17 North Second Street
12th Floor
Harrisburg, PA 17101-1601
717-731-1970 Main
717-731-1985 Main Fax
www.postschell.com

Garrett P. Lent

glent@postschell.com
717-612-6032 Direct
717-731-1979 Direct Fax
File #: 171080

September 13, 2018

VIA ELECTRONIC FILING

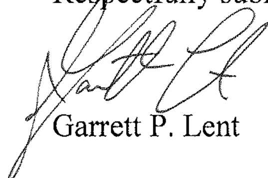
Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary Chiavetta:

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

Respectfully submitted,



Garrett P. Lent

GPL/jl
Enclosures

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

CERTIFICATE OF SERVICE

Docket No. R-2017-2640058

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

VIA E-MAIL & FIRST CLASS MAIL

Scott B. Granger, Esquire
Allison Kaster, Esquire
Bureau of Investigation & Enforcement
Commonwealth Keystone Building
400 North Street, 2nd Floor West
PO Box 3265
Harrisburg, PA 17105-3265

Hayley Dunn, Esquire
Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101-1923

Steven C. Gray, Esquire
Office of Small Business Advocate
300 North Second Street, Suite 202
Harrisburg, PA 17101

Jerome D. Mierzwa
Exeter Associates, Inc.
10480 Little Patuxent Parkway
Suite 300
Columbia, MD 21044
OCA Consultant

Lafayette Morgan
Exeter Associates, Inc.
10480 Little Patuxent Parkway
Suite 300
Columbia, MD 21044
OCA Consultant

Roger D. Colton
Fisher, Sheehan & Colton
34 Warwick Road
Belmont, MA 02478
OCA Consultant

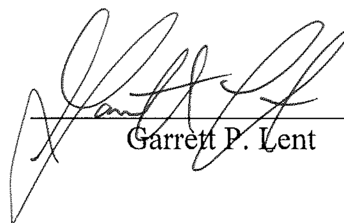
Robert D. Knecht
Industrial Economics Incorporated
2067 Massachusetts Avenue
Cambridge, MA 02140
OSBA Consultant

Office of Special Assistants
ra-OSA@pa.gov
(via E-mail Only)

VIA FIRST CLASS MAIL

Barbara McDade
863 North Street
Luzerne, PA 18709

Date: September 13, 2018



Garrett P. Lent

16669898v1

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

EXCEPTIONS OF UGI UTILITIES, INC. – ELECTRIC DIVISION

Kent D. Murphy (ID # 44793)
Mark C. Morrow (ID # 33590)
Danielle Jouenne (ID #306839)
UGI Utilities, Inc.
460 North Gulph Road
King of Prussia, PA 19406
Phone: 610-768-3628
Phone: 610-992-3203
E-mail: murphyke@ugicorp.com
E-mail: morrowm@ugicorp.com
E-mail: jouenned@ugicorp.com

David B. MacGregor (ID # 28804)
Post & Schell, P.C.
Four Penn Center
1600 John F. Kennedy Boulevard
Philadelphia, PA 19103-2808
Phone: 215-587-1197
Fax: 215-320-4879
E-mail:dmacgregor@postschell.com

Jessica R. Rogers (ID # 309842)
Garrett P. Lent (ID # 321566)
Post & Schell, P.C.
17 North Second Street, 12th Floor
Harrisburg, PA 17101-1601
Phone: 717-731-1970
Fax: 717-731-1985
E-mail:jrogers@postschell.com
E-mail:glent@postschell.com

Counsel for UGI Utilities, Inc. – Electric Division

Date: September 13, 2018

TABLE OF CONTENTS

I. INTRODUCTION 1

II. EXCEPTIONS 6

Exception No. 1: The RD's Proposed Cost Of Common Equity Is Too Low And Should Be Increased To 10.40% Or Higher. RD, pp. 54-90. 6

A. The RD Erroneously Rejects The Leverage Adjustment Proposed By UGI Electric. 9

B. The RD Fails To Properly Utilize Other Methodologies As A Check On Its DCF Analysis. 11

C. The RD Erred By Relying On An Incorrect Forecasted CAPM Analysis..13

D. The RD Erred By Failing To Reflect Unrebutted Evidence of Increased Risk Factors In Its Analysis. 15

E. Conclusion As To The Cost Of Common Equity. 18

Exception No. 2: The RD Incorrectly Rejected The Company's Revised Claim To Recover The Costs Of Its New Operations Center. RD, pp. 22-24. 18

Exception No. 3: The Impact Of Excluding The Operations Center From Rates In The RD Must Be Recalculated If The Adjustment Is Accepted. RD, p. 24. 21

Exception No. 4: The RD Erred In Requiring UGI Electric To Refund To Customers The 2018 Impacts Of The TCJA. RD, pp. 90-107...23

A. The RD Fails To Apply The Two-Part Test Applicable to Single Issue and Retroactive Ratemaking. 23

B. The RD Did Not Conduct Any Analysis Of UGI Electric's Current Earnings And Therefore Incorrectly Concludes That The 2018 Tax Reductions From The TCJA Are A "Windfall" To UGI Electric's Shareholders...26

Exception No. 5: The RD Erred When It Reduced UGI Electric's Rate Base To Reflect EADIT Associated With The TCJA. RD, pp. 90-107. 28

Exception No. 6: The RD's Rejection Of Expenses Associated With Incentive Compensation Is Based On A Fundamental Factual Error And Should Be Rejected. RD, pp. 47-50...31

Exception No. 7: The RD's Exclusion Of Expenses Associated With Environmental Remediation Ignores Commonwealth Court Precedent And The Appropriate Use Of The Test Year. RD, pp. 34-36. 34

Exception No. 8: The RD's Adoption Of I&E's Rate Case Expense Adjustment Fails To Reflect The Evidence Of Ongoing Capital Costs Presented by UGI Electric. RD, pp. 38-41. 36

Exception No. 9: The RD Errs By Recommending That Customer Charges and Usage Rates Should Be Scaled Back Proportionally To The Percent Increase Originally Requested. RD, pp. 130-131....................37

III. CONCLUSION....................40

17497999v1

TABLE OF AUTHORITIES

Page

Federal Statutes

Tax Cuts and Jobs Act of 2017, Pub. L. 115-97, 131 Stat. 2054 (“TCJA”) .... *passim*

United States Supreme Court Decisions

Bluefield Waterworks and Imp. Co. v. P.S.C. of West Virginia, 262 U.S. 679, 690 (1923) 15, 17

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944).......................15

Pennsylvania Appellate Court Decisions

Cheltenham & Abington Sewerage Co. v. Pa. Pub. Util. Comm’n, 25 A.2d 334, 337 (Pa. 1942) 23

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*”)..38

Lower Paxton Twp. v. Pa. Pub. Util. Comm’n, 317 A.2d 917, 921 (Pa. Cmwlth. Ct. 1974) 14

Pa. Indus. Energy Coal. v. Pa. Pub. Util. Comm’n, 653 A.2d 1336 (Pa. Cmwlth. 1995).......23, 26

Pa. Pub. Util. Comm’n v. Pennsylvania Gas and Water Co. - Water Division, 19 Pa. Cmwlth. 214, 233, 341 A.2d 239 (Pa. Cmwlth. 1975) 14

Phila. Elec. Co. v. Pa. Pub. Util. Comm'n, 502.A.2d 722 (Pa Commw. 1981)............................23

Philadelphia Suburban Water Co. v. Pa. Pub. Util. Comm’n, 427 A.2d 1244 (Pa. Cmwlth. 1981) 36

Popowsky v. Pa. Pub. Util. Comm’n, 683 A.2d 958 (Pa. Cmwlth. 1996) (“*Equitable*”) 26, 27

West Penn Power Co. v. Pa. Pub. Util. Comm’n, 100 A.2d 110, 114 (Pa. Super. 1953)..24

Pennsylvania Administrative Agency Decisions

Aqua Pennsylvania, Inc., Docket No. R-00038805, 236 PUR 4th 218, 2004 Pa. PUC LEXIS 39 (Order entered Aug. 5, 2004) (“*Aqua 2004 Order*”) 24, 25

Pa. P.U.C. v. Duquesne Light Co., 63 Pa. PUC 337, 1987 Pa. PUC LEXIS 342 (Order dated March 10, 1987)....................33

Pa. P.U.C. v. Philadelphia Gas Works, Docket No. R-2008-2073938, 2008 Pa. PUC LEXIS 32 (Order dated Dec. 19, 2008)....................34

Pa. P.U.C. v. PPL Gas Utilities Corporation, Docket No. R-00061398 (Order dated Feb. 8, 2007)....................33, 34

Pa. Pub. Util. Comm'n v. Aqua Pa., Inc., Docket No. R-00072711, 2008 Pa. PUC LEXIS 50 (Order dated July 17, 2008)....................33

*Pa. Pub. Util. Comm'n v. Mechanicsburg Water Co.¸*80 Pa. PUC 212, 232 (Order dated July 22, 1993)....................24

Pa. Pub. Util. Comm'n, et al., v. PPL Elec. Utils. Corp., Docket Nos. R-2012-2290597, et al., at p. 51 (Order Entered Dec. 28, 2012) ("*PPL 2012 RC Order*")....................*passim*

Pa. Pub. Util. Comm'n, et al. v. UGI Utilities, Inc. (Electric Division), Docket Nos. R-00832862 et al., 1994 Pa. PUC LEXIS 136 (Order entered September 23, 1994) ("*1994 Rate Case*")....................31

Petition of UGI Utilities, Inc. – Electric Division for Approval of its Long-Term Infrastructure Improvement Plan, Docket No. P-2017-2619834, at pp. 8-9 (Order entered Dec. 21, 2017)....................36

Tax Cuts and Jobs Act of 2017, Docket No. M-2018-2641242, p. 19 (Order entered March 15, 2018) ("*March Order*")....................27

Tax Cuts and Jobs Act of 2017, Docket No. M-2018-2641242, p. 19 (Order entered May 17, 2018) ("*May Order*")....................27, 28

Tax Cuts and Jobs Act of 2017 – PPL Electric Utilities Corporation, Docket No. R-2018-3000775, at p. 3 (Order entered May 17, 2018)....................27

I. INTRODUCTION

The Recommended Decision ("RD") provides a reasonable and appropriate resolution of many of the issues raised in this proceeding, and therefore should be largely adopted by the Pennsylvania Public Utility Commission ("PUC" or the "Commission"). There are, however, nine issues where Commission intervention and revision are required in order to establish just and reasonable rates. These are: (1) the cost of common equity; (2) the Electric Engineering and Operations Center ("Operations Center"); (3) a recalculation of the impact of excluding the Operations Center from rates; (4) the 2018 impact of the Tax Cuts and Jobs Act of 2017, Pub. L. 115-97, 131 Stat. 2054 ("TCJA"); (5) excess accumulated deferred income taxes ("EADIT") associated with the TCJA; (6) incentive compensation; (7) environmental remediation expense; (8) the normalization period for rate case expense; and (9) the scale back adopted in the RD. These issues should be carefully reviewed and adjusted by the Commission to reflect record evidence and controlling precedent. In these instances, the RD adopted adjustments proposed by the Bureau of Investigation and Enforcement ("I&E") and/or the Office of Consumer Advocate ("OCA") which failed to follow controlling precedent and/or were based on clearly erroneous factual findings.

Cost of Common Equity. The RD's proposed 9.8% return on common equity (10.0% including 0.20% adjustment for management effectiveness) is based on an unadjusted discounted cash flow ("DCF") calculation. The Commission, in accordance with prior precedent, should adopt several adjustments to this base calculation, including a proper reflection of other methods such as the Capital Asset Pricing Model ("CAPM") and Risk Premium ("RP") methodologies, a leverage adjustment adopted by the Commission in other cases where the unadjusted DCF fails to reflect a reasonable rate of return, a small company adjustment recognizing that UGI Electric is far smaller than other companies in the selected Barometer Group, rising interest rates,

increased risk associated UGI Electric's major construction program, and the negative financial and risk consequences of the TCJA. With these adjustments, the minimum reasonable return on common equity in this proceeding would be 10.40%, or higher. Notably, 10.40% is the return on equity adopted by the Commission in its last order in a fully litigated electric base rate proceeding. *See Pa. Pub. Util. Comm'n, et al., v. PPL Elec. Utils. Corp.,* Docket Nos. R-2012-2290597, *et al.*, (Order Entered Dec. 28, 2012) ("*PPL 2012 Rate Case*"). Financial and risk conditions in 2012 and 2018 are quite similar and provide compelling support for a 10.40% or higher return on common equity.

Operations Center. The RD concludes that costs associated with UGI Electric's new Operations Center should be disallowed, because the project did not appear to be sufficiently certain at the close of the record. No party has challenged the need for the new Operations Center, its location or its cost. Moreover, the record evidence demonstrates that UGI Electric has diligently pursued the Operations Center project and has made appropriate progress based on an anticipated in-service date of September 2019, 15 months after the close of the record and clearly within the fully projected future test year ("FPFTY"). While an FPFTY may result in somewhat less detail regarding projects that are not expected to be in service until later in the FPFTY, this should not be a basis for excluding such projects from rates as it would defeat the FPFTY's purpose in reducing regulatory lag. The capital cost of the Operations Center therefore should be fully reflected in rates.

Recalculation Of Operations Center Adjustment. In the alternative, if the Operations Center adjustment was to be adopted, and it should not be adopted, the revenue requirement impact of this adjustment is in error and needs to be corrected. UGI Electric provides both distribution and transmission service and the cost of the Operations Center must be divided

between transmission and distribution cost functions. The calculation in the RD does not properly reflect the transmission related portion of the project and should be corrected. Using the correct calculation would increase the revenue requirement reflected in the RD by $237,000.

2018 One-Time Tax Adjustment Surcharge. Ratemaking is prospective, and it is undisputed that UGI Electric has fully reflected all of the prospective impacts of the TCJA in its proposed tax expense claim. The RD errs by adopting an additional adjustment, proposed by I&E and OCA, to refund to customers the 2018 impact of the TCJA. This adjustment should be rejected for two reasons. First, single issue/retroactive ratemaking is only permitted where the underlying expense is both extraordinary and non-recurring. The RD incorrectly conflates this two-part test into a one-part test and finds that the tax law change is non-recurring simply because it is extraordinary. The changes made by the TCJA are clearly recurring events. For example, the TCJA permanently reduced the federal corporate income tax rate from 35% to 21%; the change was not limited to 2018 and therefore the impact recurs annually. UGI Electric has fully reflected the ongoing effects of the TCJA in its prospective rates. No further adjustment is permitted.

Second, appellate case law is clear that single issue ratemaking is not permitted for this type of expense item without some examination of a utility's current earnings. The only evidence presented on this issue shows that UGI Electric is significantly underearning a fair rate of return in 2018. The RD failed to consider UGI Electric's 2018 earnings and erroneously concluded that UGI Electric shareholders would receive an unjustified "windfall" if the 2018 effects of the TCJA are not refunded to customers. This conclusion is both legally and factually in error and should be rejected.

Excess Accumulated Deferred Income Taxes. The TCJA's change in the federal corporate income tax rate from 35% to 21% also reduced accumulated deferred income taxes, which increases rate base and allowed earnings. UGI Electric fully reflected this change in its proposed rates. The RD rejects this adjustment and finds that these "excess" accumulated deferred income taxes should continue to be deducted from rate base. This adjustment is in error for several reasons: (1) it deducts from rate base accumulated deferred income taxes ("ADIT") that no longer exists; (2) it selectively reflects the effects of the TCJA which reduce rate, but fails to reflect the effects which increase rates; and (3) it improperly attached a return component to an unamortized expense, which is contrary to controlling Commission and appellate precedent. The primary basis for the RD's ruling is that these excess deferred taxes have been previously reflected in customer's rates. This is simply not the case for UGI Electric. UGI Electric's rates were last set in 1996, more than two decades ago. They reflect plant in service and associated deferred taxes from 1996. No plant additions since 1996 and no deferred taxes associated with those plant balances are currently reflected in rates. Therefore, the fundamental factual premise underlying the RD is in error and should be rejected.

Incentive Compensation. The RD concludes that the expenses associated with certain portions of UGI Electric's incentive compensation claim should be disallowed because the employees receiving these benefits are not proximately responsible for the provision of safe and reliable service to customers, and eligibility requirements are driven by financial metrics rather than a mix of financial and operational metrics. These conclusions are not supported by the record. First, the incentive compensation at issue is for UGI Utilities, Inc. employees, not holding company employees at UGI Corporation. These UGI Utilities, Inc. employees are clearly and directly responsible for the provision of safe and reliable service to customers.

17497999v1

Second, UGI Electric's incentive compensation plan, as a whole, includes both financial and operating metrics and clearly meets the standard applied by the Commission in prior case decisions, and in particular the decision in the *PPL 2012 Rate Case*. The facts in this case therefore are clearly distinguishable from the decisions cited in the RD, which involved holding company employees. There is no basis for any adjustment for incentive compensation in this proceeding.

Environmental Remediation Expense. The RD concludes that UGI Electric's expenses associated with environmental remediation of a property that has been used to serve customers for nearly a century should be disallowed, and that the Company should instead use profits from any future sale of the associated property to offset the expense of the environmental remediation. This adjustment should be rejected for three reasons. First, it is undisputed that any sale of the property will occur outside of the FPFTY and should not be reflected in current rates. Second, the timing and terms of any sale are entirely speculative at this time. There is no evidence as to when the sale might occur, what the purchase price would be and whether that price would provide any net proceeds to offset the current environmental remediation expense. Third, the adjustment is inconsistent with long-standing Commission ratemaking practice and policy with respect to sales of utility property in two respects: (1) any gain on the sale of land belongs to shareholders, not customers; and (2) any gain on the sale of depreciable property is recorded as net salvage expense which is credited to customers based on a five-year average of that expense. The RD's proposal to use proceeds from the sale of property to offset current expense recovery is inconsistent with long-standing Commission ratemaking practice and should be rejected.

Rate Case Expense. The RD rejects the Company's use of a three-year normalization period for rate case expense because the Company did not provide evidence in support of its

claim. The record evidence supports the use of a three-year period between rate case filings, a period which is financially driven by UGI Electric's ongoing capital improvement program. Reliance on the capital improvement program in support of the shorter normalization period is consistent with recent Commission precedent on rate case normalization. As a result, the Company's proposed rate case expense claim should be adopted by the Commission.

Scale Back. The RD rejects the Company's scale back proposal for the increases applicable to individual rate classes. UGI Electric demonstrated that, within each class, the scale back should be first applied to any proposed increase to usage charges, then to any proposed increase to demand charges, and then finally to any proposed increase to customer charges. By recommending that the scale back be applied proportionally to the usage, demand and customer charges, the RD reduces the Rate R customer charge that it determined to be reasonable and appropriate and disconnects this charge from the fixed costs to serve residential customers. The RD's proposal conflicts with cost of service principles and should not be adopted by the Commission.

II. EXCEPTIONS

Exception No. 1: The RD's Proposed Cost Of Common Equity Is Too Low And Should Be Increased To 10.40% Or Higher. RD, pp. 54-90.

UGI Electric excepts to the RD's conclusion that the Company's cost of common equity is 10.00% (inclusive of a 20 basis point adjustment for management performance and effectiveness). RD, p. 89. The principal errors in the RD are its rejection of a DCF leverage adjustment accepted by the Commission in prior proceedings where the unadjusted DCF calculation produces an inadequate result, reliance on an erroneous CAPM analysis as a check on the DCF result, failing to consider other methods, particularly the RP, and failing to recognize undisputed additional risk factors that clearly indicate a rising cost of common equity.

UGI Electric demonstrated that a cost of common equity of 11.25%, inclusive of a management performance adder, was appropriate in this proceeding. *See* UGI Electric MB, pp. 74-106; UGI Electric RB, pp. 35-50. In particular, UGI Electric witness Mr. Moul demonstrated, using multiple methods of evaluating the cost of common equity, that the zone of reasonableness for UGI Electric ranged from 10.55% (DCF cost rate accounting for a 107 basis point leverage adjustment) to 12.55% (comparable earnings result). *See* UGI Electric St. No. 5, pp. 4-5. Mr. Moul's recommendation accounted for both the inherent infirmities associated with the various methodologies used by the parties in this proceeding and used informed judgment to reflect relevant aspects of the current financial climate, including rising interest rates and the negative financial impacts of the TCJA. *See* UGI Electric MB, p. 78 (discussing the necessity of using multiple methodologies and informed judgment); *see also* UGI Electric MB, pp. 88-91 (using informed judgment to account for the current financial climate). Mr. Moul also properly reflected, and the RD properly adopted, a 20 basis point adjustment for UGI Electric's management performance. RD, pp. 85-87. Based upon these facts, UGI Electric's recommended 11.25% cost of common equity is reasonable and appropriate.

However, to the extent that the Commission elects to adopt a cost of common equity less than the 11.25% which UGI Electric demonstrated is reasonable, then the Commission should correct the RD errors, discussed below, and adopt a cost of common equity of no less than 10.40% (*i.e.* 10.20% plus a 20 basis point adjustment for excellent management performance). This is essentially the same result reached by the Commission in the 2012 PPL Electric base rate case (10.4%), the last fully litigated base rate case for a major electric utility. *See PPL 2012 RC Order*, p. 101. Importantly, financial and market conditions at the time of the PPL Electric decision are remarkably similar to conditions today and these conditions demonstrate that UGI

Electric should receive a return on equity above 10.40%. For instance, the average return on A-Rated Public Utility Bonds in December 2012 (when the Commission issued the *PPL 2012 RC Order*) was 4.00%; the average return on A-Rated Public Utility Bonds in August 2018 was 4.20%. As such, the Commission should adopt a cost of common equity at or above the 10.40% cost rate adopted in the *PPL 2012 RC Order*.

Furthermore, the record evidence in this proceeding demonstrates that the DCF analysis conducted by the RD understates the cost of equity for UGI Electric during the FPFTY for several reasons. First, the RD incorrectly rejects the Company's proposed leverage adjustment. RD, p. 75. Correcting for this error would increase the DCF result to 11.02% for the Altered Proxy Group.

Second, the RD fails to properly utilize other methodologies as a check upon the DCF. Importantly, the DCF cost rate (9.80%) is outside the range of cost rates calculated under the RD's adopted CAPM analysis (9.83% to 10.18%). RD, p. 88. Even if the RD's CAPM analysis were correct, which it is not, it demonstrates that the DCF cost rate is understated. Where the CAPM cost rate suggests that the DCF cost rate is understated, the Commission should rely upon additional methods, in particular the RP method, to determine the cost of common equity. *PPL 2012 RC Order*, p. 81. UGI Electric demonstrated under the RP method that the cost of common equity was 11.25%. UGI Electric MB, p. 77.

In addition, the RD's CAPM findings (10.18% historic and 9.83% future) are inconsistent with the undisputed evidence of rising interest rates. If interest rates on risk-free investments are expected to continue to rise, which they are, the RD's proposed forecasted CAPM cannot reasonably be lower than the historic CAPM. Indeed, the RD erroneously calculated a forecasted CAPM of 9.83%; the forecasted CAPM calculation should have been 10.07% using the correct

forecasted interest rates and 11.09% with the Company's proposed size adjustment. The minimum reasonable CAPM result is the historic 10.18% number, which clearly demonstrates the inadequacy of the DCF result. *See* UGI Electric MB, pp. 74, 88-91; UGI Electric RB, pp. 36-39.

Finally, in addition to ignoring the undisputed evidence of rising interest rates, the RD fails to utilize informed judgment because it ignores clear evidence regarding the current financial climate and its effects on attracting capital on reasonable terms. RD, pp. 82-83. UGI Electric demonstrated that the marketplace is currently, and will continue to be, characterized by increased risks associated with rising interest rates, increased volatility and other negative effects associated with the TCJA, which necessitate an increased return on common equity investments in order to attract sufficient capital on reasonable terms. UGI Electric MB, pp. 88-91; UGI Electric RB, pp. 36-39. In addition, the cost of common equity must be sufficient to support the Company's expanded construction program. *See* UGI Electric St. No. 1, p. 23; *see also* UGI Electric St. No. 5, p. 5.

As explained below and in UGI Electric's briefs, these errors result in an inadequate cost of common equity. Correcting for these errors and by taking into consideration the cost of common equity adopted in the *PPL 2012 RC Order*, UGI Electric has demonstrated that it is entitled to a cost of common equity of no less than 10.40% in this proceeding.

A. The RD Erroneously Rejects The Leverage Adjustment Proposed By UGI Electric.

UGI Electric demonstrated that a leverage adjustment is necessary, because the DCF analyses by the parties and the RD have understated the cost of common equity. UGI Electric MB, pp. 80-85. As explained by the Company, a leverage adjustment is proper in this case because the Company has a stock price above its book value, has an embedded cost of debt

different from the marginal cost of debt, and has a market value or capitalization of its equity that is greater than the book value of its equity. UGI Electric MB, p. 80. As such, the DCF cost rate based on market prices must be adjusted to reflect the greater financial risk created by a higher debt ratio when that cost rate is applied to a book value capitalization in utility proceedings. UGI Electric MB, p. 80.

The RD ignores this reasoning and simply concludes that because it recommends a cost of common equity of 10.00% (inclusive of a 20 basis point adjustment for the Company's management performance), no leverage adjustment is necessary. RD, p. 75. The RD appears to credit the suggestion by OCA witness Mr. Rothschild that "when a company has a market to book value above 1…[it] is over earning" to support its determination that a leverage adjustment is not necessary here. *See* RD, p. 74. However, neither the OCA nor any other party submitted any evidence that UGI Electric is overearning. Rather, the record evidence demonstrates that it is currently under earning and, therefore, that a rate increase is warranted.

In addition, the RD errs in its reliance on the *PPL 2012 RC Order* to support its decision not to adopt a leverage adjustment. In the *PPL 2012 RC Order*, the Commission declined to adopt a leverage adjustment where it adopted an <u>unadjusted</u> return on equity of 10.28%. *PPL 2012 RC Order*, at p. 91 (cited by RD, p. 75).[1] The RD, however, relies upon its recommended unadjusted cost of common equity of 9.8% to argue a leverage adjustment is not warranted. In determining if a leverage adjustment is warranted, the question is not whether UGI Electric's cost of common equity, inclusive of an adjustment for excellent management performance is sufficient, but whether the unadjusted DCF cost rate understates the cost of common equity. If

[1] In the *PPL 2012 RC Order*, the Commission adopted a 10.40% cost of common equity, which was inclusive of a 12 basis point management efficiency adjustment. *See PPL 2012 RC Order*, p. 101.

the DCF cost rate is understated, then a leverage adjustment is warranted. The apples to oranges comparison set forth in the RD is not reasonable and should be rejected.

For these reasons and the reasons more fully explained in UGI Electric's briefs, the RD's conclusion regarding the proposed leverage adjustment should be rejected and the Commission should adopt a leverage adjustment. By adopting the leverage adjustment, the DCF cost rate is further adjusted to 11.02% (9.80% + 1.22%) for the Altered Proxy Group.

B. The RD Fails To Properly Utilize Other Methodologies As A Check On Its DCF Analysis.

UGI Electric explained that multiple methodologies must be used in order to properly evaluate the cost of common equity. UGI Electric witness Mr. Moul explained:

> My cost of equity determination was derived from the results of the methods/models identified above. In general, the use of more than one method provides a superior foundation to arrive at the cost of equity. At any point in time, a single method can provide an incomplete measure of the cost of equity depending upon extraneous factors that may influence market sentiment. The specific application of these methods/models will be described later in my testimony.
>
> ***
>
> It is also important to reiterate that no one method or model of the cost of equity can be applied in an isolated manner. Rather, informed judgment must be used to take into consideration the relative risk traits of the firm. It is for this reason that I have used more than one method to measure the Company's cost of equity. As I describe below, each of the methods used to measure the cost of equity contains certain incomplete and/or overly restrictive assumptions and constraints that are not optimal. Therefore, I favor considering the results from a variety of methods.

UGI Electric St. No. 5, pp. 4, 17.

The *PPL Electric 2012 RC Order* further supports an unadjusted cost of common equity above the RD's proposed 9.80%. 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).[2] In the *PPL 2012 RC Order*, the Commission explained that the unadjusted DCF cost rates proposed by the parties ranged from 8.38% to 9.69%, while the RP cost rates ranged from 7.3% to 10.75% and the CAPM rates ranges from 8.14% to 11.28%. *PPL 2012 RC Order*, p. 82. As the DCF cost rates were understated in comparison to the other methodologies used in the proceeding, the Commission properly declined to confine its cost of common equity to a value within the range of DCF calculations. *PPL 2012 RC Order*, p. 81. Therefore, where, as here, both the CAPM and RP methods suggest that the unadjusted DCF cost rate is understated, the Commission should adopt a cost of common equity that is higher than the unadjusted DCF cost rate.

Importantly, each of the methodologies used by UGI Electric witness Mr. Moul and I&E witness Mr. Spadaccio reveals that the DCF cost rate proposed by each of the parties is <u>less than</u> the cost of common equity calculated under other models. *See* UGI Electric MB, p. 77 (noting a DCF cost rate of 10.55%, an RP cost rate of 11.25%, a CAPM cost rate of 11.03% and a Comparable Earnings cost rate of 12.55%); *see also* UGI Electric MB, p. 93 (noting I&E's DCF

[2] *See also 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>.").

cost rate of 8.62% and CAPM cost rate of 8.98%).[3] UGI Electric demonstrated that the DCF cost rate is understated as compared to other methodologies by between 0.48% and 2%. I&E similarly demonstrated, albeit under a flawed analysis, that the DCF cost rate is understated by 0.36%. As such, even if the DCF cost rate of 9.80% used in the RD were appropriate, the record evidence in this proceeding demonstrates that this cost rate is understated by at least 0.42%.[4] This comparison of the DCF and the historic CAPM cost rates proposed by UGI Electric and I&E demonstrates that the Commission should adopt a cost of common equity of at least 10.40% (inclusive of a 20 basis point adjustment for excellent management performance).

The RP analysis performed by Mr. Moul further demonstrates that the RD's DCF cost rate is understated by as much as 1.45%. UGI Electric MB, pp. 85-86. As in the *PPL 2012 RC Order*, the Commission should incorporate the Company's RP method in its analysis and adjust the cost of common equity closer to the 11.25% rate calculated by the Company under this method.

For these reasons, the Commission should look to other methodologies, in particular the Company's RP analysis, and adopt a cost of common equity higher than the 10.00% recommended by the RD.

C. The RD Erred By Relying On An Incorrect Forecasted CAPM Analysis.

While the Commission should use methodologies in addition to the DCF to calculate UGI Electric's cost of common equity, including the CAPM and RP, it should not adopt the forecasted CAPM cost rate recommended by the RD. RD, p. 89. The RD errs by declining to

---

[3] As explained in UGI Electric Main Brief, OCA witness Mr. Rothschild's analysis is fundamentally flawed and, ultimately, illogical. *See* UGI Electric MB, pp. 95-98. Moreover, the data that forms the foundation for Mr. Rothschild's recommendation demonstrates that other utilities are earning an 11.0% return. UGI Electric MB, p. 95.

[4] The difference between UGI Electric's DCF and CAPM cost rates is 0.48% and the difference between I&E's DCF and CAPM cost rates is 0.36%. The average of these two figures is 0.42%, *i.e.* ((0.48 + 0.36) / 2).

use UGI Electric's proposed risk free rate of return ("Rf") and by declining to adopt UGI Electric's proposed size adjustment to account for the Company's small size.

UGI Electric demonstrated that the appropriate risk free rate of return in the Rf calculation is 3.95% using 30-Year Treasury Bonds (UGI Electric St. No. 5-R, pp. 26-27), rather than 10-Year Treasury Notes (RD, p. 79; *see also* I&E Exhibit 2, Schedule 10). As explained by Mr. Moul, use of 10-Year Treasury Notes systematically understates the CAPM calculation due to extraordinary monetary policy actions taken by the Federal Open Market Committee to deal with persistent sluggishness in the economy. UGI Electric St. No. 5-R, pp. 25-26. The susceptibility of 10-Year Treasury Notes to federal policy actions makes them a less reliable proxy for the risk free rate of return in comparison to 30-Year Treasury Bonds. By using 30-Year Treasury Bonds as the Rf variable, the forecasted CAPM calculation should by increased to 10.07%.

In addition, UGI Electric demonstrated that a size adjustment was necessary to recognize the inherently higher risks associated with equity investments in a smaller company. UGI Electric MB, p. 88; *see also* UGI Electric St. No. 5, p. 37. Indeed, Pennsylvania case law recognizes that the Commission must consider, among other factors, "the size and nature of the utility" in order to establish fair rate of return. *See* UGI Electric MB, pp. 72-73 (citing *Pa. Pub. Util. Comm'n v. Pennsylvania Gas and Water Co. - Water Division*, 19 Pa. Cmwlth. 214, 233, 341 A.2d 239 (Pa. Cmwlth. 1975) and *Lower Paxton Twp. v. Pa. Pub. Util. Comm'n*, 13 Pa. Cmwlth. 135, 317 A.2d 917 (Pa. Cmwlth. 1974)). Regardless of whether financial literature supports or rejects the use of a size adjustment (*see* RD, p. 81), Pennsylvania law requires the Commission to consider a public utility's size. Therefore, the Commission should adopt the Company's proposed 1.02% size adjustment in its forecasted CAPM calculation.

Based on the above proposed size adjustments, the Commission should adopt a forecasted CAPM calculation of 12.97% (*i.e.*, the result of using Rf = 3.95% and adding the Company's proposed 1.02% size adjustment). This result further supports a cost of common equity above 10.00%, and demonstrates that the Commission should adopt a cost of common equity above the 10.40% it adopted in the *PPL 2012 RC Order*.

D. The RD Erred By Failing To Reflect Unrebutted Evidence of Increased Risk Factors In Its Analysis.

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. The RD erroneously ignores the requirement that the equity return for UGI Electric must reflect the size of the Company.

The zone of reasonableness established in this proceeding demonstrates that UGI Electric's cost of common equity is between 10.55% (*i.e.* UGI Electric's DCF cost rate) and 12.55%. However, the use of informed judgment and consideration of the increased risk factors faced by UGI Electric demonstrates that it is entitled to a return on equity at the upper end of this range.

The RD runs afoul of this fundamental requirement by ignoring unrebutted evidence regarding the increased risks faced by UGI Electric. UGI Electric MB, pp. 88-91. In particular, UGI Electric explained 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 future test year ("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.

Finally, UGI Electric is a small company that faces increased risks that further justify a higher cost of common equity. UGI Electric St. No. 5, p. 11. As explained above, the CAPM return must be adjusted upward by 1.02% in recognition of the Company's size. As a smaller company, a given change in revenue and expense has a proportionately greater impact on a small firm. UGI Electric demonstrated that its smaller size could significantly affect investors' expectations for returns on common equity. *See generally* UGI Electric St. No. 5.

The RD attempts to ignore this evidence and concludes:

> We recommend against consideration of the additional risk factors identified by UGI Electric as a reason to increase the allowed return on common equity. We are recommending a return on common equity rate of 10.00%. This rate includes a 0.2% increase for management effectiveness. The 10.00% rate is already significantly higher than the 8.5% ROE rate recommended by OCA and the 8.62% ROE rate recommended by I&E. Further, assessing the potential impacts of the factors identified above by UGI Electric on potential equity investors requires a degree of

> speculation, rendering precise quantification of the potential impacts difficult at best.

RD, pp. 82-83.

None of these reasons justify rejecting UGI Electric's unrebutted evidence of increased risks. The RD's reliance upon the flawed cost rates proposed by I&E and OCA is not persuasive. The RD properly rejected both of these flawed results when it established an unadjusted cost of common equity that was over 100 basis points higher than either proposal. As such, it is not correct to rely on these rejected analyses to gauge the reasonableness of the recommended 10.00% cost of common equity.

Finally, this reasoning disregards the fact that the Commission, like investors, is tasked with utilizing informed judgment to consider the "risks and uncertainties" associated with common equity capital investments in other business undertakings when establishing the cost of common equity. *See* UGI Electric RB, p. 38 (quoting *Bluefield Waterworks*). The Commission should account for the unrebutted risks and uncertainties advanced by UGI Electric, and adjust the cost of common equity upward to reflect those risks and uncertainties. UGI Electric MB, pp. 88-91; UGI Electric RB, pp. 37-39.

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; *see also* UGI Electric RB, pp. 37-39. The Company's presentation is unrebutted. Therefore, the Commission should also consider the additional risks and uncertainties presented by UGI Electric and adopt an unadjusted cost of common equity of at least 10.40% (inclusive of a 20 basis point adjustment for excellent management performance).

E. Conclusion As To The Cost Of Common Equity.

As explained above, the RD errs by recommending a cost of common equity of 10.00%. UGI Electric has demonstrated that its proposed 11.25% cost of common equity is reasonable and appropriate under various methodologies and by demonstrating that certain financial conditions increase the Company's risk profile, thereby necessitating a higher return. In addition, the Company has demonstrated that, even if the Commission does not adopt the Company's proposed 11.25% cost of common equity, the Commission should adopt a cost of common equity no less than the 10.40% cost rate it previously adopted in the *PPL 2012 RC Order*. Therefore, and for the reasons more fully explained above, the Commission should adopt a return on equity of no less than 10.40% (inclusive of a twenty basis point adjustment for management performance and effectiveness).

Exception No. 2: The RD Incorrectly Rejected The Company's Revised Claim To Recover The Costs Of Its New Operations Center. RD, pp. 22-24.

UGI Electric excepts to the RD's conclusion that the costs associated with the Company's planned Operations Center should be denied. The Company's original and unchallenged need for a new Operations Center in its direct case included a cost estimate of $10 million. In rebuttal, UGI Electric updated its claim to $17.3 million, only $13.4 million of which was included in UGI Electric's rate base,[5] to reflect additional information obtained as the Company moved forward with the site selection and plan development process. For the reasons set forth below, the Company's revised claim should be approved.

The RD excluded the Operations Center from rates because, in its view, the Operations Center was still in the preliminary planning stages. RD at 24. The RD specifically criticized the lack of contracts and agreements for the purchase and construction of the Operations Center, as

[5] The additional $3.9 million is allocated to the transmission operations. *See* UGI Electric Ex. No. JFW-1 (UGI Electric's revised depreciation study).

well as the Company's representation that it had only recently toured the facilities, as showing that there is too much uncertainty to conclude that the Operations Center will be completed within the FPFTY. RD at 24.

The record evidence established that the Company's Operations Center will be in service within the FPFTY, with a target move-in date of September 2019. UGI Electric St. No. 3-R, p. 17. At the close of the evidentiary record, there were still fifteen months before September 2019, which the Company explained was the reason it had not yet entered into specific contracts or agreements associated with the Operations Center. UGI Electric RB, pp. 14-15. The RD also fails to consider the Company's deep familiarity with the building it plans to use for the Operations Center, and the surrounding area, because UGI Electric was previously headquartered in the building for twenty years. UGI Electric St. No. 3-RJ, p. 11. The location criteria for the Operations Center, *i.e.*, within the Company's service territory, also limited the number of commercial properties available and suitable; it similarly limits the number of commercial enterprises vying for the type of property being considered. UGI Electric St. No. 3-RJ, p. 11. Simply put, the search for a property and subsequent plan for its development involves limited options which are, or as part of the planning and execution process have become, known to UGI Electric. As a result, less time is required to complete the selection process and construction associated with the Operations Center project. Contrary to the conclusion reached in the RD, the Company provided sufficient evidence to show that the Operations Center will be in service by September 2019, which is within the FPFTY. UGI Electric St. No. 3-RJ, p. 12.

In summary, the Company has shown continual progress during the pendency of this proceeding related to the successful development and completion of the Operations Center project:

- A preliminary cost estimate of $10.0 million for the Operations Center; allowing for consolidation of currently separate employee groups into an OSHA VPP and ADA compliant facility, replacement of a nearly 100 year old warehouse facility, inclusion of a dedicated training facility and elimination of current space constraints in support of more efficient operations. UGI Electric St. No. 3, p. 16-17.
- Identification of a suitable existing 54,000 square foot facility with related property capable of meeting UGI Electric's requirements. UGI Electric St. No. 3-R, p. 17.
- Development of a formal cost estimate by a third party architect consultant in support of a revised cost estimate of $17.3 million for the Operations Center. UGI Electric St. No. 3-R, pp. 17-18 and CONFIDENTIAL UGI Electric Rebuttal Exhibit EWS-8.
- Demonstration of familiarity with the existing facility and site as a result of UGI Electric previously leasing the facility; facilitating ready understanding of building and site renovation needs. UGI Electric St. No. 3-RJ, p. 11.
- Active engagement in purchase and renovation negotiations with the existing property owner. UGI Electric St. No. 3-RJ, p. 11.

Importantly, the sufficiency of the Company's evidence on the Operations Center was not challenged until very late in the proceeding. The sufficiency of Company's claim for the Operations Center in its direct case was not challenged by any party, including the OCA. It was only in surrebuttal that OCA challenged the certainty of the Operations Center, after the Company provided updated cost estimates, based on the additional developments that occurred

while the case was pending. OCA should not be permitted to challenge the certainty that the Operations Center would enter service during the FPFTY when OCA could have done so in direct testimony, and did not. Using surrebuttal to challenge the likelihood that the Operations Center will be in service in the FPFTY, as opposed to the change in the total cost of the project, was improper and left the Company with little time to respond to it in rejoinder (3 days). OCA's challenge to the certainty of the completion of the Operations Center was untimely, and therefore should not be adopted by the Commission.

The Commission should include the Operations Center in rate base because the Company has produced evidence showing that the Operations Center will be in place by the end of the FPFTY, and OCA has produced no evidence to the contrary. Pursuant to Act 11, inclusion of the full $13.4 million in rate base is appropriate where the plant will be in service within the FPFTY.

Exception No. 3: The Impact Of Excluding The Operations Center From Rates In The RD Must Be Recalculated If The Adjustment Is Accepted. RD, p. 24.

UGI Electric excepts to the RD's calculation of the impact of excluding the Operations Center from rate base, which overstates the impact on the Company's revenue requirement by $237,000. RD, p. 24. This adjustment fails to recognize that the Company provides both transmission and distribution service. This rate case deals solely with distribution service. All costs associated with transmission service were removed from the Company's revenue requirement calculation through a separation study which directly assigns or allocates the total cost of service to the transmission and distribution functions. *See* UGI Electric St. No. 2, pp. 9-10. Even if the Operations Center is excluded from rate base in the Commission's Final Order, the Commission should recalculate the revenue requirement using the correct cost for the portion of the Operations Center that is allocated to the distribution function. Addressing the

mathematical miscalculation reflected in the RD adjusts the Company's revenue requirement upward by $237,000.

The RD does a two-part calculation in removing the Operations Center from UGI Electric's rate base. This calculation is reflected in footnote 4, on page 24 of the RD:

> The actual adjustment to rate base will be $15.352 million. We will assume that the initial $10 million claim was entirely a rate base item. Of the remaining $7.3 million, it appears only $5.577 million is attributable to plant in service less the depreciation expense of $225,000. UGI Electric St. No. 2-RJ, p. 2.

This misstates the Company's position in its testimony. The full $10 million was not included in rate base. Instead, consistent with the Company's transmission/distribution separation study, approximately $2.3 million of the original $10 million claim was allocated to the transmission function. When the Company increased its total Operations Center claim to $17.3 million, only $13.4 million was applied to distribution service, and $3.9 million was allocated to transmission service. The following schedule provides the errant and corrected calculations:

	Miscalculated Recommended Decision	UGI Electric Corrected Calculation		Rate Base Change
Original Filing	$ 10,000,000	$ 10,000,000		
Allocated to Transmission	-	(2,255,720)	1	
	10,000,000	7,744,280		
Incremental cost (less Transmission)	5,577,000	5,577,000		
Depreciation	(225,000)	(225,000)		
Rate Base Reduction	$ 15,352,000	$ 13,096,280		$ (2,255,720)

1 - Represents 22.5572% allocated to Transmission . Please see UGI Electric Exhibit C, Fully Projected, Page II-4.

As shown, the RD's calculation overstates the Company's rate base reduction by approximately $2.25 million, which translates to a $237,000 deduction in the revenue requirement.

If the Commission were to determine that the Operations Center should be excluded from rate base, which it should not, then the Commission should adopt the correct rate impact calculation.

Exception No. 4: The RD Erred In Requiring UGI Electric To Refund To Customers The 2018 Impacts Of The TCJA. RD, pp. 90-107.

The RD errs in concluding that the Company's supplemental filing failed to address the 2018 impacts of the TCJA and recommending that the Company be required to flow back the 2018 impacts to its customers. RD, p. 105. The proposed adjustment disregards judicial precedent prohibiting retroactive and single-issue ratemaking except under specified conditions, and incorrectly fails to conduct any examination of UGI Electric's current earnings and therefore mischaracterizes these dollars as a "windfall" for UGI Electric.

A. The RD Fails To Apply The Two-Part Test Applicable to Single Issue and Retroactive Ratemaking.

The "general rule" under Pennsylvania law is that "there may be no line by line examination" of "particular items of expense or revenue," and variations in "an isolated item of revenue or expense" may not, "without more," support "a Commission order of refund or recovery." *See Phila. Elec. Co. v. Pa. Pub. Util. Comm'n*, 502 A.2d 722, 727-728 (Pa. Cmwlth. 1985). As such, single issue ratemaking is generally prohibited where it impacts on a matter normally considered in a base rate case,[6] such as federal income tax expense.

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

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

pursuant to "previously approved" rates. *West Penn Power Co. v. Pa. Pub. Util. Comm'n*, 100 A.2d 110, 114 (Pa. Super. 1953).

However, the Commission may engage in single-issue ratemaking where the expense at issue is both extraordinary and non-recurring. *See Aqua Pennsylvania, Inc.*, Docket No. R-00038805, 236 PUR 4th 218, 2004 Pa. PUC LEXIS 39, *47-48 (Order entered Aug. 5, 2004) ("*Aqua 2004 Order*") ("[T]he legal standard for any such deferred claim as an exception to the prohibition against retroactive ratemaking is that it must be both 'extraordinary' and nonrecurring, not simply one or the other.") (emphasis added); *see also Pa. Pub. Util. Comm'n v. Mechanicsburg Water Co.*, 80 Pa. PUC 212, 232 (Order dated July 22, 1993) (recognizing that an ongoing expense claim is inherently recurring).

In UGI Electric's view, the changes in federal tax law resulting from the TCJA are neither extraordinary nor non-recurring. First, a change in the tax law is not extraordinary. Changes in tax law occur all the time. Congress regularly amends, extends, and adds to existing tax laws and regulations. In fact, the 2016 Annual Report to Congress published by the Taxpayer Advocate Service, stated that from 2001 – 2016, there have been more than 5,900 changes to the Internal Revenue Code which equates to more than one change per day. *See* UGI Electric MB, pp. 111-12.

Second, and even if the Commission were to find that the TCJA is an extraordinary event, it is simply not a one-time, non-recurring event. The tax law changed effective January 1, 2018, and will remain permanently in effect unless and until changed by Congress. There is no "sunset" provision or other expiration of this tax cut. It is a recurring and ongoing expense reduction that clearly does not qualify for any exception to single issue ratemaking. As noted in UGI Electric's Main Brief, OCA's witness Mr. Morgan agreed with this conclusion. UGI

Electric MB, p. 112. (citing Tr. 150:3-20. ("I would say it's an ongoing - - it's a new tax rate that is ongoing.")).

The RD errs by concluding that the TCJA "is nothing short of an extraordinary one-time event that is unlikely to be repeated." RD, p. 103. It supports this assertion by arguing that the TCJA "seems to be…one of the greatest single tax cuts in United States history." RD, p. 103. Rather than demonstrate that the TCJA impacts represent an event that is <u>both</u> extraordinary <u>and</u> non-recurring, the RD improperly relies on the amount of the impact (*i.e.* whether the amount is extraordinary) to conclude that it is also non-recurring. In this regard, the RD is inconsistent with the Commission's *Aqua 2004 Order*.

In the *Aqua 2004 Order*, the Commission declined Aqua's claimed annual amortization of deferred pension costs, which was based upon a substantial decline in the value of the equity investments made by the pension plan. *Id.*, at *47. The Commission rejected Aqua's characterization of these declines as an "extraordinary" and "non-recurring" event. UGI Electric MB, pp. 112-13. The increase in pension expense resulting from a decline in the stock market at issue in the *Aqua 2004 Order* provides an apt analogy to the instant dispute over 2018 federal income tax expense. Like the adverse impact of the stock market on pension expense, the federal income tax law changes on a regular basis; Congress regularly amends, extends, and adds to existing tax laws and regulations. Moreover, federal income taxes, just like pension expense, are a recurring expense item that is traditionally addressed in every base rate filing made by every public utility. UGI Electric MB, p. 113.

Even if the *Aqua 2004 Order* did not conclusively demonstrate that there is no exception to the rule against single issue/retroactive ratemaking due to the size of the change, the RD's assertion that the amount of the tax decrease further justifies the use of single-issue and

retroactive ratemaking is also factually incorrect. As explained in UGI Electric's MB, the 2018 impacts of the TCJA ($212,000) are substantially less than the storm damage expense resulting from a March 2018 storm that crossed UGI Electric's service territory. UGI Electric MB, p. 114.

Thus, the RD is flawed due to the reality that the 2018 impacts of the TCJA are neither extraordinary (due to the impact on the Company's earnings), nor nonrecurring because the impact will occur perpetually absent a new tax law change.

B. The RD Did Not Conduct Any Analysis Of UGI Electric's Current Earnings And Therefore Incorrectly Concludes That The 2018 Tax Reductions From The TCJA Are A "Windfall" To UGI Electric's Shareholders.

The RD further ignores controlling precedent that requires the Commission to examine a utility's current earnings before concluding that single issue ratemaking is appropriate. *See Popowsky v. Pa. Pub. Util. Comm'n*, 683 A.2d 958 (Pa. Cmwlth. 1996) ("*Equitable*"); *see also Pa. Indus. Energy Coal. v. Pa. Pub. Util. Comm'n*, 653 A.2d 1336 (Pa. Cmwlth. 1995). In *Equitable*, the Commonwealth Court reviewed a Commission order approving a proposed rate increase, wherein the public utility argued that it was not earning a fair return under its current rates in part due to the expense associated with implementing SFAS 106. *Equitable*, 683 A.2d at 959. In reviewing the order approving the requested rate increase, the Commonwealth Court reiterated the principle that when examining a change in rates, "[t]he PUC must make all findings necessary to determine whether the rates are just and reasonable." *Id.* at 962. This includes a showing that the rate increase was necessary to provide the utility with a fair rate of return. *See id.* at 962-963 (detailing the evidence submitted by Equitable that its current return on common equity was insufficient). The Commonwealth Court further explained that Equitable demonstrated its "rate of return was inadequate and that the health care and other savings did not offset the costs of complying with SFAS 106 as well as other expenses." *Id.* at 962. The RD

erred when it failed to follow the *Equitable* decision and did not examine whether UGI Electric is overearning in the FTY ending September 30, 2018.

The requirement to consider current earnings is further supported by the Commission's earlier orders regarding the 2018 impacts of the TCJA. In each instance where the Commission ordered companies not currently in a rate case to implement surcharges effective July 1, 2018, to flow back the TCJA impacts, each such order included a specific finding that the utility was currently overearning. *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…"). The RD does not find that UGI Electric is overearning under existing rates, nor could it.

Rather than determine whether UGI Electric is overearning, the RD errs by relying on the Commission's prior orders related to the TCJA, which are readily distinguishable from this proceeding. RD, pp. 103-105 (citing *Tax Cuts and Jobs Act of 2017*, Temporary Rates Order Docket No. M-2018-2641242 (Order entered May 17, 2018) ("*May Order*"); *Tax Cuts and Jobs Act of 2017*, Temporary Rates Order Docket No. M-2018-2641242 (Order entered March 15, 2018) ("*March Order*")). 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. 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. The Commission clearly expected the parties to address current earnings in determining whether rates should be reduced for the 2018 impacts of the TCJA.

Despite this direction, only UGI Electric provided any evidence as to its 2018 earnings. This evidence demonstrates that UGI Electric is currently earning far less than a fair rate of return in 2018. UGI Electric MB, pp. 114-15. In particular, Revised UGI Electric Exhibit A – Future, Schedule A-1, Line 19 demonstrates that UGI Electric's rate of return at present rates for the FTY, when accounting for the impacts of the TCJA, was 4.83% and its return on common equity was 4.96%.[7] *See* UGI Electric RB, p. 53, n.5. No other party presented any evidence that UGI Electric was overearning in the FTY. In fact, the RD concludes that a 10.00% return on common equity and overall rate of return of 7.56% is appropriate (RD, p. 89), I&E recommended associated cost of common equity of 8.62% and overall rate of return of 6.82% (I&E St. No. 2, p. 7), and OCA recommended a cost of common equity of 8.50% and an overall rate of return of 6.50% (OCA St. No. 3, p. 60). No record evidence exists to support a conclusion that UGI Electric is overearning in 2018. Therefore, the RD's conclusions regarding the 2018 impacts of the TCJA should be rejected.

Exception No. 5: The RD Erred When It Reduced UGI Electric's Rate Base To Reflect EADIT Associated With The TCJA. RD, pp. 90-107.

The Company's revenue requirement in this proceeding properly reflects the amortization of a regulatory liability for EADIT, which represents the change in the Company's ADIT

---

[7]

L-T Debt:	43.60%	x 4.65% =	2.03%
Equity:	56.40%	x 4.96% =	2.80%
Total:			4.83%

balance resulting from the TCJA's change in the corporate income tax rate from 35% to 21%. UGI Electric MB, p. 117. The RD adopts UGI Electric's proposed amortization, but erred when it also deducted the unamortized balance from rate base. RD, pp. 105-107.

As explained in UGI Electric's briefs, the recommended rate base adjustment is unprecedented, factually wrong, inconsistent and not in the public interest. UGI Electric MB, pp. 117-126; UGI Electric RB, pp. 54-55. First, the RD violates basic ratemaking principles and long-standing precedent by exacting a return component on the unamortized balance of an expense amortization, in this case, by reducing rate base by the amount of the unamortized EADIT. UGI Electric MB, pp. 121-24. Second, the RD ignores the fact that UGI Electric's current rates were last set in 1996 based on plant and deferred tax balances at that time, whereas most of UGI Electric's EADIT accumulated from plant placed in service since that time. UGI Electric MB, pp. 124-125. Third, the RD reflects only one aspect of the TCJA's impacts on EADIT; it recommends to fully reflect the rate reduction for tax expense and to further reduce tax expense by the EADIT amortization amount, but ignores the increase in rate base that should result from the reduction in ADIT. UGI Electric MB, pp. 125-26; UGI Electric RB, pp. 54-55. Fourth, UGI Electric demonstrated that the proposed adjustment was inconsistent with the goals of the TCJA and, therefore, not in the public interest. UGI Electric MB, pp. 126-127.

The analysis of this issue turns on the RD's finding that EADIT "monies were originally built into the rate formula to cover future income tax payments to the government." RD, pp. 105-106. The conclusion, however, ignores the fact that UGI Electric's current rates were last set in 1996. UGI Electric MB, pp. 124-125. UGI Electric's ADIT balance in 1996 was $4.8 million, and has grown to $23.5 million as of September 30, 2017. UGI Electric St. No. 9-RJ, p. 4. While the EADIT was created from the reduction to the ADIT balance, ratepayers have not

had to pay the deferred taxes underlying the balance since the vast majority of the EADIT was generated by property placed in service after current rates were established. UGI Electric St. No. 9-RJ, p. 4. Essentially, the RD, if adopted, would require UGI Electric to return to customers, by way of a rate base deduction, deferred taxes that were never paid by customers, because they are not part of the UGI Electric existing rates. Indeed, the RD's mistake is further compounded by its suggestion that the EADIT funds "were, and continue to be, ADIT funds because that is what the funds were collected for in the first place." RD, p. 107 (emphasis added). In this regard, the RD is incorrect and, therefore, the recommended rate base deduction should be rejected.

Second, the recommended rate base deduction fails to acknowledge that the Company has flowed through the impacts of the EADIT through a tax expense claim that is adjusted by the amortized EADIT amount. *See* UGI Electric MB, pp. 125-126; UGI Electric RB, p. 54. As the Company has proposed to flow through the principal of the EADIT by amortizing it over the life of the applicable plant in service, the Company's tax expense claim falls below even the lower TCJA statutory tax rate of 21 percent. UGI Electric MB, p. 125. The RD unreasonably ignores the flow through of the EADIT amortization, by including the full EADIT principal amount as an offset to rate base to the detriment of UGI Electric. UGI Electric MB, pp. 125-126. This not only would provide ratepayers a credit for expenses they never paid in rates, but would also provide an unprecedented rate base deduction for an expense credit that is also being amortized to the ratepayers' benefit.

If the impacts of the TCJA are to be reflected in UGI Electric's rates, then all of the impacts should be included, including the reduction in ADIT, not just the ones that reduce rates.

Exception No. 6: The RD's Rejection Of Expenses Associated With Incentive Compensation Is Based On A Fundamental Factual Error And Should Be Rejected. RD, pp. 47-50.

UGI Electric excepts to the RD's determination that expenses totaling $187,000 associated with incentive compensation should be excluded from rates. The RD concluded that the incentive compensation program is "designed to give incentives to high level employees who are not proximately responsible for serving its customers" and that UGI Electric's program is focused on financial metrics rather than operational metrics. RD at 50. The conclusions drawn in the RD regarding UGI Electric's incentive compensation program do not align with the evidence presented in the record.

First, it is critical to note that UGI Electric employees who are eligible to receive incentive compensation are not "high level employees who are not proximately responsible for serving its customers." This issue was not raised by I&E in its challenge to UGI Electric's incentive compensation benefits. Instead, the RD, at page 50, borrows the concept of the "proximate responsibility" of the employees receiving benefits from *Pa. Pub. Util. Comm'n, et al. v. UGI Utilities, Inc. (Electric Div.)*, Docket Nos. R-00932862 et. al., 1994 Pa. PUC LEXIS 136 (Order entered September 23, 1994) ("*1994 Rate Case*"), which involved incentive compensation benefits for holding company level management employees. *1994 Rate Case*, at p. 12 ("Again, we take note of the fact that nearly all of the persons eligible for … compensation are holding company employees.") Unlike the *1994 Rate Case*, the UGI Electric employees who are eligible to receive the incentive compensation benefits at issue in this proceeding are management employees directly employed by UGI Utilities Inc. *See* UGI Electric St. No. 5, p. 2 (describing UGI Electric's corporate structure). These employees are not holding company employees. The employees eligible to receive the incentive compensation challenged by I&E are key actors in the process of establishing the operating and customer-focused goals for UGI

Electric, are a driving force behind ensuring that these goals are achieved, and are directly responsible for ensuring safe and reliable service to customers. UGI Electric St. No. 4-R, p. 12.

As shown in the testimony in this proceeding, employees of UGI Utilities Inc., the employees who would be recipients of the contested benefits, have direct responsibilities for customer service. All Company witnesses in this proceeding are employees of UGI Utilities Inc. Witness Paul Szykman, for example, is responsible for "oversight and compliance for the state and federal jurisdictional activities." UGI Electric St. No. 1, pp. 1-2. Witness Eric Sorber, another UGI Utilities Inc. employee, directs the "UGI Electric engineering and operations staff, which is accountable for five major areas: (1) distribution and construction; (2) transmission & standards; (3) substation; (4) planning and compliance; and (5) safety." UGI Electric St. No. 3, p. 1. These, and other UGI Utilities Inc. employees eligible for incentive compensation benefits are directly responsible for safe and reliable service to customers. The RD errs by concluding that UGI Electric's incentive compensation will benefit high level employees with no proximate relationship to the customers being served.

Moreover, incentive compensation is needed at UGI Electric to attract and retain employees in a highly competitive market who serve key roles in ensuring safe and reliable service to customers. UGI Electric St. No. 4-R, p. 12. Had the contested funds been included as salary, there would be no question that UGI Electric could recover the expense as part of the total compensation offered by the Company. However, using incentive compensation instead of salary ensures sustained production by the Company's employees, and still results in UGI Electric having a total compensation (base salary plus incentive compensation) that is 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 the Company did not offer incentive compensation programs, then it would have to increase the level of its base salary compensation in order to remain competitive and to attract the same qualified candidates in the areas it serves, which would increase costs to customers. UGI Electric St. No. 4-R, p. 12. Alternatively, if the Company did not stay competitive in attracting and retaining qualified candidates, customer service and overall operations may be negatively impacted.

The evidence produced by UGI Electric shows that UGI Electric's incentive compensation plan identifies both financial and operational metrics in calculating benefits. UGI Electric St. No. 4-RJ, p. 9. The Company's Management employees have goals included in their metrics which are not directly tied to financial performance. UGI Electric St. No. 4-RJ, p. 9. These goals are in areas such as safety, reliability and customer service, and are all metrics utilized in the current cash incentive compensation plan. UGI Electric St. No. 4-RJ, p. 9. For instance, the incentive compensation plan includes metrics for OSHA VPP assessments, electric reliability indices (SAIDI, SAIFI, CAIDI), emergency response rate, and customer satisfaction. UGI Electric St. No. 4-RJ, p. 10. If operational goals are not met, then there is no eligibility for the portion of the cash incentive compensation regardless of the Company's financial performance. UGI Electric St. No. 4-RJ, p. 10.

The Commission has established a bright line test for approving incentive compensation expense. If the incentive compensation programs of the utility are reasonable and provide a benefit to ratepayers, then they may be recovered in their entirety. *See, e.g.*, *PPL 2012 Rate Case*, p. 26; *see also Pa. Pub. Util. Comm'n v. Aqua Pa., Inc.*, Docket No. R-00072711, 2008 Pa. PUC LEXIS 50 (Order dated July 17, 2008); *Pa. P.U.C. v. Duquesne Light Co.,* 63 Pa. PUC 337, 1987 Pa. PUC LEXIS 342 (Order dated March 10, 1987); *Pa. P.U.C. v. PPL Gas Utilities*

Corporation, Docket No. R-00061398, at p. 40 (Order dated Feb. 9, 2007); *Pa. P.U.C. v. Philadelphia Gas Works*, Docket No. R-2008-2073938, 2008 Pa. PUC LEXIS 32 (Order dated Dec. 19, 2008). UGI Electric has demonstrated that its incentive compensation plan, as a whole, includes both financial and operating metrics and goals, which benefit customers. UGI Electric therefore meets the Commission's bright line test.

For the reasons identified in this Exception and the Company's briefs, the RD's conclusion as to expenses associated with incentive compensation should be set aside, and the Commission should allow UGI Electric to include $187,000 in expenses for its incentive compensation plan.

Exception No. 7: The RD's Exclusion Of Expenses Associated With Environmental Remediation Ignores Commonwealth Court Precedent And The Appropriate Use Of The Test Year. RD, pp. 34-36.

UGI Electric excepts to the RD's denial of expenses associated with the environmental remediation of the Company's Forty Fort facility. The RD denied these expenses by reaching outside the FPFTY to offset the expenses with proceeds from the potential sale of the underlying property. RD at 36. Specifically, the RD concludes that "[w]ith remediation, the value of the property will certainly increase, increasing the gain that UGI Electric will receive from selling the property." RD at 36. The RD's conclusion ignores precedent addressing proceeds from the sale of property, as well as improperly reaching outside of the FPFTY in order to include speculative "gains" that may be associated with a sale. For these reasons, the Commission should not adopt the RD's conclusion regarding costs associated with environmental remediation, and should instead reflect in rates $417,000 amortized over three years for this expense.

The environmental remediation at Forty Fort is necessary to address surface contamination from parking line construction vehicles and storing miscellaneous items, such as

pole trailers and wire pulling equipment, over the nearly 100 years this facility has been used to serve customers. UGI Electric St. No. 3, p. 19. It is unchallenged that the environmental degradation was incurred in service to customers, and therefore it is appropriate that customers pay for the expense associated with remediating the soil. UGI Electric St. No. 3-R, p. 4. It is also unchallenged that the Company will undertake the environmental remediation, whether or not an eventual sale will occur. UGI Electric St. No. 3-RJ, p. 4.

The environmental remediation expense will be incurred in the FPFTY. UGI Electric St. No. 3-R, p. 4. The timing of the environmental remediation was not challenged. However, if a sale occurs, it will occur outside the FPFTY. UGI Electric St. No. 3-R, p. 4. Reaching outside the FPFTY for any proceeds that may occur from the sale of the property, in order to offset the expense associated with the environmental remediation, violates basic ratemaking principles. There is no assurance a sale will happen at all. The sales price for the building is certainly not known or knowable at this time, as current market conditions will likely change before the property is ready to be sold. Thus, the building may or may not be sold, and there may or may not be any net proceeds to offset the cost of the environmental remediation work. UGI Electric MB, p. 54; UGI Electric RB, p. 24. Using a hypothetical gain from outside the test year to offset known expenses that will occur within the test year is not appropriate pursuant to the Commission's standard approach to ratemaking.

The Commission's normal ratemaking approach already confers any gain associated with the sale of depreciable property to ratepayers. Any gain on the sale of the facility at Forty Fort will be reflected as net negative salvage and returned to customers. UGI Electric St. No. 3-R, p. 4; *see also* Part IV of UGI Electric Exhibit C (Historic), Part VIII of UGI Electric Exhibit C (Future), Part IV of UGI Electric Exhibit C (Fully Projected) (UGI Electric experienced and

estimated net salvage claim in this proceeding). However, 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). Shifting any gain from the sale of land to pay for costs incurred as a result of the provision of service to customers is, therefore, inappropriate. Adopting the RD's recommendation would contravene the appropriate ratemaking treatment that is already associated with the sale of land and depreciable property.

The Commission should not adopt the RD's decision regarding expenses associated with environmental remediation, and should instead allow the Company to reflect the full $417,000, amortized over three years, consistent with Commonwealth Court precedent and the use of the proper application of the FPFTY.

Exception No. 8: The RD's Adoption Of I&E's Rate Case Expense Adjustment Fails To Reflect The Evidence Of Ongoing Capital Costs Presented by UGI Electric. RD, pp. 38-41.

UGI Electric excepts to the RD's adoption of I&E's adjustment to rate case expense, which rejected the Company's use of a three-year (36 month) normalization in favor of the five-year (60 month) normalization proposed by I&E. RD at 40-41. The RD concluded that while history is not the sole determinant to be relied upon in assessing the appropriate normalization period, UGI Electric provided no basis for the use of its three-year normalization. RD at 40.

The RD fails to consider the evidence UGI Electric presented regarding its ongoing commitment to capital improvements. Particularly, the RD does not consider the impact of the Company's Long Term Infrastructure Improvement Plan ("LTIIP"), which will add $24.4 million to rate base over the three years after the FPFTY. *See Petition of UGI Utilities, Inc. – Electric Division for Approval of its Long-Term Infrastructure Improvement Plan*, P-2017-

2619834, at p. 12 (Order entered Dec. 21, 2017) (approving UGI Electric LTIIP and noting planned eligible property replacements for fiscal years 2018 through 2022). Using the numbers generated by the RD, and the capital spending identified in UGI Electric's LTIIP, if the Company had a distribution system improvement charge ("DSIC") in place as of the end of the FPFTY, it would hit the 5.0% DSIC cap in 24 months. Thus, there is sufficient record evidence to conclude that the Company's proposed normalization is appropriate. This analysis, taking into consideration an ongoing capital improvement program, is consistent with the Commission's analysis in the *PPL 2012 RC Order*.

UGI Electric has produced sufficient evidence to show that the use of a three-year normalization period for rate case expense is appropriate. The RD's finding that UGI Electric produced no basis for its three-year normalization is in error. UGI Electric's three-year normalization should be adopted, as it is a more reasonable proxy for future base rate cases in light of the Company's ongoing capital improvement plans.

Exception No. 9: The RD Errs By Recommending That Customer Charges and Usage Rates Should Be Scaled Back Proportionally To The Percent Increase Originally Requested. RD, pp. 130-131.

UGI Electric excepts to the RD's recommendation that the Commission should reduce (*i.e.* scale back) the customer charges and usage rates proportionally to the increase originally requested by UGI Electric where a less than full increase is granted to the Company. RD, p. 131. Initially, to be clear, all parties agree and the RD does not dispute that the overall revenue increase should be scaled back across all rate classes on a proportional basis. *See* RD, pp. 130-131. Then, within each class, UGI Electric proposed that the scale back should be first applied to any proposed increase to usage charges, then to any proposed increase to demand charges, and then finally to any proposed increase to customer charges. *See* UGI Electric St. No. 8-R, pp. 24-25. Only after first making these two reductions, and determining that additional revenue

reductions must be achieved, should the Commission then reduce the proposed customer charges back toward current charges.

Under the Company's scale back proposal, the resulting customer charge more closely aligns with the cost of service principles set forth in *Lloyd v. Pa. P.U.C.*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006) *appeal denied*, 591 Pa. 676, 916 A.2d 1104 (2007). The RD's scale back proposal, however, would result in a residential customer charge that is disconnected from the cost to serve UGI Electric's customers. UGI Electric demonstrated that the monthly fixed costs of a residential customer are approximately $19.00. *See* UGI Electric MB, pp. 151-152. The RD's scale back proposal, at the RD's proposed rate increase, would result in a customer charge of approximately $7.99; conversely, the Company's scale back proposal, again at the RD's proposed rate increase, would result in a customer charge of approximately $9.10.[8] While neither proposal fully permits UGI Electric to recover all of its fixed customer costs through a fixed charge, the Company's proposal more closely aligns with the actual fixed costs to serve the residential class.

In addition, the proportional scale back proposal advanced by the RD is inconsistent with the reasoning adopted by the RD that the Company's proposed $14.00 customer charge is not unreasonable. RD, pp. 126-127. The RD found that gradualism considerations should not completely trump the cost of service determined by the Company's allocated class cost of service study, which properly calculated and included relevant fixed costs in its customer cost analysis. RD, pp. 126-127. Moreover, the RD reasoned that the proposed monthly customer charge is reasonable because it will not have a disproportionate negative impact on the Company's low-income customers. RD, p. 127. Thus, it is appropriate to adopt UGI Electric's scale back

[8] Each of these customer costs assumes that the revenue increase adopted in this proceeding is the increase recommended by the RD. For the reasons explained elsewhere in these exceptions, UGI Electric submits that the Commission should reject the RD's recommended revenue increase.

proposal and have any reduction first applied to any proposed increase to usage charges, then to any proposed increase to demand charges, and then finally to any proposed increase to customer charges.

For these reasons and the reasons more fully explained in UGI Electric's briefs, the Commission should reject the RD's scale back proposal and adopt UGI Electric's scale back proposal to the extent the Commission adopts a revenue increase less than the Company's requested amount.

III. CONCLUSION

For all the foregoing reasons, UGI Utilities, Inc. – Electric Division respectfully requests that the Pennsylvania Public Utility Commission grant the above Exceptions and approve the rate increase and other proposals contained in Tariffs Electric – PA. P.U.C. Nos. 6 and 2S.

Respectfully submitted,

David B. MacGregor (ID # 28804)
Post & Schell, P.C.
Four Penn Center
1600 John F. Kennedy Boulevard
Philadelphia, PA 19103-2808
Phone: 215-587-1197
Fax: 215-320-4879
E-mail:dmacgregor@postschell.com

Kent D. Murphy (ID # 44793)
Mark C. Morrow (ID # 33590)
Danielle Jouenne (ID #306839)
UGI Utilities, Inc.
460 North Gulph Road
King of Prussia, PA 19406
Phone: 610-768-3628
Phone: 610-992-3203
E-mail: murphyke@ugicorp.com
E-mail: morrowm@ugicorp.com
E-mail: jouenned@ugicorp.com

Jessica R. Rogers (ID # 309842)
Garrett P. Lent (ID # 321566)
Post & Schell, P.C.
17 North Second Street, 12th Floor
Harrisburg, PA 17101-1601
Phone: 717-731-1970
Fax: 717-731-1985
E-mail:jrogers@postschell.com
E-mail:glent@postschell.com

Date: September 13, 2018

Counsel for UGI Utilities, Inc. – Electric Division