last filing, made November 30, 2017, reflected the quarter ending September 30, 2017). Thus, the information that would be generated in the QERs under I&E's calculation would provide no basis for determining whether a utility "will" earn an excessive return. Nor would it even provide a current snapshot, because the data would already be stale. Obviously, the QER must be adjusted to reflect future conditions if it is to provide any relevant information as to future returns. UGI Electric's method that includes a ratemaking adjustment for FPFTY data addresses this issue; I&E's method does not.

In addition, I&E's position is contrary to the position taken by the Commission in its *Act 11 Implementation Order*, where the Commission also adopted this forward looking approach to the calculation of the QER. The Commission's view in the *Act 11 Order* is that QERs should be forward looking for purposes of determining whether a utility **will** earn a rate of return in excess of that permitted in conjunction with the use of the DSIC. *Tentative Implementation Order*, at pp. 17-18 (citing 66 Pa. C.S. § 1358(b)(3)); UGI Electric St. No. 1-RJ, p. 3. I&E's proposal, focusing on a current picture of the Company's financial performance based exclusively on past data would make it impossible to fulfill the criteria clearly established by Act 11 that the earnings test be one that is forward looking for ratemaking purposes. In order to fulfil the clear statutory mandate of considering whether the utility will be overearning, the FPFTY must be used in the calculation of the QER. The Company's rationale for FPFTY ratemaking adjustments is rooted in the permissible ratemaking adjustments authorized by Act 11. UGI Electric St. No. 1-R, p. 9. It should not be modified as part of this proceeding.

This conclusion is fully consistent with Commission precedent regarding calculation of the DSIC. After the passage of Act 11, on May 11, 2012, the Commission issued its *Tentative Implementation Order* requesting comments from the industry. Many industry participants filed comments, including National Fuel Gas Distribution Company ("NFGD"). In its comments, NFGD provided as follows:

> The *Tentative Implementation Order* provides that, "For investor-owned utilities, reset is also required if, in any quarter, data filed with the Commission in the utility's most recent quarterly earnings report shows that the utility **will earn** a rate of return that would exceed the allowable rate of return used to calculate its fixed costs under the DSIC." *Tentative Implementation Order* at 17-18 citing 66 Pa. C.S. § 1358(b)(3) (emphasis added). In using the Commission's quarterly earnings report to determine if a DSIC is under the cap, clarification is needed to specify that the cap is aligned to the "Adjusted Results" column (5) found at the far right

> hand of the report. A copy of the report page is provided in Appendix B. The Adjusted Results column more accurately represents what the company *will earn* as prescribed above. Utilizing the adjusted results is also consistent with 52 Pa Code §71.6(a), which provides that, "A public utility shall make annualization, normalization and ratemaking adjustments to its intrastate data to reflect, to the extent practicable, its results of operations on a ratemaking basis."

NFGD Comments, Docket No. M-2012-2293611 at p. 9 (emphasis added). Further, in summarizing NFGD's comments, the Commission stated:

> NFGD comments that clarification is needed regarding the use of the Commission's quarterly earnings report to determine if a DSIC is under the cap. NFGD states in using the Commission's quarterly earnings report to determine if a DSIC is under the cap, it should be specified that the cap is aligned to the "Adjusted Results" column (5) found at the far right hand of the report. NFGD explains that the Adjusted Results column more accurately represents what the company will earn. **NFGD further asserts that using the adjusted results is also consistent with 52 Pa. Code § 71.6(a), which provides that, a "public utility shall make annualization, normalization and ratemaking adjustments to its intrastate data to reflect, to the extent practicable, its results of operations on a ratemaking basis.**

Act 11 Implementation Order, at *68. Thus, from both NFGD's comments and the Commission's summary of those comments, it is appropriate to conclude that the issue being addressed by the Commission in its Final Order was whether the QER would include the FPFTY adjustment.

In the Commission's *Act 11 Implementation Order* establishing procedures and guidelines necessary to implement Act 11, it considered and addressed NFGD's comments. The Commission determined:

> Resolution: **We will adopt NFGD's recommendation** that we use the adjusted results to determine if the DSIC surcharge is under the cap so as to determine whether it should be reset to zero.

Act 11 Implementation Order, at *69. Thus, the Commission recognized that ratemaking adjustments, such as the FPFTY, should be included in the calculation of QER for DSIC purposes. The Commission did not object to ratemaking adjustments associated with Act 11, and QERs inclusive of FPFTY ratemaking adjustments have been submitted now for five years since the passage of Act 11, with no related Commission action. UGI Electric St. No. 1-R, p. 11. Further, no party, including I&E, has opposed the many companies who have used FPFTY ratemaking adjustments in the calculation of their QERs for the past five years, despite all statutory advocates receiving a copy of the QERs filed by each utility every quarter.[41] UGI Electric St. No. 1-R, p. 4; 52 Pa. Code § 71.7.

I&E's proposal in this proceeding to modify the Company's calculation of the QER is improper, because it goes against the clear intention of the legislature to alter ratemaking in Pennsylvania through the adoption of Act 11, as well as the Commission's previous consideration of this issue in its *Act 11 Implementation Order*.

b. I&E's Arguments Regarding The Accuracy Of UGI Electric's QER Calculations Are Without Merit And Should Be Rejected

I&E has made three claims associated with the accuracy of the use of the FPFTY as its basis for challenging the use of the FPFTY in the calculation of the QER. The first is that UGI Electric's data for the FPFTY is speculative in nature. The second is that UGI Electric has previously included data that was inaccurate. The third is that the Company's use of the FPFTY falsely inflates its numbers in order to avoid an investigation by the Commission. Each of these three claims is without merit and should be rejected.

In its testimony, I&E's claim that UGI Electric's data is speculative does not align with the Commission's or Legislature's guidance on Act 11 or the facts presented in this proceeding.

[41] It is worth noting that a review of NFGD's most recent QER that could be obtained via the Commission's website indicated that NFGD is also using the FPFTY to calculate its QER. UGI Electric St. No. 1-RJ, p. 5.

On a fundamental basis, I&E's assertion that the Company's plant additions are speculative is legally contrary to numerous ways in which the Commission accepts projected information as reasonably reliable. FPFTY plant additions are now included in the vast majority of base rate proceedings since the passage of Act 11. Further, FPFTY plant additions are specifically contained in the Company's approved LTIIP. UGI Electric St. No. 1-R, p. 7. Act 11 requires the Company to have an approved LTIIP as a prerequisite for a DSIC. *See* 66 Pa. C.S. § 1353(b)(3). Although the Company does not yet have a DSIC, the Company's LTIIP includes projected DSIC-eligible capital projects through December 31, 2022, which means it includes the FPFTY as well as three years of plant additions past the end of the FPFTY.[42] UGI Electric St. No. 1-R, p. 7. The Commission approved the LTIIP, including its long-term forward projection of spending, which shows that the Commission considers these LTIIP projections sufficiently reliable to use them as the foundation for cost recovery through the DSIC for qualifying utilities. UGI Electric St. No. 1-R, p. 8. I&E's position that the QER should not reflect the FPFTY because the numbers are speculative should be rejected as inconsistent with the Commission's position in other proceedings. Simply stated, UGI Electric has calculated its QER on a FPFTY "ratemaking basis" as it is required to do under the plain language of the regulation, and there is no reason to presuppose that the use of the FPFTY is more speculative in the QER than in other proceedings before the Commission where projected plant is included and approved.

I&E also criticizes UGI Electric for including past data in its QERs that was inaccurate. Specifically, I&E has stated that there was a 35% decrease in projected plant between the Company's September QER and the filing of this case, which I&E believes is indicative of highly speculative FPFTY projections. I&E St. No. 5, pp. 9-10. The Company provided a detailed explanation of the difference in plant additions in this rate case and the QER reported for

[42] The Company filed its LTIIP with the Commission on August 16, 2017, at Docket No. P-2017-2619834.

the period ending September 30, 2017. UGI Electric St. No. 1-R, p. 8; UGI Electric Ex. PJS-2. The plant addition differences were principally related to "(1) budget adjustments made by the Company since the time it filed the QER, (2) corrections for transmission allocations, and (3) changes in depreciation rates updated in conjunction with the rate case." UGI Electric St. No. 1-R, p. 8. The assertion that these fully explained variances are highly speculative is simply inaccurate.

I&E's testimony broadly states that "the inclusion of FTY and FPFTY plant projections in the QER is speculative." I&E St. No. 5, p. 9. It must be noted, however, that the only evidence I&E provides in order to show that the information relied upon in the QER is speculative is the difference in rate base amounts between the most recent QER and this rate case. However, the Company acknowledged and explained specific corrections and updates that were made by the Company in the time between its most recent QER and the filing of this base rate proceeding. *See* UGI Electric St. No. 1-R, pp. 7-8. I&E has not made any other claim showing any of the Company's past QERs—five years' worth of quarterly filings since the passage of Act 11 and the adoption of the Company's current methodology for calculating the QER—were similarly flawed. However, the Company has shown that I&E is mistaken in its assertion that the FPFTY data is speculative. I&E Exhibit No. 3, Schedule 2, provides a detailed listing of all of the plant additions claimed in this case, and there is clear factual detail and support of Company plant additions in the FPFTY. These additions are not based on mere speculation. On the contrary, it is these very plant additions that the Legislature and Commission have found are appropriate for inclusion in rate base in base rate proceedings. I&E looks at one particular example to support its claim, out of years' worth of data, when there are numerous instances shown by UGI Electric, and the Commission more broadly, that FPFTY data is reasonably reliable.

I&E's final criticism of the Company's approach is an allegation that the Company has included the FPFTY in the QER merely to falsely inflate its numbers to avoid an investigation and in order to implement the DSIC sooner. I&E St. No. 5, p. 7. These allegations have no basis. First, is it not possible for the Company to be eligible for a DSIC at this time, as it has not yet even filed for a DSIC with the Commission. Thus, I&E's criticism is simply incorrect on this point. UGI Electric St. No. 1-R, p. 7. Second, as to the Company's September 30, 2017, QER, which was filed with the Commission at the end of November 2017, and was the subject of extensive testimony by I&E's witness, the claim of concern for an investigation is unfounded. At the time of that filing, the Company was well underway in developing this rate case for filing. UGI Electric St. No. 1-R, p. 6. As a result, the Company had absolutely no concerns regarding the possibility of an overearning investigation, because the Company was certain rate relief was justified. UGI Electric St. No. 1-R, p. 6. The fact that this rate case filing was made by the Company less than 60 days after the submission of the QER shows I&E's claim regarding the Company's rationale is incorrect. UGI Electric St. No. 1-R, p. 6. In surrebuttal, I&E has claimed that this concern should not be limited just to the most recent filing, but to all filings, because the Company's methodology produces a more "dire" financial picture. I&E St. No. 5-SR, p. 10-12. I&E's myopic focus on a "snapshot" is not an accurate reflection of the Company's financial position. The Company has committed significant resources to future plant additions that it is obligated to undertake consistent with its LTIIP, as well as its general obligations under 66 Pa C.S. § 1501. Inclusion of the allowable ratemaking adjustment of the FPFTY does not present a more dire picture – it presents a more accurate financial picture of the Company's ongoing operational reality.

Finally, but for I&E raising the issue of the QER in this proceeding, its calculation would have played no role in determining the outcome of this proceeding. The QER currently holds no ratemaking impact for the Company, and as such there was no incentive for the Company to overstate plant additions. UGI Electric St. No. 1-R, p. 6. I&E's suggestion that the Company has included the FPFTY in its calculation of the QER for deceptive purposes has no support, and should be rejected.

I&E's factual grounds for challenging the Company's calculation of the QER have been shown to have serious deficiencies. I&E has not supported a modification to a long-standing industry-wide practice, particularly where these assertions may be completely irrelevant for other Pennsylvania utilities facing different circumstances. I&E has not met its burden of showing that the Company's current practice should be altered.

c. Adopting I&E's Methodology Will Reverse The Progress Accomplished By Act 11.

I&E's proposed modification to the QER will significantly increase regulatory lag and may impact the ability of UGI Electric, and many other utilities in Pennsylvania, to use the DSIC as intended by the Legislature. Further, I&E's proposed adjustment in this proceeding does not produce any meaningful benefit to the Commission.

Modification of the calculation of the QER will negatively impact the ability of UGI Electric to use the DSIC. As Mr. Szykman testified, "[c]onsistent with the intent and purpose of Act 11, UGI Electric, and numerous other utilities in the Commonwealth have moved forward on the landscape established by Act 11 to make long term capital spending commitments under established, and voluntary, LTIIPs." UGI Electric St. No. 1-R, p. 11. For UGI Electric, this has included millions of dollars of accelerated spending, and across the Commonwealth, Act 11 has resulted in "billions of investment dollars on the repair, replacement and improvement of aged and aging utility infrastructure." UGI Electric St. No. 1-R, p. 11. If I&E's recommendations regarding the calculation of the QER were adopted in this rate case, it may have the impact of removing a key element included in Act 11 to support the reduction and elimination of regulatory lag for LTIIP investments. UGI Electric St. No. 1-R, p. 11. This would likely place pressure on utilities, such as UGI Electric, "to reevaluate their willingness and desire for establishing long term commitments related to voluntary LTIIP capital spending." UGI Electric St. No. 1-R, p. 11.

Further, I&E's recommendation would reduce the effectiveness of the DSIC "by imposing more stringent and unreasonable earnings test criteria, ultimately dis-incenting the use of the DSIC and incenting the utilization of more frequent and costly base rate case filings where the use of the FPFTY is without question." UGI Electric St. No. 1-R, p. 12. The specific purpose of Act 11 was to reduce the regulatory lag and to allow utilities prompt recovery of the return on investment in order to incentivize and foster investments in aged and aging infrastructure. UGI Electric St. No. 1-R, p. 11. I&E's proposal, however, would undoubtedly reduce the ability to use the DSIC. As an outcome, this result runs counter to the intent of Act 11 and will only serve to increase regulatory inefficiency.

All else being equal, I&E's adjustment to the QER calculation may result in fewer LTIIP proposals and lower LTIIP investment activity, which would slow the pace of investments in the repair, replacement and improvement of infrastructure across the Commonwealth. UGI Electric St. No. 1-R, p. 11. However, in this proceeding all else would not be equal. Not only is I&E advocating for the alteration of the QER, but as discussed previously, it is also proposing a significant reduction to the total plant reflected in rate base in the FPFTY. *See* Section IV.A.1. *supra*. The combined impact of the two proposals I&E is advancing in this proceeding associated with the use of the FPFTY – that an average approach to rate base should be used and that the FPFTY should not be included in the calculation of the QER – would aggressively undermine the Legislative goal of Act 11 of reducing regulatory lag and facilitating infrastructure repair and replacement. *See Act 11 Implementation Order*, at *4-5 ("Act 11 amends Chapters 3 and 13 of the Code in order 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").

The Commission has already provided clarity on the use of an "average" versus "fully projected" approach to rate base. In its Advanced Notice of Proposed Rulemaking Order, *Use of Fully Projected Future Test Year 52 Pa. Code Chapter 53*, Docket No. L-2012-2317273 (Order entered Dec. 22, 2017), the Commission stated:

> The FPFTY is a ratemaking mechanism that allows a utility to <u>project capital investment and correspondingly to include that projected investment in the utility's claimed revenue requirement throughout the twelve-month period</u> beginning with the first month that the new rates would be placed in effect. 66 Pa. C.S. §§315, 1350-1360; *Pa. Public Utility Commission v. Columbia Gas of PA Inc.*, Docket No. R-2012-2321748, 2013 WL 2420877 (Pa. PUC). A public utility can also use the FPFTY mechanism to project other revenue requirement and ratemaking components such as operating revenues, operating expenses, depreciation, interest expense, taxes, and return.

Id. (emphasis added). Also, in the *Supplemental DSIC Implementation Order*, the Commission, as specifically related to DSIC eligible plant additions, stated:

> The calculation of rates is developed on the device of a "test year," which is a 12-month period that is to be representative of operating conditions when the rates being established will be in effect. The test year can consist of a future test year or a fully projected future test year (FPFTY) as its baseline for setting new base rates. See 66

> Pa. C.S. § 315. As such, a utility requesting to establish new base rates pursuant to a filing under Section 1308(d) of the Code, is seeking to recover the costs of all DSIC-eligible plant in service, plus the DSIC-eligible plant that is projected to be in service either within 9 to 21 months depending on if the utility has used a future test year or a FPFTY to calculate its rates. In other words, if a utility has used a future test year or a FPFTY as the basis for the projection of the costs of all the DSIC-eligible plant that it will place in service, the new base rates should provide for the prospective recovery of the annual costs of all the DSIC-eligible property placed into service and that was previously being recovered under the utility's DISC mechanism.

Supplemental DSIC Implementation Order, p. 13 (emphasis added). Thus, the Commission has acknowledged that the FPFTY is a ratemaking mechanism intended to capture full year projections. Not allowing full year projections, as recommended by I&E for any reason simply is counter to the intent of Act 11 and Commission directive. In a single case, if both of I&E's adjustments were adopted, I&E will have rolled back five years of ratemaking progress in Pennsylvania that is directly contrary to the Legislature's intent.

Finally, the Company's QER, as currently calculated, provides the Commission with all of the relevant information that the Commission needs to make an informed decision regarding the Company's current and future financial health compared to the rest of the industry. It certainly provides the Commission with the critical information needed to assess whether the DSIC would produce excessive returns for those utilities who are utilizing a DSIC, and the likely outcome of a base rate proceeding, *i.e.* whether a utility is overearning on a ratemaking basis. It is worth noting here that I&E's proposal does not provide the Commission with additional information. Instead, it actually deprives the Commission of information currently available that specifically addresses the statutory requirements of Act 11. I&E's proposal does not provide meaningful benefits to the Commission, but does pose a significant risk of harm to the utility industry which will inevitably impact customers, particularly through the need to file more frequent base rate proceedings. UGI Electric St. No. 1-R, p. 13.

I&E's proposal could significantly and negatively impact the intent, and positive future impacts, of Act 11 for both UGI Electric and the industry as a whole. It should not be adopted in this proceeding.

4. Conclusion As To QER.

I&E has not met its burden of showing that FPFTY ratemaking adjustments, as performed by the Company in calculating its QER, should be prohibited as an outcome of this proceeding. On the contrary, I&E's testimony shows that this issue is not appropriate for inclusion in this base rate proceeding, and that this is an industry-wide issue that should be taken up in a proceeding where all industry members and stakeholders are given the opportunity to participate and to share the operational impacts anticipated as a result of this change. Moreover, the Company has demonstrated that the Commission has already addressed this issue in its *Final Implementation Order*, so that even if this issue is decided on the merits in this proceeding, I&E has failed to substantiate its claim that its recommendation is necessary or appropriate as a matter of law and fact. I&E's proposed recommendation regarding the calculation of the QER should not be adopted in this proceeding.

B. PUBLIC INPUT HEARING TESTIMONY

As noted above, two "smart" public input hearings were held on Wednesday, April 18, 2018, in Harrisburg, at 1:00 p.m. and 6:00 p.m. At the public input hearings, four members of the public participated. All members of the public indicated that they were concerned that an increase in base rates would be burdensome on low income customers. One participant indicated that she does support an increase that would allow the Company to undertake necessary repair and replacement of its aging infrastructure.

The Company provides numerous programs to identify and assist low income customers, which were described in the testimony of witness Rossi. *See generally* UGI Electric St. No. 10-R; UGI Electric St. No. 10-RJ. Therefore, UGI Electric submits that the concerns raised by members of the public at the public input hearings have been fully addressed as a part of this proceeding. *See generally* OCA St. No. 5; UGI Electric St. No. 10-R; OCA St. No. 5S; and UGI Electric St. No. 10-RJ.

XII. CONCLUSION

For all the foregoing reasons, UGI Utilities, Inc. – Electric Division respectfully requests that Administrative Law Judges Steven K. Haas and Andrew M. Calvelli and the Pennsylvania Public Utility Commission approve the rate increase and other proposals set forth in Tariffs Electric – PA. P.U.C. Nos. 6 and 2S.

Respectfully submitted,

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Date: July 2, 2018

Counsel for UGI Utilities, Inc. – Electric Division

Appendix A

UGI Utilities, Inc. - Electric Division
Before the Pennsylvania Public Utility Commission
Fully Projected Future Period - 12 Months Ended September 30, 2019
($ in Thousands)

Schedule A-1
Witness: S. F. Anzaldo

Summary of Measure of Value and Revenue Increase

Line #	Description	[1] Function	[2] Reference Section	[3] Pro Forma Test Year Ended September 30, 2019 At Present Rates	[4] Increase	[5] Proposed Rates
	RATE BASE					
1	Utility Plant		C-2	$ 188,423		$ 188,423
2	Accumulated Depreciation		C-3	(59,805)		(59,805)
3	Net Plant in service	L 1 + L 2		128,618	-	128,618
4	Working Capital		C-4	7,150		7,150
5	Accumulated Deferred Income Taxes		C-6	(16,572)		(16,572)
6	Customer Deposits		C-7	(1,419)		(1,419)
7	Materials & Supplies		C-8	1,465		1,465
8	TOTAL RATE BASE	Sum L 3 to L 7		$ 119,242	$ -	$ 119,242
	OPERATING REVENUES AND EXPENSES					
	Operating Revenues					
9	Base Customer Charges		D-5	$ 29,605	$ 7,705	$ 37,310
10	Other Electric Revenue		D-5	58,473		58,473
11	Other Operating Revenues		D-5	1,014		1,014
12	Total Revenues	Sum L 9 to L 11		89,092	7,705	96,797
13	Operating Expenses		D	(84,055)	(540)	(84,595)
14	OIBIT	L 12 + L 13		5,037	7,165	12,202
15	Pro Forma Income Tax at Present Rates		D-33	(307)		
16	Pro Forma Income Tax on Revenue Increase		D-33		(2,070)	(2,377)
17	NET OPERATING INCOME	Sum L 14 to L 16		$ 4,730	$ 5,095	$ 9,826
18	RATE OF RETURN	L 17 / L 8		3.967%		8.240%
	REVENUE INCREASE REQUIRED					
19	Rate of Return at Present Rates	L 18, Col 3		3.967%		
20	Rate of Return Required		B-7	8.240%		
21	Change in ROR	L 20 - L 19		4.273%		
22	Change in Operating Income	L 21 * L 8		$ 5,095		
23	Gross Revenue Conversion Factor		D-35	1.512278		
24	Change in Revenues	L 22 * L 23		$ 7,705		
25	Percent Increase -- Delivery Revenues	L 24 / L 9, C 3			26.03%	
26	Percent Increase -- Total Revenues	L 24 / L 12, C 3			8.65%	