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July 18, 2018

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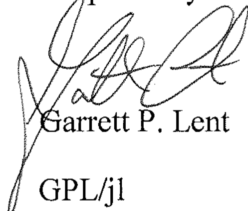
**Re: Pennsylvania Public Utility Commission v.
UGI Utilities, Inc. - Electric Division
Docket No. R-2017-2640058**

Dear Secretary Chiavetta:

Enclosed for filing is the Reply 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,



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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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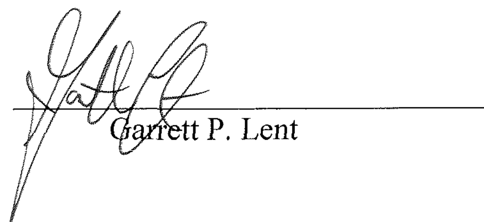

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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.	:	
	:	
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I. INTRODUCTION

On July 2, 2018, in accordance with the litigation schedule established at the Prehearing Conference and set forth in Administrative Law Judge Steven K. Haas's and Administrative Law Judge Andrew M. Calvelli's (the "ALJs") Scheduling Order dated March 30, 2018, UGI Utilities, Inc. – Electric Division ("UGI Electric" or the "Company"), the Pennsylvania Public Utility Commission's ("Commission") Bureau of Investigation and Enforcement ("I&E"), the Office of Consumer Advocate ("OCA"), and the Office of Small Business Advocate ("OSBA") submitted Main Briefs in this proceeding.

In UGI Electric's Main Brief, explaining that its proposed $7.7 million increase in rates should be approved, the Company anticipated and responded to many of the arguments that have been raised by the other parties. In several instances, UGI Electric's position is fully set forth in its Main Brief and further response is not necessary. Certain arguments presented by other parties in their briefs, however, require further response. For ease of reference, UGI Electric's Reply Brief follows the same sequence contained in its Main Brief.

II. SUMMARY OF ARGUMENT

Since its last base rate case in 1996, UGI Electric's plant investment has increased by nearly 60% and inflation has increased by more than 60%. UGI Electric also is in the midst of a major capital improvement program designed to replace aging infrastructure and assure continued safe and reliable service to customers. UGI Electric's rates are among the lowest in the Commonwealth, and its quality of service is well above average. UGI Electric seeks an 8.7% increase in total rates, or a 0.4% per year increase, since its last rate case.

I&E and OCA ignore these facts and propose drastic reductions in the requested increase. As demonstrated in UGI Electric's Main Brief, I&E and OCA achieve this counterintuitive result by ignoring the Public Utility Code, appellate precedent, Commission regulations and prior rate

case orders, and well-established principles of utility ratemaking. In particular, I&E and OCA simply ignore the most relevant available precedent, *i.e.* the Commission's Order in the 2012 PPL Electric rate case. As explained below, I&E and OCA ignore or fail to follow this decision in several important respects. If the ALJs and the Commission follow these well-established precedents, they should reject the adjustments of I&E and OCA and approve UGI Electric's requested increase.

Revenue Requirement. This case raises twelve significant contested revenue requirement issues: (1) cost of common equity; (2) calculation of rate base using the Fully Projected Future Test Year ("FPFTY"); (3) tax expense, specifically the consequences of the Tax Cuts and Jobs Act ("TCJA") and consolidated income tax adjustments; (4) vegetation management expense; (5) Company owned services; (6) incentive compensation; (7) environmental remediation expense; (8) the Electrical Engineering Operations Center; (9) rate case expense; (10) storm damage expense; (11) employee activity costs; and (12) outside services employed. The lack of merit in the adjustments proposed by I&E and OCA is addressed in UGI Electric's Main Brief and below in this Reply Brief.

Cost of Equity. Controlling Commission precedent demonstrates that in establishing the cost of common equity the Commission should consider the discounted cash flow ("DCF") method and "judgment." I&E and OCA calculate an arithmetic DCF result, but exercise little or no judgment in their recommended returns. They fail to consider undisputed evidence of the prospective cost of capital, rely exclusively on arbitrary and flawed DCF analyses, and fail to properly use other methods of calculating the cost of common equity as a check on their inadequate DCF analyses. The end result of these failures is an unreasonable and purely mathematical analysis, which produces an unreasonably low cost of common equity. In addition,

Section 523 of the Public Utility Code requires the Commission to consider management effectiveness in setting rates. UGI Electric presented unrebutted evidence of superior management. I&E and OCA effectively ignore this evidence and Section 523 of the Code. Given the rising interest rate environment, increased risks associated with TCJA, UGI Electric's major capital improvement program and the 10.4% return on equity finding in the Commission's last fully litigated electric rate case (PPL Electric's 2012 rate case), it is clear that the allowed return on equity in this case must substantially exceed 10.0%.

FPFTY. Act 11 amended the Public Utility Code to permit the use of a FPFTY and expressly provides that a utility may include, in rate base, plant added "during" the FPFTY. Despite this clear direction, I&E and OCA propose to exclude half of all plant added during the FPFTY. I&E and OCA argue that reflecting all plant will cause customers to "pre-pay" for plant that is not yet in service. This is not the case factually, but even if it were, Act 11 expressly addressed this issue by providing that the used and useful standard does not preclude the inclusion, in rate base, of plant added during the FPFTY. Finally, I&E and OCA contend that FPFTY plant additions are either not yet completed, may never be completed or may be delayed. Again, the Public Utility Code squarely addresses this issue by providing the Commission with the authority to conduct an after the fact review of plant additions, thereby fully addressing I&E's and OCA's speculative and unsupported concerns.

Taxes. The Company filed supplemental direct testimony in this case fully addressing the ratemaking impacts of the TCJA. Specifically, the Company reduced its tax expense claim by $1.799 million to reflect the lower tax rate (21% vs. 35%) and proposed to establish and amortize a regulatory liability that flows through excess federal ADIT created by the TCJA as a reduction to federal income tax expense that brings the total federal income tax expense well

below the statutory rate. Not content with these adjustments, I&E and OCA propose to further reduce tax expense through a surcharge to reflect the period January 1, 2018 through the effective date of rates in this proceeding, *i.e.* the "2018 Effects" of the TCJA and, perhaps to make things even worse, to further reduce rate base to reflect excess ADIT. OCA also proposes to reinstate a consolidated tax adjustment ("CTA") despite the adoption of Act 40 which prohibits such adjustments.

With respect to the 2018 Effects, I&E's and OCA's proposed surcharge clearly violates well-established rules against single issue and retroactive ratemaking. The only exception to these rules is for expenses which are extraordinary and non-recurring. **The change in tax rates is not a non-recurring item; it is a permanent change in tax rates.** Well-established appellate precedent requires some examination of earnings before a single issue rate adjustment is permitted. The only evidence of record demonstrates that UGI Electric is under earning its allowed return in 2018. There is therefore no basis for the proposed 2018 adjustment.

In addition, I&E and OCA rely almost exclusively on the Commission's recent orders directing utilities not filing rate cases in 2018 to implement negative surcharges effective July 1, 2018, to flow through the prospective effects of the TCJA. These cases are not on point, as the Commission adopted a completely different approach for those companies, such as UGI Electric, who have 2018 rate cases. For utilities with 2018 rate cases, the Commission did not require any immediate rate reduction and simply stated that the 2018 Effects of the TCJA should be considered as part of the impact of the seven-month suspension, as required by Section 1308(d) of the Code. This suspension period falls entirely within the future test year in this proceeding. UGI Electric has demonstrated that it is earning less than a fair rate of return throughout this period.

Regarding excess ADIT, the change in the federal income tax rate from 35% to 21% has two primary effects on rates: (1) it reduces tax expense, which reduces rates, and (2) it decreases ADIT which increases rate base and increases rates. I&E and OCA propose to reflect the reduction in rates, but not the increase in rates.

Finally, OCA proposes to reduce rate base for a hypothetical consolidated tax adjustment. Act 40, which added Section 1301.1 to the Code, clearly phases out CTAs in Pennsylvania, following the lead of 46 other states. OCA's rate base adjustment is equivalent to a CTA. Act 40, on its face, prohibits the rate base adjustment proposed by OCA.

Vegetation Management Expense. The Emerald Ash Borer ("EAB") is causing widespread damage in the Company's service territory and threatening electric service reliability. The Company prudently has added one extra tree trimming crew to address this new threat. I&E argues that the historic experience should reflect the increased expense associated with an additional vegetation crew added in the Future Test Year ("FTY"), even though I&E's own witness conceded that her method would not appropriately capture this increased expense. Ratemaking is prospective, and the Company has shown both the cause of the increased vegetation management expense in the FPFTY and the ongoing need for the additional crew. I&E does not dispute the reasonableness of the Company's response to the EAB and provides no basis for reverting to historic data to set rates.

Company Owned Services ("COS"). The Company is obligated by the Public Utility Code to provide safe and reliable service to its customers. To fulfill this obligation the Company proposes to inspect aging company owned services, repair or replace these services and transfer ownership to customers. I&E, surprisingly, proposes that this program be voluntary to the customer. Obviously, the Company cannot assure safe and reliable service if it cannot gain

access to the company owned services. I&E's proposal clearly conflicts with the Company's obligation to provide safe and reliable service and should be rejected. I&E also proposes to only allow the Company's historic costs associated with this inspection work, despite clear evidence that the Company will be significantly increasing the number of inspections and associated repairs. I&E's arguments opposing the program expense for 2019 are factually and legally insufficient, as well as irrelevant. The Company's proposed expense should be accepted.

Incentive Compensation. Well-established Commission precedent holds that a utility may recover incentive compensation in rates as long as its program has both financial and operating metrics. It is undisputed that UGI Electric's incentive compensation program, as a whole, has both financial and operating metrics. I&E seeks to sub-divide the Company's program into component parts, and identifies one sub-part of the program that looks only at financial metrics. This is inappropriate and at odds with long-standing Commission precedent.

Storm Damage Expense. In accordance with established precedent and basic ratemaking principles, the Company in its rebuttal testimony sought to update its claim for storm damage expense to reflect the most recent available data. I&E, for reasons not clearly explained, opposes this update even though it agreed to updates on other issues such as Materials and Supplies. I&E's inconsistent adjustment should be rejected. OCA provided no response to the Company's revised proposal incorporating its most recent data. Therefore, OCA's position does not reflect the evidence in this proceeding and should be rejected.

Environmental Remediation Expense. UGI Electric claims costs associated with remediation at its Forty Fort service center. I&E and OCA argue the cost should be recovered from the sale of the building. The sale of the building, if one is to occur, will not occur during the FPFTY, and it is not possible to know whether net proceeds will be sufficient to recover the

environmental remediation expense. I&E and OCA vigorously protest going outside of the FPFTY, and in several instances, oppose recovery of costs during the FPFTY. Their inconsistent attempt to reach out well beyond the end of the FPFTY should be rejected.

Rate Case Expense. UGI Electric proposes a three-year normalization of rate case expense. I&E proposes five years. I&E's adjustment is inconsistent with all recent Commission precedent on this issue. I&E does not follow the historical approach from the Commission's recent *Emporium* decision. I&E also rejects the Commission's position in the *2012 PPL RC Order*. I&E's proposal does not conform to any Commission precedent and should be rejected.

Electric Engineering and Operations Center ("Operations Center"). UGI Electric's claimed rate base includes the cost of its planned new Operations Center. OCA asserts that the completion date is speculative, and therefore this planned project should be excluded from plant in service. This is simply another example of OCA's rejection of the FPFTY, particularly where the Company has shown substantial and consistent progress on the development of the project and has demonstrated that the Operations Center will be placed into service during the FPFTY. Finally, even if OCA were correct, as explained herein, the Public Utility Code provides express authority to monitor actual experience and make appropriate adjustments if necessary.

Employee Activity Costs. UGI Electric claims $11,848 in costs associated with activities to improve employee morale. I&E opposes rate recovery for this item, claiming it is not essential to providing reliable service. This is the wrong legal standard. The standard is reasonableness, and this claimed expense is clearly reasonable as demonstrated by record evidence and the fact that the Commission also has an employee appreciation day which costs roughly the same amount and is paid for by utility customers through Section 510 assessments.

Outside Services Employed. I&E challenges UGI Electric's claim for outside services expense. The Company fully explained its proposal. I&E simply ignores this explanation, and relies solely on history to oppose the Company's claim. I&E's proposed adjustment should be rejected.

Class Cost of Service, Revenue Allocation and Rate Design. The Company's proposed revenue allocation is based upon the results of its class cost allocation study, which was based on the same principles of cost allocation approved by the Commission in the *2012 PPL RC Order*. Indeed, the same witness, Mr. John Taylor, prepared UGI Electric's study and the most recent PPL Electric study. The only challenge came from OCA, who not only rejects the *2012 PPL RC Order*, but relies heavily on a dissent in that case. The OCA contends that primary and secondary distribution lines have no customer component, *i.e.*, that the design and operation of an electric system varies only with demand and is not affected by the number of customers. This is not a rational conclusion and should be rejected, as it was in the *2012 PPL RC Order*.

With respect to rate design, the major issue is the residential customer charge. Applying the same methodology approved by the Commission in the *2012 PPL RC Order*, UGI Electric proposes a customer charge of $14 per month. This amount is still below the cost of service and is well below the $17.55 charge approved by the Commission for PPL Electric. I&E and OCA propose lower charges based on principles of gradualism, and OCA argues that low-income customers generally use less electricity than the average residential customer and a higher customer charge therefore adversely impacts low-income customers. Gradualism is applied to rates as a whole; it is not applied to the component parts of a rate increase, such as the customer charge. Additionally, UGI Electric's low-income customers use more electricity than the

average residential customers. As a result, and contrary to OCA's conclusion, a higher customer charge benefits low income customers.

Quarterly Earnings Report ("QER"). I&E failed to meet its burden of proof regarding its proposal to modify the Company's methodology for calculating the QER. This issue should be excluded from this proceeding, because it is not within the scope of a Section 1308(d) base rate proceeding and it is an issue of widespread importance to all sectors of the utility industry. It would be manifestly unfair if the other industry participants (*i.e.* utilities and other stakeholders) were denied the opportunity to comment on I&E's de facto proposed rulemaking. However, should this issue not be excluded, I&E has failed to meet its burden of proof. The plain language of Act 11 and Chapter 71 fully supports the methodology employed by UGI Electric and a dozen other Pennsylvania utilities.

UGI Electric urges the ALJs and the Commission to apply the facts to established precedent and approve the Company's requested revenue increase.

III. STIPULATION OF PARTIAL SETTLEMENT

UGI Electric fully sets forth its position with regard to the Stipulation of Partial Settlement in its Main Brief. UGI Electric MB, Section III. For the reasons explained therein, UGI Electric submits that the Stipulation of Partial Settlement is in the public interest and should be approved.

IV. RATE BASE

A. ORIGINAL COST UTILITY PLANT IN SERVICE

1. END OF TEST YEAR VS. AVERAGE RATE BASE

As explained in UGI Electric's Main Brief, the Company's use of end of test year data to calculate its claimed plant in service is fully consistent with: (1) the plain language of Act 11; (2) long-standing precedent approving calculation of rate base at a point in time; (3) long-standing

ratemaking practice using end of test year data for historic and future test years; (4) the Commission's DSIC Implementation Orders which clearly contemplate end of test year data; and (5) the goal of Act 11 to reduce regulatory lag. UGI Electric MB, pp. 25-34. I&E and OCA advance several arguments in support of their "average" test year approach. Each of these arguments is without merit and should be rejected.

Initially, both I&E and OCA claim that there is a "lack of clear guidance" as to how plant in service should be calculated for the FPFTY. I&E MB, p. 15; OCA MB, pp. 14-15, 19. This is not the case. The plain language of the Act of Feb. 14, 2012, Pub. L. 72, No. 11 ("Act 11"), codified in 66 Pa. C.S. § 315(e), states that utilities using a FPFTY may include, in rate base, plant added "during" the FPFTY. Section 315(e) of the code reads:

> 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 315(e) does not refer to "average plant" added during the FPFTY, and it does not say "a portion of plant" added during the FPFTY. It says plant added "during" the FPFTY may be included in rate base. Further, the statutory language clearly says the calculation should reflect a "fully projected" year, not a "partially projected" year. I&E and OCA seek to avoid the plain language of Act 11 by arguing that their "average" approach includes a portion of all plant added during the FPFTY. *See* I&E MB, p. 16; *see also* OCA MB, p. 15. This is simply not the case. The Company projects $31,838,000 of plant additions during the FPFTY. I&E and OCA adjustments would exclude half of these additions from rate base. This is inconsistent with the plain language of Act 11 and should be rejected.

Second, I&E and OCA argue that using end of test year plant balances requires customers to "pre-pay" for plant that will not be in service when new rates take effect. I&E MB, p. 17; OCA MB, p. 16. Again, this is not the case. Revenue requirement is determined on an annual basis. Over the course of the FPFTY, customers will pay the annual revenue requirement on all plant added during the FPFTY, no more and no less. Clearly, customers are not expected to pay in full for their service on day one, or even month one, of the FPFTY. The fact that the annual revenue requirement is billed monthly does not and cannot change that fact. And, in any event, the I&E/OCA "pre-pay" argument also applies to their own "average" method. UGI Electric MB, pp. 27-28. In this case, under the "average" method, $12,007,000 in gross plant will not be in service when new rates take effect. UGI Electric MB, p. 27. The only way to avoid this "problem" would be to use the beginning of FPFTY balance for ratemaking, which would, of course, effectively deny the Company a return on all plant placed into service during the FPFTY. The only logical conclusion that can be drawn from the "pre-pay" argument is that plant would need to be used and useful, and, therefore, only FTY plant would be included, which is fully inconsistent with Act 11.

Third, I&E and OCA contend that FPFTY plant additions are only proposed and may not be completed. I&E MB, p. 17; OCA MB, pp. 15-16. This argument should be rejected for several reasons. As an initial matter, FPFTY plant additions are by necessity "proposed"—or, consistent with the plain language of Section 315(e) "projected"— and not yet in service. 66 Pa. C.S. § 315(e) ("…facilities which are projected to be in service during the fully projected future test year…"). If I&E's and OCA's standard were adopted, then no utility could use a FPFTY. Finally, and perhaps most importantly, the legislature has already addressed this issue. Section 315 specifically provides the Commission may audit FPFTY results after the fact

to determine whether or not they were accurate and authorizes the Commission to adjust rates to reflect material difference; it states:

> Whenever a utility utilizes a future test year or a fully projected future test year in any rate proceeding and such future test year or a fully projected test year 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 or a fully projected future test year, and the commission may after reasonable notice and hearing, in its discretion, adjust the utility's rates on the basis of such data.

66 Pa. C.S. § 315(e). Settlements for utilities using a FPFTY routinely have included the following language:

> The Company shall submit an update to I&E Exhibit No. 3, Schedule 1 as well as UGI PNG's filing requirement Attachment SDR ROR-14, to I&E, OCA, and OSBA no later than January 1, 2018, which update should include actual capital expenditures, plant additions, and retirements by month from October 1, 2016 through September 30, 2017, and an additional update for actuals from October 1, 2017 through September 30, 2018 shall be filed no later than January 1, 2019.

See, e.g., Pa. Pub. Util. Comm'n, et al. v. UGI Penn Natural Gas, Inc., Docket Nos. R-2016-2580030 et al. (Joint Petition for Settlement dated June 30, 2017). Thus, to the extent, that projections are overstated and plant is not completed, the Commission has full authority to address the issue.

Finally, OSBA for the first time in its Main Brief, joins I&E and OCA in supporting an "average" FPFTY rate base. OSBA MB, pp. 5-12. OSBA asserts that the Company has been inconsistent because it did not annualize revenues to reflect end of test year conditions. OSBA MB, pp. 6-8. OSBA is wrong. The Company did, in fact, fully annualize revenues. UGI Electric stated in its direct testimony: "FPFTY sales and revenues were developed by annualizing and normalizing the Company's 2019 fiscal year planned sales and revenue budget.

Annualized sales were determined by developing sales and revenue adjustments reflective of annual expected use per customer and projected customer counts as of the end of the FPFTY, or September 30, 2019." UGI Electric St. No. 8, pp. 3-4. OSBA's argument, raised for the first time on brief, is in error and should be rejected.

For these reasons and as more fully explained in its Main Brief, the Commission should accept UGI Electric's claimed rate base and other elements of the ratemaking formula based on end of test year conditions, consistent with the Commission's prior approach in calculating the historic test year and future test year.

2. ELECTRICAL ENGINEERING AND OPERATIONS CENTER

UGI Electric's Main Brief addressed the evidence showing that its planned Operations Center facility, scheduled to be in service by September 2019, should be included in plant placed in service as part of this proceeding. UGI Electric MB, pp. 34-38. The new Operations Center will accommodate all of UGI Electric's operational needs and is projected to cost $17.3 million.

OCA recommends disallowance of the full $17.3 million. OCA MB, pp. 19-21. OCA argues that the Company did not follow "any disciplined budgeting process in making the significant changes" associated with the Operations Center. OCA MB, p. 20. In support of its claim, OCA cites the testimony of Company witness Mr. Sorber at the hearing. A review of the cited pages, however, shows that Mr. Sorber carefully walks through the comprehensive budgeting process, which includes numerous reviews to ensure that the budget is based on the best and most accurate information available. Tr. 99:21-102:6. Further, Mr. Sorber indicates that the Company's budget process must accommodate new and changing operational needs,

such as the implementation of the Long Term Infrastructure Improvement Plan ("LTIIP").[1] Tr. 100:5-101:14.

Mr. Sorber indicated that for significant projects, such as the Loomis Substation and the Operations Center, the Company may use a preliminary budget while it develops the total cost of the facility as that facility is processed through the Company's internal and external planning stages and approval processes. Tr. 101:17-102:6. The Operations Center has moved through the Company's normal budgeting process. An internal preliminary estimate was developed, and then that preliminary estimate was updated as the Company actively selected a construction option (*i.e.* renovating an existing space versus new build), selected a site location, and obtained a quote from civil, architectural, and environmental consultants. Tr. 102:18-103:21.

The Company's budget process is well-defined and rigorous, and allows the Company the flexibility to address changing operational circumstances and more detailed planning as a major project moves from the initial conception phase toward final implementation. This is consistent with the Commission's review and approval of base rate claims, which includes a requirement that updates to data be provided during the pendency of the proceeding. The Commission's process has long recognized that additional data may become available as a base rate case progresses. *See, e.g., A Guide to Utility Ratemaking,* James H. Cawley and Norman J. Kennard, p. 62 (Ed. 2018) (discussing obligation of a party answering discovery to update prior responses). However, the availability of additional and more refined data is not grounds for claiming that the Company has no defined budget process.

OCA's second criticism is that the Operations Center should be excluded because the Company has "no formal agreement to purchase the property and no contractors have been

[1] The Company's Long-Term Infrastructure Improvement Plan was approved by the Commission in Docket No. P-2017-2619834, on December 21, 2017.

hired" for remodeling and site preparation. OCA MB, pp. 20-21. The Company addressed this concern in its Main Brief. UGI Electric MB, pp. 36-37. The record evidence shows that the Company has been actively moving this project forward during the pendency of this proceeding. UGI Electric St. No. 3-R, p. 18. However, as of the date of the hearing—the last time the Company could submit evidence into the record—the projected in service date of the new facility was still more than 15 months away. That certain milestones have not yet been achieved is not a reasonable basis for rejection of the entire claim, particularly where there is still more than a year before the completion date, and where the Company has shown it has substantial familiarity with the parties involved and the location selected. UGI Electric St. No. 3-RJ, p. 11. Further, as the Company noted in its Main Brief, pages 36 through 37, adopting OCA's milestone requirements would significantly impact the use of the FPFTY, because it is frequently not prudent, necessary, or even possible to meet these milestones many months or a year prior to an in-service date. The Company has consistently moved this project forward on a reasonable timeline throughout the pendency of this proceeding, and will meet its timelines, based on its recent experience developing a new headquarters for UGI Utilities, Inc. UGI Electric St. No. 3-RJ, p. 11. The record evidence demonstrates that the Operations Center will be completed and in service during the FPFTY. UGI Electric St. No. 3-RJ, p. 12. And, if it is not, the Commission has full authority to take appropriate action.

B. ACCRUED DEPRECIATION

This issue was fully resolved in the Joint Stipulation. Joint Stipulation ¶ 7. Therefore, the Company's claim is reasonable and should be approved.

C. ADDITIONS TO RATE BASE

1. Cash Working Capital

I&E has proposed adjustments to the Company's Cash Working Capital ("CWC") claim. These include (1) an adjustment to Meter Read Lag; (2) an adjustment to Other O&M Expense Lag; (3) an adjustment to the Pennsylvania Utility Realty Tax Adjustment ("PURTA"); and (4) the power supply adjustment. I&E MB, pp. 26-28. As described in its Main Brief, UGI Electric opposed adjustment (1); accepted adjustment (2); agreed to adjustment (3) in the Joint Stipulation; and opposed adjustment (4) because it was based on I&E's use of the average test year approach.

Regarding Meter Read Lag, I&E argues for an adjustment from the Company's claimed 2.70 days down to 1.50 days, entirely because the Company has installed a new software system. I&E MB, p. 27. UGI Electric addressed this argument thoroughly in its Main Brief. UGI Electric MB, pp. 39. Meter Read timing was not within the scope of the Company's new software program, and therefore no adjustment in Meter Read Lag was expected or shown. UGI Electric St. No. 4-R, p. 8. I&E has provided no argument in support of its arbitrary adjustment, and its adjustment should be rejected.

The Company's final position on CWC is $7.15 million, of which O&M expense CWC is $5.52 million. This amount should be accepted, and I&E's contested adjustments should be rejected.

2. Materials and Supplies

I&E and UGI Electric have agreed that the materials and supplies in inventory, based on the most recent 13-month average, is $1,464,692. UGI Electric MB, p. 40; I&E MB, p. 29. This amount is unopposed, and should be adopted.

D. DEDUCTIONS FROM RATE BASE

1. Accumulated Deferred Income Taxes.

This issue is fully addressed in the Company's Main Brief, pages 106 through 127, and in Section VIII *infra* and will not be restated here.

2. Act 40.

This issue is fully addressed in the Company's Main Brief, pages 127 through 133, and in Section VIII.C *infra* and will not be restated here.

3. Customer Deposits

The Company has proposed an offset for customer deposits of $1.42 million, which is necessary to address the decrease caused by the passage of Act of October 22, 2014, Pub. L. 2545, No. 155 ("Act 155") prohibiting the Company from collecting customer deposits from customers who qualify for low-income programs. UGI Electric MB, pp. 41-42. I&E has argued that the Company should use its most recent 13 months of actual customer deposit balances. I&E MB, pp. 33-34. I&E's proposal is not appropriate, because it fails to recognize the impacts of Act 155, and particularly the need of UGI Electric to refund deposits held for certain customers who are not currently identified as "confirmed low-income". UGI Electric St. No. 4-RJ, pp. 12-13. I&E's mechanical application of its analysis, with no acknowledgement of operational circumstances, should be rejected.

E. CLOUD BASED PROGRAM

This issue was fully resolved in the Joint Stipulation. Joint Stipulation ¶ 12(a). Therefore, the Company's claim is reasonable and should be approved.

F. UNITE PHASE 2 COSTS

This issue was fully resolved in the Joint Stipulation. Joint Stipulation ¶ 12(b). Therefore, the Company's claim is reasonable and should be approved.

V. **REVENUES**

In its Main Brief, the Company described one challenged revenue item, the Hanover Industrial Park, which UGI Electric subsequently accepted. UGI Electric St. No. 3-R, pp. 15-16. Aside from the overall methodology adjustment associated with the FPFTY, no other revenue issues were raised by the parties in this proceeding. Therefore, the Company's total claimed present revenues are $89,092,000.

The Main Briefs of OCA and OSBA did not argue for any further adjustments to operating revenue as part of this proceeding. In I&E's Main Brief, I&E argues that revenues reflected in this proceeding are impacted by the determination regarding the calculation of the FPFTY. I&E proposes a decrease of $60,000, to $87,858,765, to be allocated entirely to the Rate R class. The issue of the appropriate calculation of the FPFTY is fully addressed in the Company's Main Brief, pages 25 through 34, and in this Reply Brief in Section IV.A.1 and will not be restated here. Further, the issue of the scale back of any adjustments to the Company's claim is fully addressed in the Company's Main Brief, pages 165 through 166 and in this Reply Brief in Section IX.D and will not be restated here.

VI. **EXPENSES**

As its applicable legal standard, I&E states that "a utility is entitled to recover its reasonably incurred expenses," and "a public utility is entitled to recover all reasonable and normal operating and maintenance expenses incurred by providing regulated service." I&E MB, p. 37, *citing UGI Corp. v. Pa. P.U.C.*, 410 A.2d 923 (Pa. Cmwlth. 1980) ("*UGI Corp.*") and *Western Pa. Water Co. v. Pa. P.U.C.*, 422 A.2d 906 (Pa. Cmwlth. 1980). Importantly, the Commonwealth Court recognized in *UGI Corp*. that expenses are recoverable when they are "a direct and clearly prudent step in providing public service." *UGI Corp.*, 410 A.2d at 932. In *UGI Corp.*, the Court reversed a Commission order denying recovery of expenses associated

with feasibility studies related to the company's participation in certain natural gas storage projects, which the company ultimately elected not to join. The Court explained that these studies were "reasonably calculated" to achieve more efficient operations and, therefore, reasonably and prudently incurred. Here, many of UGI Electric's claimed expenses, which are opposed by I&E, are "reasonably calculated" to achieve more efficient and safe operations, as described in Section VI of the Company's Main Brief, and this Reply Brief. Therefore, they should be recoverable pursuant to I&E's own cited legal precedent.

In many instances, I&E ignores evidence relating to the Company's expenses. Further, I&E does not consistently apply the appropriate legal standard in its review, and, therefore, proposes adjustments to certain categories of expense that should be rejected in the final determination of this base rate proceeding. OCA similarly proposes certain adjustments that are not supported by the Commission's normal approach to ratemaking and should not be adopted.

A. VEGETATION MANAGEMENT EXPENSE

UGI Electric's total claim for vegetation management expense of $2,118,501 for the FPFTY. As described in detail in the Main Brief, UGI Electric is facing a serious operational threat due to the impacts of the EAB. UGI Electric MB, pp. 44-47. As a result of the EAB, UGI Electric will incur increased expenses associated with performing planned vegetation management work. 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.

In its Main Brief, I&E recommends a reduction in vegetation management expense of $206,235, which reflects a disallowance associated with the new vegetation crew. I&E MB, p. 38. I&E proposes this disallowance because it claims that the Company's increase in the FTY is unsupported. I&E MB, p. 38. Specifically, I&E argues that the additional costs associated with

responding to the EAB somehow "would be captured in an overall historic average of the expense, thus supporting the I&E recommended yearly inflation of the HTY actual expense." I&E MB, p. 39. I&E's position in its Main Brief ignores, entirely, the evidence presented in the Company's rejoinder testimony, and makes no effort to address the evidence produced by UGI Electric showing that the increase in the FTY is specifically related to the addition of one vegetation crew. Further, I&E's arguments in its Main Brief do not acknowledge its own witness' testimony at the hearing that she was not certain that her proposed methodology would account for an additional crew. Tr. 125:15-19. I&E's witness also 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. Simply stated, I&E's position in its Main Brief is not supported by the testimony of its own witness at the hearing in this proceeding.

The approach advocated by I&E in its Main Brief is not credible. The addition of a vegetation crew to address an unprecedented threat to the Company's service territory is a prudent expense that could only be reflected on a going forward basis. I&E's proposed disallowance is directly contradicted by the record in this proceeding and should be rejected.

B. COMPANY OWNED SERVICES PROGRAM

In its Main Brief, UGI Electric supported its claimed expense of $454,418 for its Company Owned Service ("COS") Transition Program. UGI Electric MB, pp. 47-51. The program will address nearly 5,000 residential company owned services, many of which are located inside the customers' homes, which should be inspected and repaired or replaced prior to transferring these facilities to the property owner. The Company has proposed a mandatory inspection, repair and replacement program, with subsequent transfer of ownership to the customer to avoid this safety challenge in the future. UGI Electric St. No. 3-R, p. 9.

OCA recommends that the Commission approve this expense claim in order to "address the unique safety issue presented…provided that the Company is permitted to recover only program expenses and is not permitted to terminate service" as part of the program. OCA MB, p. 27. As the Company indicated in its Main Brief, it will not profit from this program. UGI Electric St. No. 3-R, pp. 9-10. Further, while UGI Electric has the right under its tariff to terminate service for failure to allow inspection of these facilities, the Company will work to achieve access without the threat of termination. UGI Electric St. No. 3-R, p. 10. This may include obtaining a court order granting entry if a homeowner refuses to allow inspection of the service facilities. UGI Electric St. No. 3-RJ, p. 7. Therefore, the Company believes that it has fully addressed OCA's conditions in this proceeding.

I&E ignores the potential safety issue, and argues that the inspection program should be voluntary, and that the Company should only be able to reflect $140,000 in expenses associated with this program. I&E MB, p. 39. The $140,000 reflects the Company's budget expense for addressing company owned services, before implementing an accelerated program. I&E St. No. 1, pp. 30. I&E's recommendation of a voluntary program is contradicted by the testimony of its own witness at the hearing that a voluntary inspection program would not accomplish the same safety assurances as a mandatory program, and that only a mandatory inspection process could assess whether the equipment was safe and reliable prior to transfer. Tr. 120:1-19.

I&E raises two arguments in its brief in support of its recommended disallowance of everything beyond the historic expense of the COS program. First, I&E argues that "if" the Company's expense claim is inflated, it would profit based on the erroneous expense projection. I&E MB, p. 41. The second is an allegation that this safety program is in some way "self-

serving." I&E MB, p. 41. Both of these arguments are unsupported by fact or logic, and provide no basis for adopting I&E's position in this proceeding.

I&E asserts that "if" the Company's expense claim is inflated, then it may earn a profit from the COS program. However, the Company has shown exactly how it arrived at its expense claim. It has planned 500 inspections for 2019—a number that I&E has not challenged. UGI Electric then calculated the anticipated cost of addressing 500 services, based on its knowledge of the updated electrical code requirements, past experience implementing the program, and the projected cost of the contractor force required to conduct the inspections and make the necessary repairs or replacements. *See* UGI Electric Exhibit EWS-7. While I&E attempted to challenge these projections, UGI Electric produced evidence showing that I&E's criticisms were based on a misunderstanding of the bases for the Company's numbers. UGI Electric St. No. 3-R, pp. 11-12; UGI Electric St. No. 3-RJ, p. 8. In addition, I&E's witness admitted on the stand that her primary criticism with the Company's projected expense was "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. I&E restates this core criticism in its Main Brief, as well. I&E MB, p. 41. However, this core criticism does not dispute the legitimacy of the 2019 expenses, nor is it an appropriate way to criticize an expense claim. Tr. 121:13-18. Simply stated, while I&E argues in its brief that "*if*" the Company's costs were inflated, then the Company might earn a profit on this program, I&E does not actually have any evidence to <u>*show*</u> that the Company's costs are inflated. Just the opposite – the evidence shows that the Company has carefully reviewed this program and reflected its anticipated costs based on the engineering data.

I&E's second argument is an assertion that the Company's program is somehow "self-serving." I&E MB, p. 41. I&E argues that these facilities were claimed in rate base, where the Company received a return of and on the service, and expenses for the repairs and maintenance associated with these would have been included in ratemaking expense, as well. This is irrelevant to the determination of the Company's claimed expense. First, it is not clear what conclusion I&E intends to have drawn from these facts. The Company has identified why it is proposing this program at this time: 5,000 services need to be inspected and repaired or replaced, and gaining access to them is difficult and also requires the use of third party contractors. UGI Electric believes that future maintenance would therefore be best accomplished by the customer, but the Company does not believe that it is prudent to transfer a service it has not inspected. Nothing about the prior rate treatment of these facilities impacts the need to inspect these facilities, or the proposal to transfer them at this time.

Moreover, while UGI Electric has included in rates both the return of and on the services, it also has reflected substantial additional revenues generated by the customers served through these facilities. These facilities were installed primarily to upgrade the services at these homes so they could take electric heating service from the Company. Heating customers provide substantial additional revenue to the Company, which increases present rate revenues and delays the time between base rate cases. Any prior maintenance expenses—a speculative category that I&E did not investigate during the pendency of this proceeding—were reflected consistent with UGI Electric's normal maintenance for Company owned facilities. Again, it is unclear what relevance these facts have in assessing the validity of the proposed program. If the Company has already recently repaired a COS so that it was safe and up to code, then only an inspection and transfer would occur. The prior rate treatment plays no role in assessing whether this program

should be mandatory, and whether the anticipated cost for the inspection, repair and replacement of approximately 500 services in 2019 is reasonable.

C. ENVIRONMENTAL REMEDIATION EXPENSE

UGI Electric has sought to include in rates $417,000, amortized over three years, associated with the environmental remediation of its Forty Fort warehouse facility, which 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 MB, pp. 51-55. 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.

In their Main Briefs, both I&E and OCA propose that the remediation expense should be removed from the cost of service, and instead should be recovered from the sales proceeds associated with the property. I&E MB, p. 42; OCA MB, pp. 28-29. There is no legitimate basis for this position. These expenses will be incurred in the FPFTY and are being incurred for the purpose of providing a safer environment for customers and employees. *See* UGI Electric MB, p. 53. Neither I&E nor OCA advance any argument in their Main Brief challenging the reasonableness of the remediation expense, or that it was incurred in service to the customers. Instead, OCA argues that the remediation should be taken out of the sales proceeds because without the remediation, there would be less proceeds. OCA MB, pp. 29-30. This is incorrect for three reasons. First, the sale of property, if it does occur, will occur well outside the FPFTY. Second, the presumption that there will be additional proceeds as a result of the remediation, or proceeds sufficient to cover the costs of the remediation, is completely speculative. As the Company indicated in its Main Brief, the sales price is not known or knowable at this time. UGI Electric MB, p. 54. It is entirely possible that the sale of the property could produce proceeds less than the $417,000 cost of the remediation. Finally, the necessity of the remediation of a

property that has been used to provide service to customers for decades is not impacted by the sufficiency of the proceeds of any sale of the property. The property was used in service to the customers, and the environmental degradation occurred while the property was being used to serve customers. Therefore, the reasonable expense incurred to remediate the facility should be borne by the customers.

It is worth noting that for the first time, on brief, OCA limits it proposal to the gain on the sale of the land, and not the building, apparently acknowledging UGI Electric's testimony that any gain on the sale of the building will be reflected as net negative salvage and returned to customers. As to gain on sale of the land, it is well-established that land is not depreciable property and therefore gain on the sale of land belongs to shareholders, not customers. *See, e.g., Philadelphia Suburban Water Co. v. Pa. Pub. Util. Comm'n*, 427 A.2d 1244 (Pa. Cmwlth. 1981) (finding that profit made on the sale of land should not be reflected in rates and should instead go to the shareholders). OCA's proposal to offset the expense through the gain on the sale of land therefore would be unlawful.

D. STORM DAMAGE EXPENSE

In its Main Brief, UGI Electric supported its storm damage expense claim of $301,000. UGI Electric MB, pp. 55-57. This claim was based on a normalized five year average of actual storm expense, from 2014 to 2018. UGI Electric St. No. 8-R, p. 23. UGI Electric's claim is based on the updated claim presented in its rebuttal testimony, which incorporated actual experience from 2018. This update is consistent with long-standing Commission practice, and was used by other parties with regard to other components of this case. *See, e.g.*, Materials and Supplies, UGI Electric MB, p. 40. I&E's witness acknowledged at the hearing that updating for actual experience is a standard Commission practice. Tr. 123:3-6.

I&E argues in its Main Brief that UGI Electric should only be allowed to reflect $253,229 associated with storm expense. I&E MB, p. 43. I&E asserts that the Company's 2018 expense claim is based on estimates and was not sufficiently supported. I&E MB, p. 43. This position ignores, entirely, the Company's rejoinder testimony supporting its 2018 storm damage expense, which was based on actual historic accounting experience, not estimates. I&E's witness acknowledged at the hearing that the 2018 data presented by the Company reflected actual data. Tr. 124:2-5. I&E's witness acknowledged that the 2018 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. However, I&E's Main Brief does not acknowledge any of this additional testimony, and therefore does not reflect the record in this proceeding.

OCA argues in its brief that OCA witness Mr. Morgan's position on storm expense was uncontested, and should therefore be adopted. OCA MB, pp. 30-32. This is clearly incorrect. The Company did not accept the position Mr. Morgan offered in his direct testimony, and when the Company updated its storm expense claim in its rebuttal testimony to reflect actual experience from 2018, the Company's claim increased by an additional $26,000. The Company's adjustment directly contradicted Mr. Morgan's proposal. While Mr. Morgan calls his adjustment a "normalization," it appears actually to be an amortization of the 2017 storm expense over a five year period. Further, even assuming that what Mr. Morgan has proposed is a five-year normalization, his proposal clearly significantly understates the Company's actual storm expense, as shown by its 2018 experience. OCA presented no response to the Company's adjusted storm expense, and did not provide any testimony regarding the inclusion of the 2018

actual expense in this proceeding. Therefore, it is UGI Electric's proposal that is uncontested, not the OCA's position.

The Company's updated claim of $301,000 for storm expense should be adopted.

E. RATE CASE EXPENSE

In its Main Brief, UGI Electric supported its normalized claim of $225,000 for rate case expense. UGI Electric MB, pp. 57-59. The normalized expense was based on the established pace of the Company's anticipated plant additions, which would likely require it to seek additional base rate relief in three years.

In its Main Brief, I&E recommends disallowance of the Company's proposal because "it is not supported by the Company's historic filing frequency." I&E MB, p. 45. I&E instead offers a five year normalization, *i.e.* 60 months, which it claims is "based on the Company's historic base rate filing of every 103 months" when reviewing all base rate cases filed by the Company since 1992. I&E MB, p. 45.

In the Commission's recent decision in *Emporium Water Company*, Docket No. R-2014-2402324 (Order Entered Jan. 18, 2015) ("*Emporium*"), which I&E had cited in testimony but did not rely on in its Main Brief, the Commission found that use of the historic average for rate case expense was "often" the best guide for normalizing rate case expense, and specifically distinguished the facts in *Emporium* from the circumstances presented in *Pa. Pub. Util. Comm'n, et al., v. PPL Elec. Util. Corp.*, Docket Nos. R-2012-2290597, *et al.* (Order Entered Dec. 28, 2012) ("*2012 PPL RC Order*"). As described in UGI Electric's Main Brief, in *2012 PPL RC Order*, the Company had sought a two-year normalization period, while I&E and OCA recommended a three-year period based on the Company's filing history. *2012 PPL RC Order* pp. 44-45. The Commission acknowledged the three-year filing history, but adopted PPL Electric's two year proposal because the Company had undertaken an accelerated capital

investment program that would drive the need for additional future base rate relief more frequently than the historic rate case experience. *2012 PPL RC Order* pp. 47-48.

The Commission's determination in *2012 PPL RC Order* should govern the outcome in this proceeding. Similar to the facts in *2012 PPL RC Order*, UGI Electric has recently and significantly accelerated its capital investment. The accelerated capital investment evident in this base rate proceeding is consistent with the Company's planned acceleration reflected in its LTIIP. As the Commission held in *2012 PPL RC Order*, pp. 47-48, "certain expenses may now be based upon future expectations. We believe that the normalization period for rate case expense is one of those expenses." The record evidence shows that a long period between base rate proceedings is very unlikely to occur going forward, and the Company estimates that base rate relief may be necessary in approximately three years. UGI Electric St. No. 2-RJ, p. 4.

I&E's proposed adjustment to rate case expense is not consistent with either of the Commission's most recent decisions on this issue—*Emporium*'s historical approach or *2012 PPL RC Order*'s anticipated future need approach—and should be rejected. The Company's original proposal should be approved, consistent with *2012 PPL RC Order*.

F. EMPLOYEE EXPENSES

1. Salaries and Wages Net of Employee Additions.

The annualization adjustment to reflect end of test year conditions in the Company's expense claim in this proceeding is impacted by the determination regarding the calculation of the FPFTY. I&E proposed to disallow the $34,000 annualization adjustment to reflect end of test year conditions based on its average test year approach. I&E MB, pp. 46-47. The Company opposes this adjustment because it reflects an improper methodology for calculating the FPFTY. This issue is fully addressed in the Company's Main Brief, pages 25 through 34, and in this Reply Brief in Section IV.A.1 and will not be restated here.

2. Employee Additions.

The expense associated with employee additions is impacted by the determination regarding the calculation of the FPFTY. I&E has proposed a reduction of $64,000 to remove the annualization of compensation for the three additional positions in the FPFTY, consistent with its average test year approach. I&E MB, pp. 47-48. Further, I&E requests that "this methodology be reflected in the anticipated Commission FPFTY regulations." I&E MB, p. 48. A utility's rate case brief is not the appropriate place to make a comment to the Commission regarding a proposed rulemaking. OCA has proposed an adjustment to reflect the expected date of employment, which again removes the annualization adjustment, consistent with OCA's proposed average test year approach. OCA MB, pp. 32-34. The Company opposes these adjustments because they reflect an improper methodology for calculating the FPFTY. This issue is fully addressed in the Company's Main Brief, pages 25 through 34, and in this Reply Brief in Section IV.A.1 and will not be restated here.

3. Outside Services Employed.

In the Company's Main Brief, it supported its claimed expense associated with Miscellaneous Outside Services Employed totaling $191,000. UGI Electric MB, pp. 60-61. This total reflects a number of smaller cost categories, including: a worker's compensation claim of $39,000 that the Company has budgeted in FERC Account 923; $17,000 of costs associated with Management Development programs organized by the Human Resource Department; $19,000 of printing costs that are budgeted to FERC 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. The Company showed the source for $166,000 of its claimed expenses. I&E St. No. 1-SR, p. 17.

I&E argues in its Main Brief that despite providing a breakdown of $166,000 of its claimed expenses, the Company "did not provide a breakdown of this expense." I&E MB, p. 49. I&E further states that "the Company's explanation fails to provide adequate support to the Company's original claim." I&E MB, p. 49. Where the Company has specifically identified the source of its expenses, it is unclear what level of further evidence would be considered satisfactory to I&E, particularly where the expenses are associated with individual projects such as printing jobs and various Management Development programs. However, the Company has shown that these expenses are incurred, that they are not duplicative of other claimed expenses in this proceeding, and that they are reasonable and appropriate for furnishing service to customers.

The Company has sufficiently justified its claimed expenses regarding Outside Services Employed. The full amount of $191,000 should be approved.

4. Employee Activity Costs.

UGI Electric has proposed to recover the cost of Employee Activities in this proceeding, totaling $11,848. The claimed expenses recognize employees' hard work and dedication, boost employee engagement, foster a sense of community, and improve the morale of the overall workforce which improves productivity and benefits customers. UGI Electric MB, pp. 61-63. They are viewed as compensation, and provide numerous specific benefits that relate to customer service. UGI Electric St. No. 4-R, p. 10.

I&E argues that this expense should be disallowed. I&E MB, pp. 49-50. Specifically, I&E applies an inappropriate legal standard, which requires that expenses be "necessary for the provision of safe and reliable service to UGI Electric ratepayers." I&E MB, p. 50. However, the correct standard is to determine whether the "expenses claimed here were unreasonable, imprudently incurred or excessive in amount." *Butler Township Water Co. v. Pa. P.U.C.,* 81 Pa. Cmwlth. 40, 43-44, 473 A.2d 219, 221 (1984) ("*Butler Township*"). There is no evidence that

the Company's claimed expenses were unreasonable, imprudent, or excessive. Rather, the Company has shown that employee appreciation activities have a positive impact on morale, which will improve customer service, and that this has been acknowledged by the Commission's spokesperson and I&E's own witness. Tr. 127:13-128:21. I&E's witness specifically agreed that a motivated workforce provides better service to customers. Tr. 128:21. Further, the evidence shows that the Company's expense of $11,848 is not unreasonable and is, in fact, very similar to the amount spent by the Commission on its own employee appreciation activities, which are paid for by utility customers. Tr. 126:13-18; Tr. 127:13.

The evidence in this proceeding shows that the Company's expense associated with Employee Activities is a reasonable and prudent cost incurred in the provision of service to its customers as required by *Butler Township,* 81 Pa. Cmwlth. 40 *supra*. This expense should be approved.

5. Allocated Stock Options and Restricted Stock Awards.

In its Main Brief, the Company supported the inclusion of $77,000 in costs associated with Allocated Stock Options, and $112,000 for costs associated with Restricted Stock Awards, for a total combined proposal of $187,000. UGI Electric MB, pp. 63-69. This represents only a portion of the Company's total incentive compensation, as I&E did not challenge the Company's claim regarding its executive bonus plan. I&E MB, p. 52.

First, it is critical to note that I&E has attempted to sub-divide the Company's total claim for incentive compensation, which is improper. By subdividing the total incentive compensation program, I&E has focused on components of incentive compensation that are more heavily focused on financial goals and metrics. Commission precedent is clear, however, that so long as the incentive compensation includes a mix of operational and financial goals, it is appropriate for inclusion in rate base. *See, e.g., Pa. PUC v. Aqua Pennsylvania, Inc.,* Docket No. R-00072711,

2008 Pa. PUC Lexis 50, *24 (Order entered July 17, 2009). This approach to analyzing the Company's incentive compensation should be rejected in favor of a holistic approach, as required by Commission precedent.

More specifically, I&E argues that "ratepayers should not be responsible for paying a benefit available only to high-level executive type positions that are likely based on stock prices and/or earnings targets rather than goals that benefit ratepayers." I&E MB, pp. 50-51. I&E's focus on the availability of this benefit to only certain executives is not relevant in determining whether the expense incurred is reasonable and prudent. Further, the evidence shows that employees who are 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. UGI Electric uses incentive plans which have both financial and operational metrics in their calculations. UGI Electric St. No. 4-RJ, p. 9. All of the Company's Management employees have goals that include metrics not specifically tied to financial performance, including safety, reliability, and customer service metrics. UGI Electric St. No. 4-RJ, p. 9. The Company showed that even the achievement of specified financial goals provides important direct and indirect benefits to customers. UGI Electric St. No. 4-R, pp. 11-12. I&E is mistaken in concluding that stock prices and earnings targets are the exclusive method for determining whether eligible employees received incentive compensation. This performance relates not just to financial goals, but customer service and safety, business strategy, and operational objectives, as well. UGI Electric St. No. 4-R, p. 13.

I&E also disagrees with the Company's assertion that UGI Electric would have to raise salaries if it did not continue to offer stock options and awards. I&E MB, p. 52. However, I&E

produces no evidence in support of this position. UGI Electric has shown 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 median of the comparison group. UGI Electric St. No. 4-R, p. 12. If UGI Electric removed incentive compensation, it would make the Company fall even farther below the market median for compensation. This would undoubtedly lead to employee attrition, and make it more difficult for the Company to obtain qualified candidates.

Further, I&E argues that UGI Electric has relied upon only one report in support of its claim that this is a standard industry practice. I&E MB, p. 52. However, UGI Electric has shown that incentive compensation similar to its own practices are documented in industry compensation surveys, as well as professional compensation organizations including WorldAtWork, AON, and the American Gas Association. UGI Electric St. No. 4-R, p. 13.

As the Company indicated in its Main Brief, the Commission has repeatedly found that incentive compensation is an allowed expense for rate recovery. UGI Electric MB, pp. 68-69. I&E has provided no legal analysis in support of its position that UGI Electric's incentive compensation plan does not fit within the Commission's prior precedent. Finally, the few facts I&E has relied upon in its Main Brief in support of its disallowance are contradicted by the record evidence in this proceeding. The adjustment to the incentive compensation expense proposed by I&E should be rejected.

G. DEPRECIATION EXPENSE

The annualized depreciation expense to be reflected in this proceeding is impacted by the determination regarding the calculation of the FPFTY. Both OCA and I&E have proposed adjustments to annualized depreciation as a result of their use of the average test year

methodology. This issue is fully addressed in the Company's Main Brief, pages 25 through 34, and in this Reply Brief in Section IV.A.1 and will not be restated here.

H. OTHER POST-EMPLOYMENT BENEFITS EXPENSE

In its Main Brief, the Company described its annual adjustment to expenses of $0.395 million per year relating to Other Post-Employment Benefits ("OPEB"). UGI Electric MB, pp. 70-71. This adjustment will address a significant overcollection in OPEB expenses that has occurred since the Company's last base rate proceeding. UGI Electric St. No. 4-R, p. 17. The Company noted in its Main Brief that no party had filed testimony on this issue, and that, therefore, it should be approved. UGI Electric MB, p. 71.

In its Main Brief, I&E states that it does not object to the Company's proposal. I&E MB, p. 54. However, I&E then suggests that it also would not object to an alternative refund period. I&E MB, p. 54. There is no record evidence to support I&E's recommendation. Further, as I&E filed no testimony opposing the OPEB refund period, it would be a violation of due process to make such an adjustment based on the "logical" suggestion made by I&E in its brief. The suggestion by I&E that an alternative refund period should be adopted is untimely, and should be rejected. UGI Electric's unopposed proposal regarding OPEB expense is just and reasonable and, therefore, should be approved.

I. POWER SUPPLY EXPENSE

The Company did not address power supply as a separate expense in its Main Brief, as this item was not identified as necessitating a separate section by any party in the negotiations which led to the common brief outline. However, I&E, in its Main Brief, has provided a separate expense section for Power Supply. In that section, I&E argues that the Company's power supply expense should be adjusted based on the use of the average test year methodology. I&E MB, pp. 54-55. The Company opposes this adjustment because it reflects an improper methodology for

calculating the FPFTY. This issue is fully addressed in the Company's Main Brief, pages 25 through 34, and in this Reply Brief in Section IV.A.1 and will not be restated here.

VII. FAIR RATE OF RETURN

A. COST OF COMMON EQUITY

In order to provide perspective on UGI Electric's responses to other parties' positions on the common equity cost rate, UGI Electric provides the following summary of the results of Mr. Moul's analysis of cost rate for common equity:

> 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.

UGI Electric St. No. 5, pp. 4-5. The 10.95% recommendation was within the 10.25% to 12.55% range of results calculated by Mr. Moul. UGI Electric St. No. 5, p. 41. UGI Electric subsequently filed supplemental testimony addressing the impacts of the TCJA on the cost of equity. These impacts created a more risky financial environment, and, therefore, Mr. Moul

adjusted his recommended cost of equity up to 11.25% to account for the additional risk. UGI Electric St. No. 5-SD, p. 7.

In subsequent sections of the Reply Brief, UGI Electric will explain the reasons that I&E and OCA's analyses of the cost of equity are flawed and respond to the criticisms of UGI Electric's presentation.

1. OCA's And I&E's Recommended Cost Rates For Common Equity Do Not Reflect The Prospective Cost of Capital.

OCA and I&E almost exclusively rely on the past to justify their very low recommended costs of common equity, and ignore undisputed record evidence demonstrating the cost of common equity is projected to increase during the FPFTY. For example, OCA's Main Brief commences by acknowledging that the recommendations of its witness, Mr. Rothschild, "reflect <u>today's</u> low capital cost environment." OCA MB, p. 48 (emphasis added). The problem with OCA's analysis is that UGI Electric's claim is not based on today's capital cost environment; it is based on the capital cost environment during the FPFTY ending September 30, 2019.

By attempting to limit its analysis to "today's" environment, OCA conveniently ignores Mr. Moul's testimony that economists and financial forecasters expect long-term interest rates to increase. UGI Electric St. No. 5-R, pp. 7, 33. Indeed, both OCA and I&E acknowledged this trend in their testimony. *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 to 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.

OCA's analysis simply ignores this fact and attempts to justify the cost of common equity in a future period based upon today's capital cost environment.

2. I&E And OCA Do Not Use Informed Judgment To Temper The Results Of Their Flawed And Unreasonable DCF Analyses.

I&E and OCA contend that the Commission has primarily relied upon the use of the DCF analysis to evaluate the cost of common equity. I&E MB, pp. 71 (citing *Pa. Pub. Util. Comm'n v. City of DuBois-Bureau of Water*, Docket No. R-2016-2554150, at pp. 96-97 (Order entered March 28, 2017) ("We note that we have primarily relied upon the DCF methodology in arriving at previous determinations of the proper cost of equity and utilized the results of methods other than DCF, such as the CAPM and RP methods, <u>as a check upon the reasonableness of the DCF derived equity return calculation, tempered by informed judgment</u>."); OCA MB, pp. 55-56 (quoting *Pa. Pub. Util. Comm'n v. Pennsylvania American Water Company*).

The use of informed judgment to temper the reliance on DCF results is necessary to ensure the utility has the opportunity to earn a reasonable return on its investment, consistent with long-standing ratemaking standards. *See, e.g.*, *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Waterworks and Imp. Co. v. P.S.C. of West Virginia*, 262 U.S. 679, 690 (1923) ("*Bluefield Waterworks*"). Pennsylvania case law applying these standards makes it clear that certain factors must be considered by the Commission, 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. UGI Electric MB, pp. 72-73.

Both I&E and OCA run afoul of these standards by failing to use informed judgment as a check on their respective flawed and unreasonable DCF analyses. In particular, both of these

parties ignore unrebutted evidence of increased risks faced by UGI Electric. Neither I&E nor OCA contest the fact that the TCJA will have significant, negative impacts on the Company's credit quality. *See* UGI Electric MB, p. 89. Diminished credit quality will increase the Company's risk profile during the FTY and FPFTY, thereby requiring a higher cost of common equity to reflect the attendant risks resulting from the implementation of the TCJA. UGI Electric MB, p. 89. Moreover, it is undisputed that the volatility of common stock investments has increased markedly since 2017. UGI Electric MB, pp. 89-90. As common stocks become more volatile, thereby signifying increased risk, so too must the return on common equity be higher than in prior periods to attract sufficient capital investments of this class. UGI Electric MB, pp. 89-90. I&E and OCA attempt to ignore this evidence of increasing risk associated with common equity capital investments in order to artificially decrease the cost of common equity set forth in their proposals.

By ignoring the corresponding risks and uncertainties attendant with common equity investments during the FPFTY, I&E and OCA completely disregard the use of informed judgment. Indeed, all parties quoted from the following passage from *Bluefield Waterworks*:

> A public utility is entitled to such rates as will permit it to earn 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 <u>which are attended by corresponding risks and uncertainties</u>. . .

Bluefield Waterworks, 262 U.S. at 692 (emphasis added). Only UGI Electric has acknowledged the "risks and uncertainties" associated with common equity capital investments in other business undertakings in the FPFTY and reflected these "risks and uncertainties" in its cost of common equity presentation. *See* UGI Electric MB, pp. 74-77, 88-91.

By failing to consider these factors and engage in the use of informed judgment, I&E and OCA have simply engaged in flawed mathematical analysis, which produced unreasonable

results. Therefore, UGI Electric's cost of common equity presentation should be adopted and the recommendations of I&E and OCA should be rejected.

3. I&E's Cost Of Common Equity Recommendation Is Flawed And Should Be Rejected.

UGI Electric explained a number of flaws associated with I&E's recommended cost of common equity of 8.62% in its Main Brief. *See* UGI Electric MB, Section VII.D.2.a. Principally, I&E witness Mr. Spadaccio arbitrarily includes low growth rates for several companies that should have been excluded from his Electric Group and he fails to employ a leverage adjustment in his DCF analysis.

I&E's DCF analysis is also flawed because Mr. Spadaccio used the percentage of revenues devoted to utility operations as a criterion for screening companies to assemble his barometer group. UGI Electric St. No. 5-R, pp. 11-12. While I&E argues that calculating the percentage of utility assets that make up the total assets of a company is "not always a reliable way of determining if a business is primarily a regulated utility," I&E MB, pp. 69-70, Mr. Moul explained why this argument is flawed in his rebuttal testimony. UGI Electric St. No. 5-R, p. 12. In particular, Mr. Moul explained that the percentage of regulated assets to total assets is appropriate because it "best describes how the potential returns on capital used in utility operations will be achieved on the total business." UGI Electric St. No. 5-R, p. 12. Moreover, the Commission's QER employs a criterion of 50% of assets related to jurisdictional operations when it assembles the Barometer Group.

Moreover, while I&E asserts that the percentage of regulated assets to total assets criterion is inappropriate because one utility may have significantly depreciated assets that require minimal capital investment while another has new equipment that could require a large capital investment, I&E never provides any evidence that either of these conditions exist for any

of the electric utilities that comprise its barometer group or the members of the Company's Electric Group. UGI Electric St. No. 5-RJ, p. 2. Therefore, I&E's criticism of Mr. Moul's analysis is flawed and unsupported.

For these reasons, and the reasons more fully explained in UGI Electric's Main Brief, I&E's cost of common equity recommendation is flawed and should be rejected.

4. OCA's Cost Of Common Equity Recommendation Is Flawed And Should Be Rejected.

a. OCA's DCF Analysis Is Inadequate.

As explained in UGI Electric's Main Brief, OCA's cost of common equity analysis contains numerous errors and flaws that render it unreliable. UGI Electric MB, pp. 95-98

Importantly, the Commission need only examine the data used in OCA witness Mr. Rothschild's DCF analysis to conclude that OCA's recommended cost of common equity is erroneous. OCA acknowledges that the other utilities comprising the Electric Group are projected to earn an 11.0% return on equity. UGI Electric St. No. 5-R, p. 19; *see also* OCA St. No. 3, pp. 25-26 (acknowledging the use of the same barometer group used by the Company).

OCA acknowledges that the Commission determines the cost of equity "primarily based upon the DCF method and informed judgment." OCA MB, p. 55 (quoting *Pa. Pub. Util. Comm'n v. Pennsylvania American Water Company*, 99 Pa. PUC 38, 42 (2004) ("*PAWC 2004*"), *aff'd on other grounds*, *Popowsky v. Pa. Pub. Util. Comm'n*, 868 A.2d 606 (Pa. Cmwlth. 2004), *accord Pa. Pub. Util. Comm'n v. Aqua Pa, Inc.*, 99 Pa. PUC 204, 233 (2004) (emphasis added). Indeed, a fair rate of return determination is to be based upon the facts of each case. *Pa. Pub. Util. Comm'n v. Pennsylvania Power Co.*, 55 Pa. PUC 552, 1982 Pa. PUC LEXIS 154 (Order dated Jan. 22, 1982). In this case, OCA's DCF analysis utterly lacks informed judgment because it ignores the fact that the average projected return on common equity for the utilities in the

Electric Group was 11.0%. Moreover, OCA's DCF results are approximately 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. By ignoring these facts, OCA has simply engaged in an arbitrary mathematical exercise designed to reach a pre-determined result: an artificially low cost of common equity.

OCA admits that it ignores these facts, as it acknowledged the stark disparity between the results of its DCF analysis and the average future return on equity forecasts and the actual historical returns on equity for the Electric Group in its Main Brief. OCA acknowledges:

> The average return on equity forecast by Value Line on average for the Electric Group is 10.80%. OCA St. 3 at 36. The actual returns on equity earned on average by the Electric Group were 10.7% in 2015, 10.09% in 2016 and 13.10% in 2017.

OCA MB, pp. 61-62. OCA's suggestion that a 8.50% return on common equity is reasonable where the actual historical returns on equity for the companies that OCA admits are comparable to UGI Electric were between 159 and 460 basis points *higher* from 2015 through 2017 is simply not credible. OCA does not, and cannot, explain why an investor expected return of 11.00% should be reduced to 7.93% or 8.31%, except by engaging in an erroneous exercise that has not been widely accepted in public utility ratesetting, and certainly not by this Commission. UGI Electric St. No. 5-R, p. 19. As such, an 8.50% return on common equity would violate fundamental ratemaking principles by subjecting UGI Electric to a return on equity that is substantially lower than the returns of comparable companies.

Furthermore, OCA ignores the many flaws associated with the DCF method. UGI Electric witness Mr. Moul explained:

> Among other limitations of the model, there is a certain element of circularity in the DCF method when applied in rate cases. This is because investors' expectations for the future depend upon regulatory decisions. In turn, when regulators depend upon the

> DCF model to set the cost of equity, they rely upon investor expectations that include an assessment of how regulators will decide rate cases. Due to this circularity, the DCF model may not fully reflect the true risk of a utility.

UGI Electric St. No. 5, p. 18. In addition to this circularity problem, Mr. Moul noted additional problems with relying exclusively on the DCF method in his rebuttal testimony. He stated:

> While the results of a DCF analysis should certainly be given weight, the use of more than one method provides a superior foundation for the cost of equity determination. Since all cost of equity methods contain certain unrealistic and overly restrictive assumptions, the use of more than one method will capture the multiplicity of factors that motivate investors to commit capital to an enterprise (i.e., current income, capital appreciation, preservation of capital, level of risk bearing). The simplified DCF model makes the assumption that there is a single constant growth rate, there is a constant dividend payout ratio, that price – earnings multiples do not change, and that the price of stock, earnings per share, dividends per share and book value per share all have the same growth rate. We know from experience that those assumptions are not realistic, because the stock market reveals performance that is very different from the assumptions of the DCF. The use of multiple methods provides a more comprehensive and reliable basis to establish a reasonable equity return for UGI Electric. The Commission has acknowledged the usefulness of other methods, such as CAPM and Risk Premium, as a check on the reasonableness of the DCF return. Indeed, the influence of other methods must have an impact on the Commission's attitude toward the DCF model because the Commission's selection of the rate of return on equity for use in the DSIC is usually set well above the cost of equity indicated by the DCF model alone. For example, in the May 17, 2018 Quarterly Earnings Report, the Commission set the DSIC return at 9.55% for the Electric Distribution Companies, while the DCF returns were 9.12% using current prices and 8.97% using 52-week average prices.

UGI Electric St. No. 5-R, pp. 12-13. Given these obvious and undisputed flaws in the DCF methodology, the Commission must also consider other methods (including the CAPM, RP, and CE methods) used by the Company in determining the cost of common equity.

b. OCA's CAPM Analysis Is Flawed And Provides No Support For Its Erroneous DCF Result.

If, as OCA suggested, primary reliance is to be placed on the results of the DCF analysis, it is nonetheless important to provide a reliable alternative measure of the cost of equity to determine the reasonableness of the results of the DCF. UGI Electric St. No. 5, p. 17; UGI Electric St. No. 5-R, pp. 12-13. In particular, an alternative method should be used to check the reasonableness of a DCF analysis before the application of the leverage adjustment.

OCA witness Mr. Rothschild purportedly performed a CAPM analysis for this purpose. OCA St. No. 3, p. 25. However, OCA's erroneous CAPM analysis cannot credibly act as a check on its DCF analysis. UGI Electric MB, p. 98. Under his CAPM analysis, OCA witness Mr. Rothschild reached a curiously low result (*i.e.* 7.08%) that does not reflect reality. Nevertheless, Mr. Rothschild made no attempt to correct the flaws in his CAPM analysis to produce a reliable result, apparently satisfied that his flawed analysis produced a cost rate below his DCF results.

UGI Electric witness Mr. Moul explained the many flaws in Mr. Rothschild's CAPM analysis, which resulted in an understated cost of common equity. UGI Electric St. No. 5-R, pp. 31-32; *see also* UGI Electric MB, p. 98. Chief among these flaws, Mr. Rothschild used "phantom betas" in his CAPM analysis, rather than betas that are available to, or used by, investors. UGI Electric St. No. 5-R, p. 31. Mr. Moul explained that "91% of the raw data used by Mr. Rothschild to compute his beta is not based on actual market data, but rather on prices/values that have been made up by him." UGI Electric St. No. 5-R, p. 32. Therefore, Mr. Rothschild's CAPM analysis is unreliable and should be disregarded.

5. I&E's And OCA's Criticisms Of UGI Electric's Cost Of Common Equity Analysis Should Be Rejected.

I&E and OCA also attempt to criticize multiple aspects of UGI Electric's cost of common equity presentation. I&E MB, pp. 71-74; OCA MB, pp. 63-69. UGI Electric responded to these criticisms in Mr. Moul's rebuttal and rejoinder testimony. UGI Electric St. No. 5-R; UGI Electric St. No. 5-RJ. UGI Electric briefly responds to certain of these criticisms below, and refers the ALJs to Mr. Moul's rebuttal and rejoinder testimony for further explanation.

a. OCA's And I&E's Criticisms Of The Leverage Adjustment Are Without Merit.

OCA and I&E continue to challenge the use of a leverage adjustment in the DCF analysis. OCA MB, pp. 64-66; I&E MB, pp. 72-74. OCA and I&E essentially argue that the leverage adjustment is unwarranted in this case based upon prior Commission decisions and the theory that investors base their decisions on the book value capital ratios for regulated utilities, rather than the market value capital ratios; UGI Electric has refuted these criticisms and explained that a leverage adjustment is proper in this case. UGI Electric MB, pp. 80-85; *see also* UGI Electric St. No. 5-R, pp. 20-25. However, certain specific criticisms by the OCA warrant further discussion.

OCA represents that leverage adjustments are unwarranted where a company has a market to book value above one, because in this situation the utility is overearning. OCA MB, pp. 64-65. As such, OCA argues the Commission and other regulatory bodies have "uniformly" rejected such adjustments. OCA MB, pp. 65-66. As explained below, the precedent cited in OCA's Main Brief actually undermines their cost of common equity analysis.

First, OCA attempts to argue that the Commission's prior rejection of a similar leverage adjustment in the *PPL 2012 RC Order* demonstrates no adjustment is warranted here. OCA MB, p. 65. While the Commission did reject a leverage adjustment, it adopted a management

efficiency adjustment of 0.22%, for a total return on equity of 10.4%. For the reasons explained above, the base DCF calculation produces an unreasonably low result that does not reflect the true prospective cost of equity. For this reason, a leverage adjustment, a management performance adjustment, or both adjustments should be adopted in this proceeding.

Second, OCA attempts to rely on orders from other jurisdictions that rejected a market to book value adjustment. OCA MB, pp. 65-66. The determinations reached in other jurisdictions are not relevant to the decision making process of the Commission. UGI Electric MB, pp. 33-34.[2] Moreover, Mr. Moul's leverage adjustment is not a market to book value adjustment. UGI Electric St. No. 5-R, p. 20. Further, the leverage adjustment is not refuted by OCA's contention that market prices in excess of book value means that utilities earn in excess of the cost of equity because the Commission has repeatedly rejected the assertion that it should try to control market prices. *See* UGI Electric MB, p. 96.

As explained in UGI Electric's Main Brief, the Commission has employed the leverage adjustment to the DCF in circumstances where it believed the DCF understated the cost of equity. UGI Electric MB, pp. 80-85. This is such a circumstance. Rising interest rates,

[2] If these non-jurisdictional cases are determined to be relevant, the Company notes that OCA fails to recognize that in the vast majority of the cited orders, the subject regulatory body ultimately adopted a return on equity value that is substantially higher than OCA's proposed 8.50%. *See In the Matter of the Application of Washington Gas Light Company, District of Columbia Division, for Authority to Increase Existing Rates and Charges for Gas Service*, 2003 D.C. PUC LEXIS 220, at *75 (2003) (adopting a **10.60%** cost of common equity); *In the Matter of St. Louis, Missouri, for Authority to File Tariffs to Increase Water Service Provided to Customers in the Missouri Service Area of the Company*, 1988 Mo. PSC LEXIS 13, at *23 (1988) (adopting a **12.85%** cost of common equity); *In the Matter of the Application of Wisconsin Electric Power Company for Authority to Increase its Rates for the Sale of Electricity in Michigan*, 2002 Mich. PSC LEXIS 294, at *35, 38-39 (2002) (adopting ALJ recommended **11.0%** cost of common equity). While the West Virginia Public Service Commission ultimately approved a 7.00% cost of common equity in the order cited by OCA, the factual grounds involved in this decision are not comparable to the facts in this proceeding. *See West Va. Pub. Serv. Comm'n v. West Virginia-American Water Works*, 2004 Pa. PUC LEXIS 6, at *49 (2004). In particular, the West Virginia Public Service Commission found that there were no flaws associated with the low end of the returns on equity presented in the case and that the high-end was heavily influenced by the use of a gas group, which was not comparable in risk to the water group. *See id.*, at *41-42. In this case, OCA and I&E have engaged in analyses that contain a number of significant flaws and the Company has not utilized a non-electric proxy group in developing its common equity presentation. Therefore, *West Va. Pub. Serv. Comm'n v. West Virginia-American Water Works* is inapposite to this proceeding. To the extent that these decisions demonstrate no leverage adjustment is warranted, these orders also demonstrate that OCA's proposed 8.50% return on equity is unreasonably low.

increased volatility, and the impacts of the TCJA may be depressing growth rates. In contrast, growth should be expected to accelerate as electric utilities enter into expanded infrastructure investments. Mr. Rothschilds' retention growth rates are impacted by commission allowed returns on equity and, therefore, result in circular reasoning. This is particularly inappropriate and troublesome when using an unadjusted DCF result as the sole source for determining the cost of equity. UGI Electric St. No. 5, p. 18.

b. OCA's And I&E's Criticisms Of The Risk Premium Method Should Be Rejected.

OCA argues that the Commission has rejected the Risk Premium ("RP") method as the primary basis for cost of common equity determinations. OCA MB, pp. 67-68. On the contrary, the Commission at different points in time has used the RP method both as a primary method and a check on the DCF analysis.[3]

Indeed, in the *PPL 2012 RC Order*, the Commission specifically credited the RP method in its disposition of the cost of common equity. The Commission explained:

> In particular, we note that the evidence presented in this case based on the CAPM and RP methods produced a range of results that was consistently higher than the results produced by a DCF-only approach. <u>This suggests that, while properly computed in the abstract, the DCF-only results understate the current cost of equity for PPL and that consideration should be given to the CAPM and RP evidence in determining the appropriate range of reasonableness</u>.

PPL 2012 RC Order, p. 81 (emphasis added).

I&E additionally contends that the RP method does not measure the current cost of equity as directly as the DCF; this is similarly without foundation. UGI Electric witness Mr. Moul

[3] *See Pa. P.U.C. v. PPL Electric Utilities Corp.*, Docket No. R-00049255, pp. 67 and 72 (Order entered Dec. 22, 2007); *Pa. P.U.C. v. Philadelphia Suburban Water Co.*, Docket Nos. R-870840 *et al.*, 96 P.U.R. 4th 158, 207, 1988 Pa. PUC LEXIS 433, at *135-137, (Order entered July 26, 1988); *see also*, *Pa. P.U.C. v. National Fuel Gas Distribution Corp.*, Docket No. R-891218 *et al.*, 109 P.U.R. 4th 250, 272, 1989 Pa. PUC LEXIS 225 at *52 (Order entered Dec. 29, 1989).

explained that he reflected the undisputed prospect of rising interest rates in his RP analysis, which resulted in a cost of equity of 11.25%. UGI Electric St. No. 5-R, p. 33.

The criticisms of the RP method should be rejected. The RP cost rate of 11.25% strongly suggests that the DCF results offered by OCA and I&E are grossly inadequate. As noted earlier, OCA and I&E provide no reliable or otherwise credible check on their extraordinarily low DCF results. *See* Section VII.A.2-3 *supra*. In addition, the RP cost rate of 11.25% demonstrates that Mr. Moul's DCF analysis of 10.55% is reasonable.

c. OCA's and I&E's Criticisms Of The CAPM Method Should Be Rejected.

OCA and I&E also criticized the Company's use of the capital asset pricing model ("CAPM") analysis. OCA MB, pp. 68-69; I&E MB, pp. 72-73. In particular, both OCA and I&E criticize the use of a size adjustment to account for UGI Electric's smaller size and increased risk profile. As explained in UGI Electric's Main Brief, 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. And, as noted in this Reply Brief, *supra*, Pennsylvania case law requires recognition of the size and nature of the utility when setting the return on equity.

In addition, both OCA and I&E contend that Mr. Moul's use of the arithmetic average return is improper. OCA MB, p. 68; I&E St. No. 2, p. 26. However, Mr. Moul thoroughly explained why the use of the arithmetic mean to calculate the historical risk premium is proper, and why OCA's use of the geometric mean is improper. UGI Electric St. No. 5-R, pp. 27-28. Unlike the geometric mean, "the arithmetic mean provides an unbiased estimate, provides the correct representation of all probable outcomes, and has a measurable variance." UGI Electric

St. No. 5-R, p. 28. As such, OCA's and I&E's criticisms of Mr. Moul's CAPM analysis are unfounded and should be rejected.

d. I&E's Reliance On The Quarterly Earnings Reports Is Misplaced And Should Be Rejected.

Finally, I&E contends that the Company's cost of common equity presentation is skewed by FPFTY ratemaking adjustments that were included in the Company's Quarterly Earnings Reports, which I&E believes are improper. I&E MB, p. 74. As explained in Section IX.A *infra* and Section XI.A of UGI Electric's Main Brief, I&E's discussion of the Company's Quarterly Earnings Reports is irrelevant, improper and should be disregarded in this proceeding.

B. MANAGEMENT PERFORMANCE

As explained in UGI Electric's Main Brief, the Commission is required to consider management effectiveness in setting rates, and the Commission has, where appropriate, included an incremental upward adjustment to the cost of common equity to reflect management effectiveness. UGI Electric MB, pp. 99-106. UGI Electric presented extensive, unrebutted evidence that demonstrates it has provided excellent service at low rates and has implemented numerous programs designed to enhance the service it provides to its customers, which fully supports its proposed 20 basis point addition to the market based cost of common equity. In their Main Briefs, I&E and OCA each oppose the Company's addition, but neither party contests that UGI Electric's policies and programs have resulted in excellent service and neither party provides any substantial basis for its position.

I&E attempts to brush aside the Company's presentation of management effectiveness by arguing that management points should be awarded "in a case-by-case basis" and that UGI Electric should not be awarded management points for programs "funded by ratepayers for meeting the Company's obligations to provide safe and reliable service." I&E MB, p. 73. OCA

similarly attempts to ignore the Commission's statutory directive to consider management effectiveness in setting rates and concludes, without basis, that the evidence of record in this proceeding does not support UGI Electric's request. OCA MB, pp. 66-67.

Both I&E and OCA attempt to ignore the statutory directive of Section 523 of the Public Utility Code, which requires the Commission to consider management effectiveness in setting rates. 66 Pa. C.S. § 523; *see also* UGI Electric MB, pp. 103-104. I&E and OCA both attempt to obfuscate this issue by arguing that UGI Electric must demonstrate that its practices, processes or programs are superior to other electric utilities or that such programs and initiatives must not be funded by ratepayers in order to satisfy Section 523 of the Code. This is incorrect. The issue to be determined is 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. As explained in UGI Electric's Main Brief, the Company's efforts have achieved these goals, and it has done so above and beyond its obligation to provide reasonably safe and reliable service. UGI Electric MB, pp. 100-102.

Importantly, I&E and OCA do not dispute the actions UGI Electric submits demonstrate its superior management performance. Rather, these parties simply advance arguments that would ultimately render Section 523 of the Public Utility Code a nullity. UGI Electric MB, pp. 105-106.

Finally, I&E briefly posits that UGI Electric should have proposed a reconcilable rider to flowback the 2018 impacts of the TCJA to ratepayers and appears to suggest that its failure to do so demonstrates poor management. I&E MB, p. 74. This suggestion is baseless. UGI Electric was in a base rate proceeding at the time that the Commission issued its *Tax Cuts and Jobs Act of 2017*, Docket No. M-2018-2641242, p. 19 (Order entered March 15, 2018) ("*March Order*") and

was directed to consider the impacts of the TCJA as a part of this base rate proceeding. The argument that UGI Electric's decision to address the impacts of the TCJA as a part of this proceeding, and not implement a reconcilable rider while it litigated the very issue the Commission order directed be dealt with in this case, is indicative of poor management puts the cart before the horse. UGI Electric simply proceeded in a logical fashion and in accordance with the Commission's directive in the *March Order*; UGI Electric addressed the TCJA impacts as a part of this proceeding. I&E's argument is spurious and should be rejected.

For these reasons, I&E's and OCA's arguments regarding the Company's proposed adjustment for management performance should be rejected and the Commission should adopt the 20 basis point increment proposed by the Company.

VIII. TAXES

A. 2018 TAX ADJUSTMENT

In addition to fully reflecting the prospective impact of the federal Tax Cuts and Jobs Act of 2017, Pub. L. 115-97, 131 Stat. 2054 ("TCJA") in rates, I&E and OCA also propose an additional adjustment to reflect the 2018 impact of the TCJA. I&E MB, pp. 55-62; OCA MB, pp. 37-39. As explained in the Company's Main Brief, however, the additional rate reductions proposed by I&E and OCA violate long-standing rules against single issue and retroactive ratemaking, and the adoption of these adjustments would be extraordinarily poor public policy and not in the public interest. UGI Electric MB, pp. 108-117. In their respective briefs, I&E and OCA primarily rely on Commission orders directing utilities who have not filed and do not plan to file 2018 base rate cases to implement surcharges, effective July 1, 2018, which would reduce rates to reflect six months of the 2018 impact of the TCJA. *See* I&E MB, pp. 56-61; *see also*

OCA MB, pp. 37-38.[4] For the reasons set forth below, these orders do not support the proposed 2018 adjustments in the context of a base rate case and, therefore, should be rejected.

First, the referenced *March Order* and *May Order* setting temporary rates on their face have no application to this proceeding. For those companies that would not be involved in a general rate increase proceeding in 2018, the Commission recognized that there was no base rate case available to reflect the impacts of the TCJA, so the Commission ordered an immediate rate reduction. *See March Order*, pp. 3-4; *see also May Order*, pp. 17-20.

These orders did not require companies who were in the midst of, or were soon to file, Section 1308(d) general rate increase proceedings to implement an immediate rate reduction or negative surcharge. *See March Order*, pp. 4-5; *see also May Order*, pp. 20-21. For those companies filing base rate cases, an immediate rate reduction for 2018 was not necessary and the Commission took a different approach. Specifically, the Commission directed that the effects of the TCJA be addressed in each company's individual base rate proceeding and explained:

> Accordingly, the Commission expects the public utility and the parties in each such [general rate increase] proceeding to address the effect of the federal tax rate reduction on the justness and reasonableness of the consumer rates charged during the suspension period, and, in particular, whether a retroactive surcharge or other measure is necessary to account for the tax rate changes that became effective on January 1, 2018.

See May Order, pp. 20-21. That is exactly what UGI Electric has done in this proceeding. The Company has fully reflected the prospective impact of the TCJA in its proposed rates. Neither I&E nor OCA dispute this fact. Instead, they propose an additional adjustment for the 2018

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[4] I&E and OCA principally cite the Commission's *Tax Cuts and Jobs Act of 2017*, Temporary Rates Order Docket No. M-2018-2641242 (Order entered May 17, 2018) ("*May Order*"). OCA also cites the Commission's prior *Tax Cuts and Jobs Act of 2017*, Temporary Rates Order Docket No. M-2018-2641242 (Order entered March 15, 2018) ("*March Order*").

impact which clearly overstates the impact of the TCJA and would provide an unjustified windfall to customers.

Rates are set on an annual basis based on a test year. All elements of the ratemaking formula must match and be consistent. Only where a utility is shown to be overearning would it be appropriate to order a refund. Unlike the Commission's approach to utilities that were not currently in a base rate proceeding, where the Commission made a specific determination as to overearning prior to the implementation of a surcharge mechanism, those utilities currently in a base rate proceeding were ordered to consider "the justness and reasonableness of the consumer rates charged during the suspension period." Consistent with the Commission's treatment of other utilities, in order for a surcharge to be appropriate for the 2018 Tax Effects, there would need to be a specific showing that UGI Electric was overearning in the FTY. However, there has been no showing that UGI Electric was overearning in the FTY – just the opposite has been shown in this proceeding. Therefore, there is no basis to further reduce the rates charged to customers during the period from January 1, 2018 until new base rates go into effect. The Commission itself recognized this issue and expressly did not order 2018 rate reductions for utilities with 2018 base rate cases.

Second, the proposed 2018 adjustment constitutes impermissible single issue and retroactive ratemaking. UGI Electric MB, pp. 109-114. I&E and OCA provide no support for their conclusion that the TCJA adjustment constitutes a valid exception to the prohibition against single issue and retroactive ratemaking, except to cite to the summary conclusions in the *March* and *May Orders* that the change in federal tax rates is an extraordinary non-recurring event which qualifies for an exception to the rule against single issue ratemaking. I&E MB, pp. 55-62; OCA MB, pp. 37-39. The rules against single issue and retroactive ratemaking are judicial

rules. The Commission's conclusion that single issue ratemaking does not apply because the change in tax rates is extraordinary and non-recurring is simply wrong. Tax laws change all the time, and all witnesses agree in this case that the change in tax rate is not a non-recurring event. UGI Electric MB, pp. 111-114.

Third, even if the change in tax rate is viewed as an extraordinary and non-recurring event, controlling court decisions require some determination that the utility is overearning on its allowed return before a refund of a cost or cost reduction due to such an event can occur. UGI Electric MB, pp. 114-115. In its prior orders, the Commission expressly found that each utility not filing a base rate case was earning at least a 5% return as a basis for setting temporary rates. *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 or other companies filing 2018 base rate cases. The evidence presented in this case demonstrates that UGI Electric is under-earning its allowed return in 2018. Even I&E and OCA concede that UGI Electric is entitled to some rate increase and have presented no testimony or evidence that UGI Electric is overearning for 2018.[5]

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[5] I&E seeks to cobble together an argument that UGI Electric is earning more than 5% in 2018, but this proves nothing. *See* I&E MB, pp. 59-60. The 5% figure is relevant to setting temporary rates. No party is proposing temporary rates here. I&E's proposed overall rate of return in this proceeding for the FPFTY is 6.82%, reflecting an 8.62% return on common equity. For 2018, the FTY in this proceeding, UGI Electric is earning a 4.83% overall rate of return including a 4.96% return on common equity. I&E's proposed return is clearly inadequate, but in any event, it is clear that the Company is underearning in the FTY compared to I&E's low return, and that no adjustment to rates would be lawful and appropriate.

For the reasons explained above and in UGI Electric's Main Brief, I&E and OCA have failed to present any legal or factual basis for their proposed 2018 TCJA adjustment. Therefore, this adjustment should be rejected.

B. EXCESS ACCUMULATED DEFERRED INCOME TAX

It is undisputed that there were two principal ratemaking impacts of the TCJA: (1) a reduction in current and deferred tax expense (which for ratemaking purposes is a reduction to tax expense), and (2) a reduction in ADIT (which, for ratemaking purposes, is an increase in rate base and an increase in rates). UGI Electric MB, pp. 125-126. I&E and OCA propose to fully reflect the rate reduction for tax expense and to further reduce tax expense by the EDFIT amortization amount, but want to ignore the increase in rate base as a result of the reduction in ADIT. This result is patently inconsistent. The Commission should reflect all impacts of the TCJA, not just those which reduce rates.

The only response offered is that excess ADIT was a reduction from rate base prior to the adoption of the TCJA. I&E MB, pp. 64-66; OCA MB, pp. 42-44. This proves nothing. The purpose of these adjustments is to reflect the impact of the adoption of the TCJA. I&E and OCA are more than willing to reflect the lower tax expense resulting from the TCJA and the amortization of the EDFIT, but want to ignore the impact on ADIT and propose that ADIT accumulated at 35% (inclusive of unamortized EDFIT) should continue to be deducted from rate base even though the tax rate has changed to 21%. This argument ignores the fact that ratemaking is prospective. The tax rate is now 21%, not 35%, and the tax rate will be 21% at the time UGI Electric's proposed rates take effect. As such, all effects of the tax rate change should be reflected in rates, not just the ones that reduce rates.

Moreover, as explained in UGI Electric's Main Brief, all parties agree that excess ADIT should be amortized as a regulatory liability. UGI Electric MB, pp. 121-124. There is no

precedent for allowing a return to the utility or customers for regulatory assets and liabilities, respectively. Moreover, the Commission did not explicitly adopt any rate base adjustment for excess ADIT in 1986 when the federal corporate income tax rate last changed. UGI Electric MB, pp. 122-123. I&E and OCA's adjustment is unprecedented, patently inconsistent and should be rejected.

C. ACT 40

OCA asserts that the Company has not complied with Act 40 of 2016, Pub. L. 332 ("Act 40"), which eliminated CTA in Pennsylvania, and that the revenue impact of a hypothetical CTA should be a reduction to rate base as ratepayer supplied capital. OCA MB, pp. 44-47. This argument should be rejected for four reasons.

First, and perhaps most importantly, Act 40 itself clearly addresses and rejects the OCA's proposed adjustment. Act 40 states:

> 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). The OCA adjustment would reduce rate base for the deferred taxes associated with the CTA in direction violation of the statute.

Second, the Company has fully complied with Act 40 requirements regarding revenue use, which states:

> (b) Revenue use.--If a differential accrues to a public utility resulting from applying the ratemaking methods employed by the commission prior to the effective date of subsection (a) for ratemaking purposes, the differential shall be used as follows:
>
> > (1) fifty percent to support reliability or infrastructure related to the rate-base eligible capital investment as determined by the commission; and

(2) fifty percent for general corporate purposes.

66 Pa. C.S. § 1301.1(b). UGI Electric witness Mr. Anzaldo fully explained the Company's compliance with Act 40. UGI Electric MB, pp. 129-130. In his rebuttal testimony, Mr. Anzaldo 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. As these quotations demonstrate, UGI Electric has fully complied with the plain language of the statute.

OCA contends that UGI Electric did not provide "specific" information about how the amounts would be used. OCA MB, pp. 45-47. As shown above, the statute contains no such requirement. If the legislature had wanted specific information, it would have so provided. It did not.

Third, as explained in detail in UGI Electric's Main Brief, the rate base adjustment proposed by OCA is simply a variation of the CTA that was outlawed by Act 40. UGI Electric MB, pp. 132-133. Different states make the CTA in different ways. Some, such as Pennsylvania, did it through a reduction to tax expense. Others, such as New Jersey and New York, did it through a rate base reduction, as proposed by OCA in this proceeding. *See* UGI Electric MB, p. 132. It is clear that OCA is simply trying to implement a variation of the CTA post-Act 40, contrary to the plain language and clear intent of Act 40. The OCA should not be permitted to resurrect the CTA through its proposed rate base adjustment.

Fourth, as explained in UGI Electric's Main Brief, OCA badly misreads Act 40. UGI Electric MB, pp. 131-132. As explained therein, Section 1301.1(a) deals with ratemaking, while

Section 1301.1(b) only addresses the use of revenues from the elimination of the CTA. OCA simply assumes that subsection (b) requires the Commission to treat the "differential" as if it were ratepayer contributed capital. However, subsection (b) deals with the "uses" of the differential calculated under subsection (a), and has nothing to do with ratemaking. OCA's interpretation of Section 1301.1 is simply wrong. UGI Electric MB, pp. 132-133.

For these reasons, OCA's adjustment should be rejected.

IX. RATE STRUCTURE

A. COST OF SERVICE

UGI Electric explained that the cost of service study prepared by the Company in this proceeding is virtually identical to the methodology adopted by the Commission in the *PPL 2012 RC Order*. UGI Electric's proposed cost of service study classified both its primary and secondary distribution system as part customer-related and part demand-related. UGI Electric MB, pp. 138-139. The only party that significantly criticized UGI Electric's cost of service study was OCA.[6]

OCA proposed a cost of service study that allocates 100% of UGI Electric's primary voltage level facilities and secondary voltage level facilities as demand-related. OCA MB, p. 72. In support of this proposal, OCA contends that its cost of service study, unlike the minimum system study proposed by the Company: (1) is consistent with a NARUC report and the majority of other jurisdictions; (2) considers customer density; and (3) accounts for those portions of each class's peak load that can be met by the minimum system itself, *i.e.* the peak load carrying capability ("PLCC"). In its Main Brief, UGI Electric responded to OCA's proposed cost of

[6] OSBA proposed minor technical adjustments to the cost of service study, which were generally adopted by the Company in its rebuttal testimony. UGI Electric MB, pp. 139-140. Additionally, I&E argued that UGI Electric's customer cost analysis was "overly inclusive," but did not offer specific criticisms of the Company's cost of service study or propose an alternative cost of service study. I&E St. No. 3, pp. 33-37.

service study and OCA's opposition to UGI Electric's cost of service study. *See* UGI Electric MB, Section IX.A. Nevertheless, it is appropriate for UGI Electric to respond to certain contentions advanced by the OCA. For the reasons explained below, as well as those more fully explained in the Company's Main Brief, the OCA's proposed cost of service study and opposition to UGI Electric's cost of service study are without merit and should be rejected.

1. OCA's Criticism That There Is No Direct Relationship Between The Number Of Customers And The Cost Of Upstream Primary And Secondary Distribution Plant Is Erroneous And Should Be Rejected.

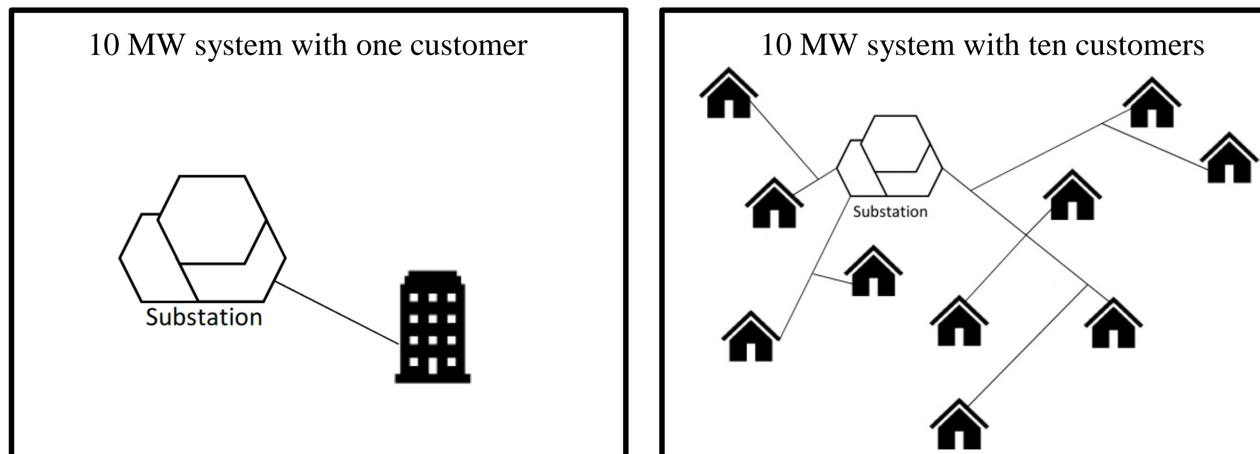
OCA's principle criticism of the Company's cost of service study is that it allocates part of cost of upstream primary and secondary distribution plant as part customer-related and part demand-related. OCA MB, p. 72. OCA argues that the use of a "minimum system" approach results in an improper allocation of plant costs as customer-related. Specifically, OCA witness Mr. Mierzwa contended:

> These costs are not, in any meaningful way, directly related to the number of customers served. The cost of upstream distribution plant is incurred in order to meet the coincident loads of the customers that it serves. The size and costs of the required plant are a function of the diversity of customers' loads that must be served from this plant, as well as the expected future coincident loads that may have to be served from these facilities as growth occurs on the system. <u>There is no direct relationship between the number of customers and the size or the cost of poles or conductors, and Mr. Taylor has presented no evidence of a direct relationship</u>.

OCA MB, p. 73 (quoting OCA St. No. 4, p. 9) (emphasis added).

UGI Electric explained in its Main Brief and in Mr. Taylor's rebuttal testimony that its proposed classification of primary and secondary upstream distribution plant is consistent with Commission precedent, 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 MB, pp. 141-143; *see also* UGI Electric St. No. 6-R, pp. 3-12.

OCA's proposed allocation of primary and secondary distribution plant as 100% demand-related also defies the reality of how a distribution system is designed and constructed. Consider, as shown in the graphic below, two hypothetical distribution systems with equivalent demand (10 MW), but a different number of customer counts (one customer vs. ten customers):



In the first system, the sole customer uses 100% of the 10 MW system demand, and receives power over a single line and pole configuration. In the second system, ten customers each use 1 MW of the 10 MW system demand (*i.e.* 10%), and are served over separate line and pole configurations. Despite the fact that both systems have equivalent demand, additional distribution facilities are required in the second system to serve a greater number of customers. As such, the second system obviously has a greater customer cost component than the first system. OCA witness Mr. Mierzwa's position would essentially ignore this fact and suggest that the customer cost component for each system is exactly the same. This erroneous viewpoint must be rejected.

UGI Electric also demonstrated that the OCA's other criticisms of the minimum system approach are similarly flawed. UGI Electric MB, pp. 141-143. Regardless of whether other jurisdictions take a different approach, the fact remains that the Commission has repeatedly

affirmed the use of the minimum system method as the accepted approach to classify and allocate distribution system costs. *See* UGI Electric St. No. 6-R, pp. 4-5. OCA has not presented any compelling reason to depart from the use of this accepted method in this case.

In addition, OCA's attempt to rely on the dissenting statement of former Commissioner James Cawley in the *PPL 2012 RC Order* is misguided for two reasons. OCA MB, p. 75; OCA St. No. 4, pp. 74-75. First, OCA relies on a dissenting opinion, not the actual decision of the Commission. In the *PPL 2012 RC Order*, Commissioner's Cawley's views were rejected by the majority. The majority disagreed with the OCA and agreed with PPL Electric. It is unclear why the OCA would cite as support a case where it lost the same issue it is litigating here.

Second, Commissioner Cawley's dissent specifically refers to the record before the Commission in the *PPL 2012 RC Order*. OCA St. No. 4, pp. 74-75 ("But the company never fundamentally addresses why its model is appropriate…"). In this proceeding, UGI Electric witness Mr. Taylor fully explained the appropriateness of the minimum system approach in both his direct and rebuttal testimony. UGI Electric St. No. 6; UGI Electric St. No. 6-R. Specifically, even if, as Mr. Mierzwa suggests, UGI Electric's customers are evenly distributed across its service territory, Mr. Taylor explained that the location-based variations in installation costs effectively offset any customer density differences. UGI Electric St. No. 6-R, p. 8. As such, it is incorrect to assume that customer density differences invalidate the use of a customer component of upstream distribution facilities.

Finally, UGI Electric refuted OCA's misleading contention that the minimum system study does not account for those portions of each class's peak load that can be met by the minimum system. UGI Electric MB, p. 143. OCA attempts to bolster this argument in its Main Brief by quoting select portions of the Commission's order in *Pa. Pub. Util. Comm'n v.*

Duquesne Light Co., 1985 Pa. PUC LEXIS 68, at *231 (Order entered Jan. 25, 1985) ("*Duquesne Light*"). *See* OCA MB, p. 76. The full quote in this order, however, reads:

> The customer component of distribution plant is a theoretical minimum size system that is required to serve a customer with an infinitely small load and represents the costs of just being a customer. This system can be represented as wet thread supported by long tooth picks to serve a Christmas tree light. Basically, it is a cost that measures customer density. <u>If two customers are served from a pole, each customer would share the customer component of the pole. If only one customer were served from the pole, his customer component of poles would be twice that of the previous example.</u>

Duquesne Light at *231 (emphasis added). Contrary to OCA's representations, the description of the minimum system size study in this order comports with UGI Electric's position that the minimum system approach does, in fact, properly account for customer density. Moreover, the Commission's description of the minimum system study is consistent with the basic logic behind allocating upstream distribution facilities as partially customer-related: where fewer customers are served by the same upstream facilities, those customers must bear greater cost responsibility for those facilities.

Based on the foregoing, OCA's contention that UGI Electric's primary voltage level facilities should be classified as 100% demand-related should be rejected. Clearly, UGI Electric's upstream distribution facilities are required to connect customers located in rural and suburban areas to the electric system. Therefore, it is reasonable to allocate a portion of these facilities as customer-related in the manner specified in the Company's cost of service study.

2. OCA's Additional Modifications To The Allocation of Costs in Specific O&M Accounts Should Be Rejected.

UGI Electric explained in its Main Brief that OCA's proposed modifications to Accounts 364, 365 and 367 and of Outside Service expenses in Accounts 539, 594 and 923 are unwarranted. UGI Electric MB, pp. 144-145. Contrary to OCA's assertions, the amounts in

these accounts are not correlated to total sales of electricity and, therefore, should not be classified as 50% energy-related.

3. I&E's Argument That The Company's Customer Cost Analysis Is Overly Inclusive Is Unsupported And Should Be Disregarded.

I&E contends that the Company's allocated class cost of service study is "overly inclusive." I&E MB, p. 75. UGI Electric demonstrated that its cost of service study is consistent with Commission precedent, 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 MB, pp. 141-143. Therefore, I&E's criticism of UGI Electric's cost of service study is unfounded and must be rejected.

B. REVENUE ALLOCATION

Both OCA and OSBA addressed the Company's proposed revenue allocation. OCA MB, pp. 79-83; OSBA MB, pp. 23-25. UGI Electric fully addressed the parties' adjustments to its revenue allocation in its Main Brief, pages 145 through 151, but makes the following limited additional responses to the positions of OSBA and OCA.

As explained in UGI Electric's Main Brief, the Company's proposed revenue allocation follows the results of the Company's revised cost of service study, UGI Electric Exhibit D – Cost of Service Study (REBUTTAL). UGI Electric MB, pp. 146-148. This cost of service study is a slightly modified version of the study that was included in the Company's initial filing, which incorporates certain adjustments and modifications proposed by the OSBA and rejects others. UGI Electric MB, pp. 148-149.

In particular, the Company declined to adopt OSBA's proposed revenue allocation for the Large Power and Lighting Customer Groups. As explained in UGI Electric's Main Brief, there is no reasonable basis for adopting the revisions to the revenue allocation for the Large Power

and Lighting customer groups proposed by OSBA. UGI Electric MB, Section IX.B.4. As the proponent of this proposal, OSBA bears the burden of proving that its alternative revenue allocation for these customer groups is reasonable. *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). It has not carried this burden. Therefore, the OSBA's proposal to allocate a portion of the revenue increase to the Rate LP and Lighting classes should be rejected.

Finally, UGI Electric explained that OCA's proposed revenue allocation should be rejected because it is based off the flawed cost of service study performed by Mr. Mierzwa. UGI Electric MB, pp. 149-150. For the reasons explained in Section IX.A *supra*, in addition to those discussed in UGI Electric Main Brief, the OCA's proposed cost of service study is flawed and, therefore, its proposed revenue allocation should also be rejected.

C. RATE DESIGN

All parties to this proceeding addressed the Company's proposed rate design. Specifically, I&E and OCA disputed the Company's proposed residential customer charge, and OSBA addressed the Company's proposed non-residential customer charges. For the reasons explained below, and in UGI Electric's Main Brief, the Company's proposed rate design should be approved.

1. Residential Customer Charge.

As explained in the Company's Main Brief, UGI Electric proposed to increase the Rate R customer charge from $5.50 per month to $14.00 per month based on its cost of service study and the underlying minimum size system study. The proposed increase in the customer charge for Rate R is supported by the results of UGI Electric's cost of service study, which utilizes the same methodology that has previously been approved by the Commission. Further, UGI Electric's proposal is consistent with *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*"), which held that rate structures should be adjusted to reflect the cost of service to each rate class and to eliminate cross-subsidization, and should be approved. UGI Electric MB, pp. 134-35.

I&E and OCA argue that the Rate R customer charge should not increase as the Company has proposed. I&E and OCA raise several arguments in opposition to the proposal to increase the customer charge and recommend that the customer charge be increased to $10.00 or $8.00, respectively. In its Main Brief, UGI Electric anticipated and responded to the parties' opposition to the proposed Rate R customer charge. Nevertheless, it is appropriate for UGI Electric to respond to certain arguments advanced by I&E and OCA.

a. Gradualism Concerns Cannot And Should Not Trump The Cost Of Service In Evaluating The Company's Proposed Customer Charge.

One of the principal contentions of both I&E and OCA is that the Company's proposed $14.00 Rate R customer charge does not reflect the principle of gradualism.[7] I&E MB, p. 78; OCA MB, pp. 87-88. Also, both I&E and OCA similarly contend that their proposed Rate R customer charges do properly reflect this principle.

However, I&E and OCA ignore controlling precedent by attempting to advance gradualism considerations ahead of the cost to serve the residential class. *See* UGI Electric MB, Section IX.B.5. 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* UGI Electric MB, pp. 155-156; I&E St. No. 3, pp. 35-36 (acknowledging

[7] I&E raises the same gradualism arguments regarding its proposed $10.00 customer charge for Rate GS-5 customers, which are general service customers that receive service under the residential schedule. UGI Electric explained in its Main Brief that I&E's proposal for Rate GS-5 should be rejected for the same reasons as its proposal for Rate R. UGI Electric MB, p. 154, n. 39.

the cost of service study reflects a customer charge of $17.70, but proposing a customer charge of $10.00); 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). UGI Electric further explained that these gradualism arguments improperly focus on a single component of the company's rate design, rather than the entirety of the increase. UGI Electric MB, pp. 155-156.

For these reasons, the gradualism concerns advanced by I&E and OCA do not justify their proposed Rate R customer charges and, therefore, these proposed charges should be rejected.

b. OCA's Proposed Residential Customer Charge Completely Ignores The Cost To Serve The Residential Customer Class.

OCA also devotes a substantial portion of its Main Brief arguing that the Company improperly includes certain costs in its customer cost analysis, and that increasing the fixed monthly charge does not send meaningful price signals to UGI Electric's customers regarding energy usage and conservation. OCA MB, pp. 84-87. UGI Electric explained that 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 MB, p. 156.

In addition, OCA's proposed rate design improperly attempts to prohibit the recovery of certain fixed costs through a fixed charge, based upon its contention that a greater portion of costs should be recovered through energy charges. OCA MB, pp. 86-87. OCA contends that this will send proper price signals to customers and encourage energy conservation. However, OCA's attempt to shift the recovery of fixed costs from a fixed charge to a variable charge

actually distorts pricing signals. UGI Electric MB, p. 156; *see also* UGI Electric St. No. 6-R, pp. 6-7. Therefore, OCA's proposed rate design, which attempts to prioritize recovery of costs through a higher energy charge, should be rejected.

c. OCA's Contention That Low-Income/Low-Usage Customers Will Be Harmed By The Proposed Customer Charge Is Incorrect.

OCA also contends that the Company's proposed residential customer charge should be rejected because it will negatively impact low-income, lower-usage customers. OCA MB, pp. 88-93. UGI Electric demonstrated that OCA's premise—that low-income customers are low-usage customers—is inherently flawed. UGI Electric MB, p. 158. In particular, OCA ignores record evidence demonstrating that low-income customers in UGI Electric's service territory use more electricity on average than non-low-income customers. UGI Electric witness Ms. Rossi included the following table in her rejoinder testimony:

Rejoinder Table 1. Annual Electric Usage in Kwh

Year	CAP Customers	All Low-Income Including CAP	Non-Low Income Customers	Non-CAP Low-Income Customers
2015	15,865	13,125	10,511	12,104
2016	15,040	12,752	10,214	11,800
2017	15,523	12,986	10,022	11,826

UGI Electric St. No. 10-RJ, p. 2. This table clearly demonstrates that all segments of low-income UGI Electric customers, regardless of whether or not these customers are enrolled in CAP, use more electricity on average than non-low-income customers.

In addition, OCA completely ignores UGI Electric witness Mr. Taylor's testimony that low-income customers will pay less for their service under UGI Electric's proposed rate design

than under OCA's proposed rate design. UGI Electric MB, pp. 159-160. As shown in the tables included in Mr. Taylor's Rejoinder testimony, which are reproduced in UGI Electric's Main Brief, under UGI Electric's proposed $14.00 customer charge, low-income non-CAP customers will pay $1.26 per month less, and $15.06 per year less, 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 less, and $41.42 per year less, 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 benefit from the Company's proposed $14.00 per month customer charge, in comparison to the OCA's proposal. Therefore, OCA's arguments regarding the impact of the proposed customer charge on low-income customers should be disregarded.

2. Non-Residential Customer Charges.

The Company and OSBA were the only parties to submit testimony regarding non-residential rate design.

a. Rates GS-1 and GS-4.

As explained in UGI Electric's Main Brief, the Company adopted minor modifications to the cost of service study, which ultimately necessitated minor changes to its proposed rate design for Rates GS-1 and GS-4. UGI Electric MB, pp. 161-162. OSBA noted its numerous rate design proposals for Rates GS-1 and GS-4 in its Main Brief. OSBA MB, pp. 29-30. While UGI Electric did not adopt all of these proposals as a part of its rebuttal testimony, the rate design for Rates GS-1 and GS-4 generally reflect the directional recommendations of OSBA. Given that the proposed rate design for Rates GS-1 and GS-4 are the result of the Company's proposal to adopt reasonable modifications to its cost of service study (*see* UGI Electric MB, Section IX.A.2.b), which have influenced the revenue to be allocated to each customer class, and which

are aligned with OSBA's proposal (*see* UGI Electric MB, Section IX.B.2-3), 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. OSBA Has Not Met Its Burden To Prove That The Existing Rate Design For The Large Power Customer Groups Is Unjust Or Unreasonable.

OSBA recommended several "directional" changes to the rate design for Rate LP. OSBA MB, pp. 29-30. However, UGI Electric demonstrated in its Main Brief that no rate design changes for Rate LP are warranted because no portion of the revenue increase was allocated to this customer class and because OSBA failed to demonstrate any changes were warranted.

As noted in the Company's Main Brief 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.[8] UGI Electric MB, pp. 6-7, 162-63. 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.[9] *Id.* 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.[10] *Id.*

OSBA is the proponent of the proposed changes to the rate design for Rate LP and, therefore, bears the burden of proof. UGI Electric explained that OSBA has not met this burden and that no changes to the design of this rate are justified. OSBA provided no evidence that the

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[8] *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).

[9] *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).

[10] *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).

current design of Rate LP is unjust or unreasonable. In addition, OSBA provided no analysis regarding the bill impacts for Rate LP customers that would occur if this alternative rate design proposal were adopted and no evidence that the current rate design, without these changes, is unreasonable. UGI Electric MB, pp. 162-63. Therefore, OSBA's proposal to alter the existing rate design of Rate LP should be rejected.

D. SCALE BACK

Each of the parties submitted a scale back proposal, in the event that the Commission approves a rate increase less than the full increase requested by the Company. UGI Electric MB, p. 165; I&E MB, pp. 79-80; OCA MB, p. 93; and OSBA MB, p. 31. I&E recommended a sequential scale back proposal designed to produce specific revenue levels for the Rate GS-5 and Rate R classes, *i.e.* the usage rate revenue level under present rates for each class, and then a scale back from its recommended $10.00 customer charge for each of these classes. I&E MB, p. 79. OCA recommended a proportionate scale back of the increase for each rate class. OCA MB, p. 93. OSBA recommended that a proportionate scale back only be applied to those classes that are assigned rate increases. OSBA MB, p. 31.

UGI Electric demonstrated that any scale back should be proportionally applied based on its proposed revenue allocation, and that it should apply to any proposed increases and proposed decreases. UGI Electric MB, p. 165. In particular, UGI Electric demonstrated that the scale back should first be applied to energy charges, then to any demand charges, and that any scale back should be based upon the Company's proposed rates, rather than the reduced customer charges proposed by I&E and OCA. For these reasons, the Company submits that, in the event the Commission adopts a rate increase that is less than the full requested amount, it should reject the scale back proposals submitted by I&E, OCA and OSBA, and adopt the Company's scale back proposal.

X. UNIVERSAL SERVICE

This issue was fully resolved in the Joint Stipulation. Joint Stipulation ¶ 11. Therefore, the Company's claim is reasonable and should be approved.

XI. MISCELLANEOUS ISSUES

A. QUARTERLY EARNINGS REPORTS

As explained in UGI Electric's Main Brief, I&E has raised an issue relating to the methodology used in calculating the Company's QER. UGI Electric has argued, first, that this issue is improper for a base rate proceeding and should be excluded. UGI Electric MB, pp. 168-171. Second, UGI Electric has argued that I&E's proposal should be rejected, because it would be manifestly unfair to decide an issue of statewide importance without allowing other interested parties to participate. UGI Electric MB, pp. 171-173. Finally, UGI Electric has argued that should this issue be determined on the merits, UGI Electric's methodology is fully consistent with the Commission's regulations, which require that the Company use current ratemaking adjustments in the calculation of the QER. UGI Electric MB, pp. 173-186.

In its Main Brief, I&E has not shown that this issue should be resolved in an individual utility's base rate proceeding; nor has it shown that the Company's methodology is incorrect. I&E's arguments in its Main Brief conflate the issue of the rate of return, which is an appropriate subject of this base rate proceeding, with the QER. The QER has no relevance in determining the rate of return in a base rate proceeding. Further, I&E's Main Brief includes a number of misstatements regarding the record evidence. Finally, I&E does not support the need to modify the QER calculation based on the plain language of the Commission's regulations or the logical conclusion of its own arguments. I&E's proposal should not be adopted.

I&E bears the burden of proof on the issue of how the QER should be calculated. UGI Electric MB, pp. 5-7. UGI Electric did not include a proposal in this base rate case regarding the

calculation of the QER. On the contrary, UGI Electric has shown that the QER is unrelated to the Company's base rate claim. UGI Electric MB, pp. 168-171. The Commission's precedent is clear that I&E should bear the burden of proof as to its proposal to modify the calculation of the QER. For the reasons explained in UGI Electric's Main Brief, and below, I&E has failed to satisfy its burden of proof on this issue.

I&E's first critical failure is that it has not established that this issue belongs in a base rate proceeding. I&E was well aware that the Company would challenge the inclusion of the QER in this proceeding, as that issue was the subject of the June 8, 2018, *Motion in Limine of UGI Utilities, Inc. – Electric Division to Strike the Testimony of Bureau of Investigation and Enforcement Witness Joseph Kubas* ("Motion to Strike"). While the ALJs dismissed the Company's Motion to Strike in their *Order Denying Motion in Limine of UGI Utilities, Inc. – Electric Division to Strike the Testimony of Bureau of Investigation and Enforcement Witness Joseph Kubas* ("Motion Order") dated June 25, 2018, their Motion Order clearly stated as follows:

> We tend to agree with UGI, however, that any Commission decision on Mr. Kubas's ultimate recommendation, that no projected plant additions should be included in future QERs, would have no impact on either the amount of increase granted in this proceeding, or on the allocation or rate design of that increase. We also tend to agree with UGI that <u>a determination on Mr. Kubas's recommendation would be more appropriately made in the context of a QER filing proceeding or an industry-wide proceeding</u>, where all utilities that may be affected by resolution of this issue would have an opportunity to participate.

Motion Order, p. 4 (emphasis added). It is clear I&E was aware both that the Company would challenge the inclusion of this issue in its brief, and that the ALJs were inclined to agree that its inclusion was improper. And yet, I&E does not raise a single affirmative argument, or provide any reference to case law, to support its position that the QER should be included. Instead, I&E

provides a narrative description of what brought its witness, Mr. Kubas, to examine the QERs in the first place. I&E MB, pp. 81-82. I&E also describes in great detail the various different rates of return it was provided during the discovery process in this proceeding and those produced in the QER. I&E MB, p. 86. However, none of these rates of return are in any way relevant to the outcome of this proceeding. I&E has provided no legal argument that supports extending the scope of this base rate proceeding to include the QER. I&E had an affirmative obligation to show that this issue is relevant to a Section 1308(d) base rate proceeding, 66 Pa. C.S. § 1308(d), and it has not met that burden. This issue should be excluded.

Further, I&E's legal arguments regarding the language of 52 Pa. Code § 71.1 *et. seq.* ("Chapter 71") leads to the logical conclusion that the Company's position is correct. The first of I&E's ill-fated legal arguments is that Chapter 71 does not mention future of fully projected future accounts or periods. I&E MB, p. 83. However, there is no need for Chapter 71 to include the specific type of test year to be used, because, as I&E acknowledges, Chapter 71 provides for "ratemaking adjustments." I&E MB, pp. 83-84. I&E further includes the clear language of Chapter 71 applicable to its argument in this proceeding, which provides that the QER should contain "adjustments to reflect current Commission ratemaking policy and practice." I&E MB, p. 84. Even adopting I&E's argument that Chapter 71's "ratemaking adjustments" only include adjustments from prior cases decided by the Commission, I&E's recommendation in this proceeding becomes moot. By the time UGI Electric files its next QER, the Commission will have decided this base rate proceeding, which included the FPFTY as the Company's ratemaking methodology, and therefore inclusion of the FPFTY in the QER calculation would be appropriate on a going-forward basis.

I&E argues that the language of Act 11 and Chapter 71 are clear and unambiguous in their meaning and application. I&E MB, pp. 84-85. The Company could not agree more with I&E on this point. I&E has provided the language of Chapter 71, which supports the Company's inclusion of the current Commission ratemaking policy and practice of using the FPFTY. I&E provides no language from Act 11 or the Commission's Orders interpreting Act 11. However, UGI Electric showed in its Main Brief that the language of Act 11 established a new ratemaking practice, and that the Commission's Implementation Orders specifically addressed the question of whether the FPFTY should be included in the calculation of the QER. UGI Electric MB, pp. 174-178; 184-186.

Finally, on a basic point of law, I&E contends that Act 11 does not include language modifying Chapter 71. I&E MB p. 84. Act 11 was a statute adopted by the General Assembly, which changed certain provisions of Chapter 66 of the Pennsylvania Consolidated Statutes. It provided authority to the Commission to adopt and modify the necessary regulations reflected in the Pennsylvania Code to effectuate Act 11. It was, therefore, entirely within the Commission's authority and discretion to determine whether the plain language of Chapter 71 could be read to accommodate the new ratemaking policy established by Act 11 (*i.e.*, allowing the FPFTY), or whether some modification to Chapter 71 was necessary. When presented with the question of how to calculate the QER after the passage of Act 11, in the Commission's discussion in the Final Implementation Order, it determined that no alteration to Chapter 71 was necessary to accommodate the changes to ratemaking caused by Act 11. UGI Electric MB, pp. 176-178.

In addition to the flawed legal arguments advanced in its Main Brief, I&E also makes a number of assertions in its brief that are not supported by the record in this proceeding. The first of these is the claim that the Company has made unilateral adjustments in Net Plant and Annual

Depreciation Expenses. I&E MB, p. 85. This is simply incorrect. The Company's FPFTY adjustments in the QER calculation are consistent with the methodology it has utilized in this proceeding, and its adjustments include both FPFTY expenses and capital spend, as well as the additional revenues anticipated during that time period.

Further, in discussing the difference between the Company's last QER and the filing of the base rate case, I&E states that the Company was "overly optimistic" in its reflection of projected plant in the QER, and that the Company became "less optimistic" in its base rate filing. I&E MB, pp. 87-88. This is utterly false, and the record in this proceeding says nothing of the sort. The Company explained that the difference in the numbers were entirely related to three factors: budget adjustments made since the filing of the QER; an error in allocating a portion of the Company's expenses to transmission; and changes in depreciation rates updated in conjunction with the rate case. UGI Electric St. No. 1-R, p. 8; UGI Electric Ex. PJS-2; UGI Electric MB, pp. 179-180. I&E provides no citation for its quoted "less optimistic" language, because nowhere in the record in this proceeding does any witness state that optimism played any role in the projected plant balance in the FPFTY. I&E has misstated the record on this point.

I&E also argues that the use of the FPFTY should not be included in the QER calculation, because I&E believes that the Company's planned plant investment is speculative in that "budgeted amounts do not always result in actual plant in service." I&E MB, pp. 91-92. However, the evidence presented in this case shows three things: (1) the Commission regularly relies on projected plant in rate cases and in developing the LTIIP, UGI Electric St. No. 1-R, p. 7; UGI Electric MB, pp. 178-179; (2) the adjustment between the September 30, 2017, QER and the filing of this case was primarily driven by non-budget related adjustments, UGI Electric St. No. 1-R, p. 8; UGI Electric MB, pp. 179-180; and (3) that the Company's budget process is

reasonably reliable. UGI Electric St. No. 1-R, pp. 7-8; UGI Electric St. No. 3-R, pp. 2-3; Tr. 99:21-102:6. I&E's insistence that the budget process is speculative is not supported by any concrete evidence. Rather, long-standing Commission practice, as well as the will of the General Assembly in passing Act 11, shows that the use of the budget process to determine FPFTY ratemaking adjustments is an acceptable and reasonable approach.[11]

Finally, I&E misstates the breadth of the impact of its proposal in its Main Brief. On page 92, I&E states that "the fact that another company besides UGI Electric is doing the same thing does not change I&E's belief that inclusion of the FPFTY Plant in the QER is impermissible." As the Company has shown, the impact of this proposal is not limited to just one other Company. UGI Electric was able to identify more than a dozen other companies, in all parts of the utility industry, which will be impacted by I&E's proposal. UGI Electric St. No. 1-R, p. 10. Further, UGI Electric has shown why it would be a deprivation of due process to deny these other industry participants the opportunity to comment on any proposed rulemaking on this issue. UGI Electric MB, pp. 171-173. I&E seeks to minimize the impact of its proposal, and in doing so it has certainly misstated the clear record evidence: this proposal would have broad industry impacts that cannot be fully assessed based solely on this proceeding.

Beyond I&E's misstatement of law and fact, I&E's arguments are either irrelevant to the determination of this issue or support the Company's conclusion. I&E argues that the Company's methodology will reduce the likelihood of an overearning investigation, because I&E believes that it improperly reduces the Company's earnings. However, any overearning investigation would apply the Commission's current ratemaking approach, which is the FPFTY. This is, in fact, why Chapter 71 includes ratemaking adjustments. Without those adjustments,

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[11] Further, as described previously in this brief, 66 Pa. C.S. § 315(e) provides the Commission with tools to audit and adjust any use of the FPFTY. Thus, the Commission is fully empowered to address any concern it may identify with flawed projections, and I&E's concern regarding budget projections is moot.

the QER would not produce a reasonable proxy for the outcome of a Commission initiated rate investigation. Without the Company's use of the FPFTY, the QER would produce results that would not indicate to the Commission whether it should initiate a formal investigation into a utility's rates. As UGI Electric has shown, rather than producing a "more direr financial picture," as I&E claims on page 89, UGI Electric's calculation shows a more accurate financial picture that provides the Commission with all relevant information so that it may determine the Company's financial health based on the ratemaking methodology made available to UGI Electric by the General Assembly. UGI Electric MB, pp. 185-186. Using the historic data with no FPFTY adjustment would provide no meaningful information regarding whether the Company's rate of return is appropriate under the Commission's current ratemaking methodology. I&E's insistence on a backward looking QER, rather than one that reflects the Commission's current ratemaking methodology, would deprive the Commission of the ability to assess whether a rate investigation may result in a determination that a utility is overearning. I&E's proposed approach undermines one of its own stated goals for the QER. For this reason, alone, I&E's proposal should be rejected.

I&E raises the issue of the impacts on the distribution system improvement charge ("DSIC") in support of its position. However, as the Company has already noted, the impact of its QER calculation on the DSIC did not motivate the Company's calculations. UGI Electric St. No. 1-R, p. 7. The Company does not currently have a DSIC, and contrary to I&E's assertion that this "will pave the way" for a DSIC, I&E MB, p. 90, UGI Electric will need to file a petition with the Commission requesting a DSIC, which would be subject to comment, complaint, and the possibility of a fully litigated proceeding. I&E's reliance on the impacts the calculation of

the QER will have on the DSIC extend far beyond the scope of this base rate proceeding, requiring an additional petition proceeding before they could even be relevant to UGI Electric.

Regarding its substantive arguments on the DSIC, I&E argues that inclusion of FPFTY adjustments will "artificially lower the ROR and ROE, thus not triggering a disk [sic] reset to zero" which would invalidate an important customer safeguard. I&E MB, p. 90. First, the QER is not "artificially lower" through the inclusion of Commission-approved ratemaking adjustments. If it is lower, it is lower because the significant amount of plant that will be placed in service is not offset by additional revenues. Second, as the Company discussed in great detail in its brief, the General Assembly and the Commission have agreed that the reset analysis must focus on whether the utility "will" overearn—indicating a forward looking analysis. UGI Electric MB, pp. 175-178. Despite this clear directive, I&E continues to advocate for a backward looking "financial snapshot", I&E MB, p. 92, which relies on data that is already stale by the time the QER is filed with the Commission. UGI Electric MB, p. 175. I&E's reliance on the impacts to the DSIC are without merit.

I&E has failed to show that the calculation of the QER is within the scope of this 1308(d) base rate proceeding. Further, I&E has failed to meet its burden in showing that its proposed methodology for calculating the QER is appropriate because it has misstated the applicable law and the evidentiary record. The QER issue should be excluded, and if not, then I&E's proposed adjustment to the QER should be denied.

B. PUBLIC INPUT HEARING TESTIMONY

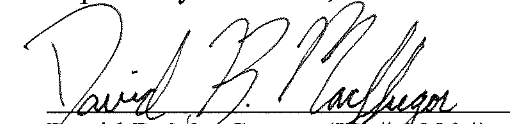
OCA provided quotations from certain testimony presented at the Public Input Hearing. Based on this testimony, OCA summarizes that "(1) customers, especially those on a fixed income, such as Social Security Disability, are not able to afford the proposed rate increase (2) customers believe that utility rates in Pennsylvania, and specifically UGI Electric's rates, should

decrease as rates are decreasing in other states, and (3) customers do not believe that UGI Electric has demonstrated a need for the rate increase." OCA MB, p. 97. OCA then concludes that for these reasons, its recommendations should be adopted. OCA MB, p. 97. For the reasons set forth in the Company's Main Brief and this Reply Brief, the Company's as-filed increase is just and reasonable. The Company has shown that its proposal is actually more beneficial to low-income customers when compared with OCA's proposal, that it has included downward adjustments related to the TCJA, that its adjustments are consistent with long-standing Commission precedent, and that its increase is justified.

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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