COMMONWEALTH OF PENNSYLVANIA

July 18, 2018

E-FILED

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

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

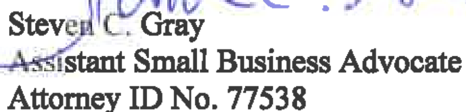
Dear Secretary Chiavetta:

Enclosed please find the Reply Brief, on behalf of the Office of Small Business Advocate ("OSBA"), in the above-captioned proceeding.

Copies will be served on all known parties in this proceeding, as indicated on the attached Certificate of Service.

If you have any questions, please do not hesitate to contact me.

Sincerely,



Steven C. Gray
Assistant Small Business Advocate
Attorney ID No. 77538

Enclosures
cc: Robert D. Knecht
Parties of Record

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

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For:

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Date: July 18, 2018

I. Introduction

A. UGI Electric

On January 26, 2018, UGI Utilities, Inc. – Electric Division ("UGI Electric" or the "Company") filed Tariff Electric – Pa. P.U.C. Nos. 6 and 2S with the Pennsylvania Public Utility Commission ("Commission"). The proposed Tariff, as originally filed, would increase UGI Electric's annual revenue by $9.254 million per year. The Company also proposed a new Storm Expense Rider, a Universal Service Program Rider, and a new Rate EV (for Electric Vehicle Services).

On March 12, 2018, UGI Electric submitted Supplemental Direct Testimony and Revised Exhibits.

B. History of the Proceedings

On February 12, 2018, the Office of Small Business Advocate ("OSBA") filed a Formal Complaint.

On March 1, 2018, the Commission entered an Order suspending the Tariffs and instituting an investigation before the Office of Administrative Law Judge ("ALJ").

On March 22, 2018, a Prehearing Conference was held before ALJs Steven K. Haas and Andrew M. Calvelli.

On March 30, 2018, ALJs Haas and Calvelli issued their Scheduling Order.

On April 26, 2018, the OSBA served the Direct Testimony of Robert D. Knecht.

On May 11, 2018, the OSBA served the Supplemental Direct Testimony of Mr. Knecht.

On May 25, 2018, the OSBA served the Rebuttal Testimony of Mr. Knecht.

On June 7, 2018, the OSBA served the Surrebuttal Testimony of Mr. Knecht.

On June 11 & 12, 2018, Evidentiary Hearings were held before ALJs Haas and Calvelli.

On June 20, 2018, the Company filed a Partial Stipulation Resolving Certain Contested Issues ("*Partial Stipulation*") with ALJs Haas and Calvelli.

On July 2, 2018, the OSBA submitted its Main Brief.

The OSBA submits this Reply Brief in accordance with the ALJs' March 30th Scheduling Order.

II. <u>Summary of Argument</u>

The fully projected future test year ("FPFTY") rate base should be based on average net plant values throughout the year, and FPFTY depreciation should reflect forecast depreciation for the test year. This approach properly matches average FPFTY revenues with average FPFTY costs.

The rate base treatment of excess accumulated deferred income taxes ("Excess ADIT") should follow that of ADIT, and that Excess ADIT should be recognized as an offset to rate base.

Mr. Knecht's allocated cost of service study ("ACOSS") should be adopted for the purposes of revenue allocation and rate design in this proceeding. Mr. Knecht's ACOSS corrects several technical and methodological errors in the Company's original ACOSS. UGI Electric's "rebuttal testimony" ACOSS is also acceptable, as it generally adopts the modifications proposed by Mr. Knecht.

Mr. Knecht's revenue allocation recommendation should be adopted. It moves rate classes closer to their respective cost of service and provides relief to rate classes that have been overpaying for decades.

Mr. Knecht's "directional" recommendations for rate design for the GS-1, GS-4, and LP-4 rate classes should be adopted. UGI Electric generally agrees with the OSBA's rate design proposals, and no party has voiced opposition to those proposals.

IV. <u>Rate Base</u>

A. Original Cost Utility Plant in Service

1. End of Year vs. Average Rate Base Methodology

As explained in the OSBA Main Brief, the use of average rate base for the fully projected future test year ("FPFTY") provides a careful match between the period when costs are incurred and the period when the new rates are in place, as compared to the Company's year-end method which does not. Under the Company's method, ratepayers are charged for the entire year for assets that go into place throughout the year. Under the average method, advanced by the Office of Consumer Advocate ("OCA") and the Bureau of Investigation and Enforcement ("I&E"), the rates charged throughout the year reasonably reflect an average of the plant costs throughout the year. *OSBA Main Brief,* at 6-12. Nothing in the Company's Main Brief credibly explains why the average rates in the FPFTY should exceed the average costs in the FPFTY.

The Company's argument relies substantially on precedent, by citing to the regulatory practices in place when rates were set based on a future test year ("FTY"). The Company states, "[a]s noted above, for the FTY it is standard ratemaking practice to use end of test year balances for determining plant in service. There is no reason that the FPFTY plant balances should be calculated any differently." *UGI Electric Main Brief,* at 26-29.

The Company's statement is incorrect. There are very good reasons to calculate rate base for the FPFTY differently than for the FTY. Under FTY regulation, rates did not go into effect after the end of the FTY. I&E Statement No. 3-SR, at 7. Under FPFTY regulation, rates will go into effect at the beginning of the FPFTY. If, as the Company indicates, the objective is to match revenues and costs, then a change in when rates go into effect should reasonably be expected to have an impact on how average costs are calculated.

Moreover, if the Commission were to follow the Company's argument about precedent to its logical conclusion, not only should the Commission rely on end-of-FPFTY plant balances for rate base, it should ensure that the new rates do not go into effect until the end of the FPFTY. The OSBA suspects that the Company would not advocate for this result and would prefer to selectively follow precedent only when it is in its interest to do so.

The fact is that Act 11 was designed to remedy the inequity that, under FTY regulation, rates would go into effect based on plant in place at that time and would quickly be insufficient for cost recovery, as soon new capital in excess of depreciation was added. Under its proposal in this proceeding, UGI Electric would simply shift that inequity from one in favor of ratepayers to one in favor of the utility. By way of contrast, the OCA and I&E average methodology would match an average year's worth of revenues with an average year's worth of costs, thereby achieving the intent of Act 11.

The Company goes on to make a similar argument about regulatory lag, namely that the intent of Act 11 was to reduce or eliminate regulatory lag associated with FTY regulation. *UGI Electric Main Brief*, at 30-32. The OSBA agrees. However, eliminating regulatory lag does not mean replacing it with "regulatory lead," which is exactly what the Company proposes. The Company proposes that rates for the entire year be based on plant and equipment that is added to the system throughout the year. In effect, rates will reflect more than the utility's average cost in the FPFTY. The OSBA respectfully submits that setting rates for the FPFTY that are based on average costs for the FPFTY will result in neither regulatory lag nor regulatory lead.

VII. Taxes

B. Excess Accumulated Deferred Income Taxes

UGI Electric begins its review of this issue with a primer in accumulated deferred income taxes ("ADIT"), regulatory assets and liabilities, and excess accumulated deferred income taxes ("EADIT"). *UGI Electric Main Brief*, at 117 to 121. To a large extent, OSBA has no material objection to this lesson. As the Company explains, ADIT is a balance sheet liability for the utility, in that it represents income taxes that will need to be paid in the future. However, UGI Electric describes the ADIT as "an 'interest free' loan from the government and non-investor supplied capital." The OSBA observes that I&E witness Ms. Wilson similarly refers to ADIT as an interest-free loan from ratepayers. I&E Statement No. 1, at 38.

For non-regulated companies, ADIT can indeed be seen as an interest-free loan from the government, in that taxes are recorded as an expense but are deferred for future payment with no interest penalty. As the taxes eventually come due, the loan is paid down.

However, in the case of a Pennsylvania regulated utility, it is important to recognize that this loan has come from ratepayers, in that ratepayers are paying cash for non-cash tax expenses for which payment is deferred. Under normal circumstances, that loan is treated as an offset to rate base, because it offsets the Company's need to raise debt and equity capital. In effect, ratepayers are compensated for the loan they provide in the form of reduced utility return.

With the passage of the Tax Cut and Jobs Act ("TCJA"), the corporate tax rate is reduced. This reduction in the tax rate serves to (a) reduce the ongoing regular tax expense, and (b) reduce the magnitude of ADIT, because the future tax bill is now lower than it was.

The reduction in ADIT caused by TCJA is re-categorized as EADIT, since the future tax liability is no longer there. However, it remains a liability, as all parties agree that this amount should be refunded to ratepayers. Thus, the amortization of the EADIT serves to offset the annual costs incurred by the utility.

Therefore, the only question is whether the balance of the EADIT, until it is fully refunded to ratepayers, should continue to be treated as a loan from ratepayers and serve as an offset to rate base, or whether it should be treated as a regulatory asset/liability, which generally are not added to/deducted from (liability) rate base.

In the OSBA's view, this is a simple issue. Before TCJA, the ADIT balance based on a 35 percent tax rate was correctly reflected as a loan from ratepayers to the Company, and therefore served as an offset to rate base. It would be drawn down in due course as the Company made cash tax payments. With TCJA, the Company gains a windfall, in that its future tax obligation is much lower than it anticipated, and the funds can be returned to ratepayers rather than being sent to the tax collector. However, as EADIT, these funds still represent a loan from ratepayers that will eventually be paid down, and the balances should therefore be treated in the same manner as ADIT.

It is illogical for the Company to claim that the windfall received from TCJA in the form of a reduced future tax obligation should somehow serve to increase rates. The Company argues that, as EADIT, this amount represents an expense and not a capital item, and argues that it is now equivalent to other regulatory assets and liabilities that reflect deferred revenues and expenses. *UGI Electric Main Brief*, at 121-124. This argument ignores some obvious points.

First, ADIT already is a liability based on regular tax expense. The only difference between the EADIT liability and the ADIT is that the future obligation for EADIT is now to ratepayers when formerly it was to the taxing authorities.

Second, there are other examples where regular revenues and expenses serve as an increase or offset to rate base. Consider cash working capital, which typically reflects the average lag between when the Company incurs an expense and when the Company receives

payment for ratepayers. The basic issue is that regulators sometimes reflect deferrals in non-interest-bearing accounts, and sometimes as rate base which attracts a return. As EADIT is a new item, the only reasonable way to evaluate it is to determine whether it is more like ADIT, or whether it is more like a storm expense variance account.

The Company also argues that, in the specific circumstances facing UGI Electric (the 22-year lag since the last base rates proceeding) the ADIT on the books was not actually contributed by ratepayers. *UGI Electric Main Brief*, at 124-125. The OSBA addressed this argument in its Main Brief. *OSBA Main Brief*, at 15-16. In short, it is the OSBA's view that the current ADIT was implicitly included in current rates, because the Company would have included it as an offset to rate base had it filed a base rates proceeding in the intervening period. UGI Electric chose not to do so for reasons of its own, but it presumably considered the magnitude of the rates that it could have achieved if it had filed, which necessarily reflect consideration of ADIT.

Third, the Company appears to complain that the I&E/OCA proposed rate base treatment of EADIT is somehow inconsistent with the proposed treatment of going-forward income tax and the refunding of the EADIT balances. The OSBA takes strong exception to this flawed logic – there is no inconsistency. Going forward, the tax rate is 21 percent, and recognizing it as such has nothing to do with ADIT. Furthermore, the fact that the EADIT needs to be amortized and returned to ratepayers is simply a recognition that these are funds (previously contributed by ratepayers for expected future cash requirements that have turned out to be unnecessary) that should be returned. Even UGI Electric recognizes this. However, once it has been recognized that these are funds to be returned to ratepayers, it is not at all inconsistent to also compensate the ratepayers for the time value of the funds they have provided, until such time as those funds

have been fully repaid. The Company's arguments against the I&E and OCA proposal are entirely unfounded.

Finally, the Company argues that including EADIT as an offset to rate base will increase the outside financing requirements of UGI Electric, and then proceeds to complain about rising interest rates, leading to the assertion that this policy is not in the public interest. *UGI Electric Main Brief*, at 126-127. This argument is baseless. Ratepayers have provided this loan, and it is currently being used to reduce outside financing requirements. Like the Company's other loans, it is being repaid, and should be repaid with interest. In this proceeding, the Commission will grant UGI Electric a return of and on the reasonable and prudent rate base that is not financed by an EADIT loan from ratepayers. Unlike the Philadelphia Gas Works, UGI Electric is not a cash flow regulated utility, and it is entitled only to a return of and on the capital it raises in the capital markets.

Therefore, the OSBA respectfully concludes that the rate base treatment of Excess ADIT should follow that of ADIT, and that Excess ADIT should be recognized as an offset to rate base.

IX. Rate Structure

A. Allocated Cost of Service Study

In its Main Brief, the OCA argues for a different ACOSS. *OCA Main Brief*, at 70-79. Specifically, the OCA argues against the use of the "minimum system" cost of service study ("COSS") methodology. *Id.*, at 72-75. OSBA witness Robert D. Knecht's Rebuttal Testimony thoroughly addressed the OCA's ACOSS. *See* OSBA Statement 1-R. Mr. Knecht testified that this is not the proceeding in which to review the minimum system COSS precedent:

> The differences in impacts of different classification methods for electric distribution costs are largest between the smallest customers (namely residential and the smallest general service customers) and the largest distribution voltage commercial and

> industrial customers. While the largest industrial customers that take service at transmission voltage are unaffected by distribution cost classification, ***many large commercial and industrial customers would be significantly impacted by a change in Commission policy in this proceeding***. In contrast, the impacts on small to medium businesses tend to be mixed. If an alternative method with a lower customer component of costs were to be adopted, the smallest commercial customers would face lower costs and medium commercial customers would face higher costs.

OSBA Statement No. 1-R, at 3 (emphasis added). Mr. Knecht continued, as follows:

> However, in this proceeding, larger commercial and industrial customers are not represented by counsel or expert witnesses. In contrast, in the PPL Electric proceedings at Dockets No. R-2010-2161694 and R-2012-2290597, industrial customers were represented by both counsel and an independent expert, who generally supported the use of the minimum system classification method. As such, establishing a precedent in favor of an alternative method in this proceeding would likely have an impact on customer groups that are not represented in this proceeding.
>
> Thus, given the small size of UGI Electric and the incomplete representation of the affected customers, I conclude that even if the Commission wishes to reconsider its policy, this would not be the case to do so.

Id., at 4 (footnote omitted).

Therefore, the OSBA respectfully submits that the Commission should adopt either Mr. Knecht's ACOSS or the Company's rebuttal ACOSS for the purposes of revenue allocation and rate design in this proceeding. As set forth in the OSBA's Main Brief, both Mr. Knecht's ACOSS and the Company's rebuttal ACOSS include error corrections and methodological fixes recommended by the OSBA. This results in both ACOSS's providing similar results. *OSBA Main Brief*, at 16-25.

B. Revenue Allocation

The Company's Main Brief indicates that the OSBA's proposal for revenue allocation to the Rate LP and Lighting classes should not be accepted because the indexed rate of return for

these classes is high. *UGI Electric Main Brief*, at 149. The Company states further that Mr. Knecht proposed "to allocate a portion of the revenue increase to the Rate LP and Lighting classes."

It appears that the Company has misread Mr. Knecht's testimony. Mr. Knecht recommended that a *zero increase* be assigned to Rate LP class and a *modest rate reduction* be applied to the Lighting classes. OSBA Statement No. 1-SR at 2, OSBA Statement No. 1-SD at 5.

Mr. Knecht's proposed revenue allocation for the Rate LP and the Lighting classes is consistent with both Mr. Knecht's cost allocation study and the Company's rebuttal cost allocation study.

C. Rate Design

3. Non-Residential Customer Charges

Strangely, UGI Electric Company argues that the OSBA ". . . recommended splitting this class [General Service] into two rates." *UGI Electric Main Brief*, at 161. To be clear, separate Rate GS-1 and Rate GS-4 tariff schedules are part of the Company's *currently approved tariff*, and these schedules have distinctly different customer eligibility requirements and rate designs. OSBA Statement No. 1, at 2-3. Mr. Knecht recommended that the Company continue to segregate those classes for cost allocation purposes. *Id.*, at 11-12.

Mr. Knecht also made recommendations regarding rate design for those classes, which the Company has generally accepted. *See OSBA Main Brief*, at 28-31.

The OSBA further observes that the Company does not comment on Rate FCP in its Main Brief. Rate FCP is a flood control service, applicable only to seven municipalities for flood pumping stations for emergency pumping operations. OSBA Statement No. 1, at 4. Although it is a separate tariff schedule, Rate FCP is included in Rate GS-4 for cost allocation

and revenue allocation purposes. Mr. Knecht observed that the rates for this class are set well below those for the GS-1 and GS-4 classes, without cost justification. Mr. Knecht therefore recommended that an increase equal to two-times system average be applied to this class, or that the tariff schedule be eliminated. OSBA Statement No. 1, at 5-6.

Mr. Knecht's Rate FCP proposal was not opposed by the Company in rebuttal and is not addressed in the Company's Main Brief. Therefore, the OSBA respectfully recommends that Mr. Knecht's proposal to assign a two-time system average increase to this class be adopted.

Regarding the Large Power class, Mr. Knecht made certain recommendations in his direct testimony. These recommendations generally followed the logic of his recommendations for the GS-4 rate class, which the Company accepts. OSBA Statement No. 1-SD, at 8-9. However, in its Main Brief, the Company concludes, "As Mr. Knecht's proposed Rate LP design is reflective of no revenue increase being allocated to Rate LP, the Company submits that Mr. Knecht's proposed rate design changes are unnecessary." *UGI Electric Main Brief*, at163.

The Company's Main Brief is inconsistent with its own testimony.

In rebuttal testimony, UGI Electric witness Mr. Lahoff stated, as follows:

> As with Mr. Knecht's proposal to assign a revenue increase to Rate LP, the Company does not agree with Mr. Knecht's rate design proposal. However, if Mr. Knecht's revenue allocator to Rate LP is adopted in this proceeding, the Company would agree to Mr. Knecht's associated rate design.

UGI Electric Statement No. 8-R at 15.

Thus, it appears that the Company's testimony objected to Mr. Knecht's Rate LP rate design if it involved a rate increase for that class. Mr. Knecht proposed a *zero* increase for the LP rate class. The OSBA respectfully requests that the Commission approve Mr. Knecht's rate

design recommendations for Rate LP consistent with the testimony of Mr. Lahoff and ignore the contradictory position taken in the Company's Main Brief.

Finally, the Company's Main Brief correctly indicates that Mr. Knecht recommended that the Company adopt a merchant function charge ("MFC") for supply-related uncollectibles. The Company submitted rebuttal to the effect that a MFC was not feasible or reasonable at this time. *UGI Electric Main Brief*, at 164.

The Company then indicated that the OSBA did not provide surrebuttal on this subject and did not meet its legal burden to justify this proposed change. *Id.*

In fact, Mr. Knecht considered the Company's rebuttal testimony, and observed that the Company agreed that a MFC was conceptually correct. Mr. Knecht further indicated that it was reasonable to defer implementation of the MFC. OSBA Statement No. 1-SR, at 1, footnote 1.

The OSBA therefore recommends that the Commission allow UGI Electric to defer adoption of an MFC.

XII. Conclusion

Wherefore, based upon this Reply Brief, the OSBA's Main Brief, and the written testimony of the OSBA, the OSBA respectfully requests that the ALJs and the Commission decide these specific issues, as follows:

Approve the *Partial Stipulation* without modification;

Decide that the FPFTY rate base should be based on average net plant values throughout the year, and that FPFTY depreciation should reflect forecast depreciation for the test year;

Decide that the rate base treatment of Excess ADIT should follow that of ADIT, and that Excess ADIT should be recognized as an offset to rate base;

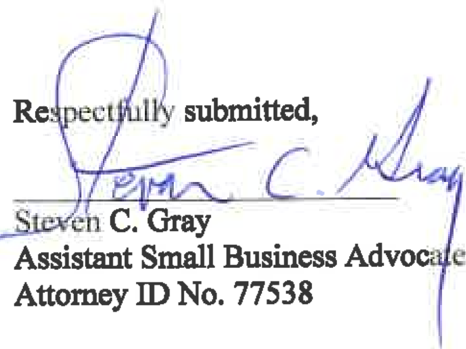
Adopt either Mr. Knecht's ACOSS or the Company's "rebuttal testimony" ACOSS for the purposes of revenue allocation and rate design in this proceeding;

Adopt Mr. Knecht's revenue allocation recommendations for the Company's rate classes;

Adopt Mr. Knecht's recommendations for the rate design of the GS-1, GS-4, and LP-4 rate classes; and

Employ a traditional proportional scale back only to those rate classes that are assigned rate increases.

Respectfully submitted,



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Dated: July 18, 2018

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	**Docket No. R-2017-2640058**
	:	**Docket No. C-2018-2647268**
UGI Utilities, Inc. – Electric Division	:	

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been served via email and/or First-Class mail (*unless other noted below*) upon the following persons, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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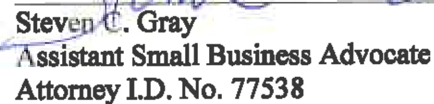

DATE: July 18, 2018

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