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September 24, 2018

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

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

Dear Secretary Chiavetta:

Attached for electronic filing please find the Office of Consumer Advocate's Reply Exceptions in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

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Attachments
cc: Honorable Andrew Calvelli, ALJ
Honorable Steven K. Haas, ALJ
Office of Special Assistants (e-mail only: ra-OSA@pa.gov)
Certificate of Service

*259173

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the following documents, the Office of Consumer Advocate's Reply Exceptions, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 24th day of September 2018.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY EXCEPTIONS OF THE OFFICE OF CONSUMER ADVOCATE

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Dated: September 24, 2018

TABLE OF CONTENTS

I. INTRODUCTION 1

II. REPLY EXCEPTIONS 2

OCA Reply Exception No. 1: The ALJs Were Correct In Finding That UGI's Various Arguments That Were Intended To Artificially Inflate The Cost Of Common Equity Are Without Merit And Accordingly Should Be Rejected 2

A. Introduction 2

B. The ALJs Correctly Rejected UGI's Proposed Leverage Adjustment 3

C. The ALJs Were Correct In Primarily Relying On The DCF Method To Establish An ROE For UGI 4

D. The ALJS Were Correct In Holding That UGI's Arguments As To Increased Risk Factors Were Unsupported And Speculative 6

OCA Reply Exception No. 2: The ALJs Correctly Rejected The Company's Claim To Recover The Costs Of Its Proposed New Operations Center 7

OCA Reply Exception No. 3: The ALJs Properly Concluded That UGI Should Be Required To Refund To Customers The 2018 Savings Resulting From The Tax Cuts And Jobs Act 8

A. The ALJs Properly Classified The TCJA Savings As Both Extraordinary And Nonrecurring And Determined That Flowing Back TCJA Savings To Customers Does Not Constitute Impermissible Retroactive Or Single-Issue Ratemaking 8

B. The ALJs Did Not Engage In Impermissible Retroactive or Single-Issue Ratemaking And Properly Evaluated, In The Context Of This Base Rate Case, All Relevant Criteria In Determining That The TCJA Savings Constitute A Windfall To UGI 11

OCA Reply Exception No. 4: The ALJs Properly Concluded That UGI's Rate Base Should Be Reduced To Reflect Excess Accumulated Deferred Income Taxes 13

OCA Reply Exception No. 5: The ALJs Properly Concluded That UGI's Company Owned Services Program Transition Should Be Approved With Certain Conditions 15

OCA Reply Exception No. 6: The ALJs Properly Concluded That UGI's Environmental Remediation Expense Claim Should Be Rejected 16

OCA Reply Exception No. 7: The ALJs Properly Concluded That The Scale Back In This Proceeding Should Be Applied Proportionally 18

III. CONCLUSION 20

TABLE OF AUTHORITIES

Page(s)

Cases

Philadelphia Electric Co. v. Pa. PUC,
502 A.2d 722 (Pa. Commw. 1985) 9

Popowsky v. Pa. PUC,
695 A.2d 448 (Pa. Commw. 1997) 9

Administrative Decisions

Tax Cuts and Jobs Act of 2017,
Docket No. M-2018-2641242 (Order entered May 17, 2018) .... *passim*

Other Authorities

Statement of Vice Chairman Andrew G. Place,
Docket No. M-2018-3001577 (Statement Issued May 17, 2018) 3

I. INTRODUCTION

Administrative Law Judges (ALJs) Steven K. Haas and Andrew M. Calvelli issued a Recommended Decision (R.D.) setting forth their conclusions in UGI Utilities, Inc. – Electric Division's (UGI) base rate case on August 24, 2018. The Office of Consumer Advocate (OCA) filed Exceptions addressing various aspects of the ALJs' R.D. on September 13, 2018. UGI, the Bureau of Investigation and Enforcement (I&E), and the Office of Small Business Advocate (OSBA) also filed Exceptions on that date. In these Reply Exceptions, the OCA primarily addresses UGI's Exceptions and certain portions of I&E's Exceptions.

For the reasons set forth below, the OCA submits that the ALJs properly concluded that: (1) UGI's arguments intended to artificially inflate the cost of common equity are without merit and should be rejected, (2) UGI's claim to recover the costs of the proposed Operations Center should be rejected, (3) UGI should be required to refund to customers the 2018 tax savings resulting from the Tax Cuts and Job Act of 2017, (4) UGI's base rate should be reduced to reflect excess accumulated deferred income taxes, (5) UGI's Company Owned Service Transition Program should be approved with certain conditions, (6) UGI's environmental remediation expense claim should be rejected, and (7) the scale back in this proceeding should be applied proportionally. The OCA respectfully requests that the Commission deny UGI's Exceptions as well as certain portions of I&E Exceptions and modify the R.D. in the manner set forth in the OCA's Exceptions. See gen'ly OCA Exc.

II. REPLY EXCEPTIONS

OCA Reply Exception No. 1: The ALJs Were Correct In Finding That UGI's Various Arguments That Were Intended To Artificially Inflate The Cost Of Common Equity Are Without Merit And Accordingly Should Be Rejected. (R.D. at 54-89; OCA M.B. at 48-69; OCA R.B. at 24-28)

A. Introduction.

In the R.D., the ALJs correctly held that UGI's proposed "leverage adjustment" was unsupported and should be rejected. R.D. at 75. As the ALJs discussed, this mechanism is an "artificial upward adjustment". Id. The ALJs also provided a lengthy discussion on the various methods in use to calculate the cost of common equity, including the DCF, CAPM, RP and CE methods. R.D. at 65-82. After a thorough discussion, the ALJs correctly concluded that the DCF should be used as the primary determinant for calculating the return on equity (ROE) with the CAPM as a check on the reasonableness of the DCF results. R.D. at 88. The ALJs also addressed UGI's arguments as to the additional risk factors that would warrant a higher ROE number, and effectively rejected UGI's invitation to peer into the future and adjust the ROE higher based on nothing more than speculation.[1] R.D. at 82-83.

In its Exceptions, UGI argues that the ALJs' recommended 10% ROE is too low, based on several factors. UGI Exc. at 6. Principally, UGI asserts that the ALJs' holdings as to the leverage adjustment, the CAPM determinations, the principal reliance on the DCF and CAPM as a check and the rejection of UGI's additional risk factors in arriving at the 10% ROE are all in error and should not be upheld. Id.

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[1] To be clear, the OCA supports the ALJs' decisions to principally rely on the DCF and CAPM in the R.D. As noted in its Exceptions, however, the OCA continues to assert that a reasonable ROE for UGI based on the evidence here is 8.5%. See OCA Exc. at 10-19.

The OCA addresses each of these contentions in these Reply Exceptions and submits that substantial, credible evidence supports the ALJs' decisions on each of these issues. The OCA, however, continues to oppose any additional ROE adder for management performance.[2]

B. The ALJs Correctly Rejected UGI's Proposed Leverage Adjustment.

The ALJs adequately considered and correctly rejected UGI's proposed leverage adjustment in this matter. R.D. at 73-75. In Exceptions, the Company primarily argues that a leverage adjustment is proper in this case and should be granted as the unadjusted DCF results are simply too low. UGI Exc. at 9-11. The OCA submits that there is no valid reason why such artificial upward adjustments to the ROE are necessary or consistent with traditional ratemaking.

OCA witness Rothschild testified as to why such artificial constructs should not be accepted, as follows:

> **Q. DOES MR. MOUL'S LEVERAGE ADJUSTMENT GO AGAINST ORIGNAL COST RATEMAKING?**
>
> A. Yes. Mr. Moul claims, "The need for the leverage adjustment arises when the results of the DCF model (k) are to be applied to a capital structure that is different than indicated by the market price (P)." In other words, Mr. Moul is saying that as a consequence of original cost ratemaking an upward adjustment is needed. When a company has a market to book value above 1, and is thus over earning, applying the correct rate of return to the book value could have downward pressure on the stock price. No matter what logic is applied to the reason for adding a value to the rate of return, the leverage adjustment distorts the natural market dynamic between a regulated utility's stock price and its allowed rate of return.

OCA St. 3 at 55-56 (footnote omitted). Mr. Rothschild's testimony here as to the inherent fallacy of artificially adjusting the DCF results has also recently been noted in other Commission proceedings.

On May 17, 2018, Vice Chairman Place issued a Statement in response to the quarterly earnings report for public utilities for the period ending December 31, 2017. Statement of Vice

[2] See OCA Exc. at 17-19.

Chairman Andrew G. Place, Docket No. M-2018-3001577 (Statement Issued May 17, 2018) (Place Statement). Vice Chairman Place was commenting on the results of the report as compiled by the Commission's Bureau of Technical Utility Services (TUS), with particular attention to the DCF and CAPM results found in the report and the corresponding "proxy" numbers that would then be used for calculating the return for distribution system improvement charges (DISC). Place Statement at 1.

Although the Vice Chairman was directing his comments to the DISC, his concerns and observations on the issue are directly relevant here. Specifically, for electric utilities Vice Chairman Place noted the DCF and CAPM results, performed by TUS, and the obvious large upward "adjustment" to the "proxy" ROE, as follows:

> Similarly, as documented in the report, DCF analysis for electric utilities produces an average ROE of 9.05%, and a range of 8.26% to 9.83% for one standard deviation around the mean. The CAPM analysis produces an ROE of 8.94%. The proposed 9.55% proxy ROE is well above the average DCF ROE and the CAPM ROE check.

Id. Vice Chairman Place went on to comment that:

> It is needlessly costly to reason that ROEs above what the market demands are necessary to attract capital. This is not a choice between attracting investment capital or avoiding rate payer impacts. To the contrary, being attentive to market signals ensures optimal investment at the lowest cost to rate payers.

Place Statement at 2.

As the Vice Chairman correctly pointed out, needlessly high ROEs cost ratepayers real dollars. The OCA submits that the ALJs were correct in holding that UGI's leverage adjustment should be denied.

C. The ALJs Were Correct In Primarily Relying On The DCF Method To Establish An ROE For UGI.

The ALJs correctly held that the DCF and CAPM are the preferred methods for establishing the ROE for UGI.[3] R.D. at 76. In Exceptions, UGI argues that the Commission should place more reliance on the RP method and should also reject the forecasted CAPM results relied on by the ALJs. UGI Exc. at 11-15. The OCA submits that UGI's arguments on these issues are without merit and should be rejected.

The Commission has consistently rejected the idea that greater weight or emphasis should be placed on other methods such as the RP or CE. As the OCA provided in its Main Brief:

> Historically, we have primarily relied on the DCF methodology in arriving at our determination of the proper cost of common equity. We have, in many recent decisions, determined the cost of common equity primarily based upon the DCF method and informed judgment. *See Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company*, 71 Pa. PUC 593, 623-632 (1989); *Pennsylvania Public Utility Commission v. Western Pennsylvania Water Company*, 67 Pa. PUC 529, 559-570 (1988); *Pennsylvania Public Utility Commission v. Roaring Creek Water Company*, 150 PUR4th 449, 483-488 (1994); *Pennsylvania Public Utility Commission v. York Water Company,* 75 Pa. PUC 134, 153-167 (1991); *Pennsylvania Public Utility Commission v. Equitable Company*, 73 Pa. PUC 345-346 (1990). We determine that the DCF method is the preferred method of analysis to determine a market based common equity cost rate.

OCA M.B. at 55-56 (additional citations omitted). Here the ALJs confirmed and upheld long-standing precedent that the DCF method should be the primary determinant used to arrive at an ROE number.

The Company's primary argument with the ALJs' adoption of a 9.83% forecasted CAPM is that Mr. Moul's risk-free rate based on 30-year Treasury Bonds was not accepted. UGI Exc. at 13-15. In the RD, the ALJs thoroughly evaluated the Company's arguments on this point and correctly rejected them in favor of using a 10-year Treasury Note as advocated for by I&E witness

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[3] The OCA supports the DCF and CAPM methodologies chosen by the ALJs to arrive at an ROE number, but does disagree with some of the conclusions reached by the ALJs in their applications of these methods. See OCA Exc. at 10-16.

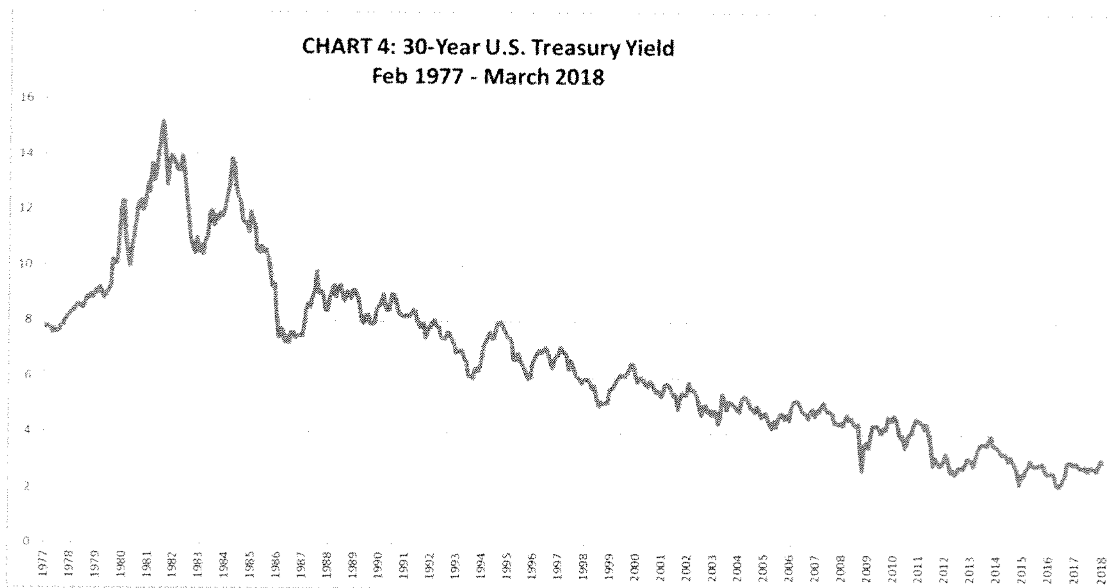
Spadaccio. R.D. at 79. The OCA submits that the ALJs' decision on this issue is supported by the evidence and should be upheld.

D. The ALJS Were Correct In Holding That UGI's Arguments As To Increased Risk Factors Were Unsupported And Speculative.

The ALJs were correct when they concluded that no upward adjustment to the ROE was necessary based on UGI's "additional risk" arguments. R.D. at 82-83. In Exceptions, UGI primarily argues that current market conditions and uncertainty should support the need for a higher ROE for UGI. UGI Exc. at 15-17. As the OCA discussed above, there is no valid reason for artificially inflating the ROE results.

In accord with the evidence presented by the OCA, we are in a continued and long-term period of low capital costs. As Mr. Rothschild explained, interest rates remain low by historical levels:

> As of March 31, 2018 the yield on the 30-Year U.S. Treasury bond is at 3.03%. As shown in Chart 4 below, yields on 30-year U.S. treasuries remain low by historical measures:



OCA St. 3 at 9-10 (footnotes omitted). UGI's claims of uncertainty and increased financial risk based on the current economic environment are speculative and unsupported. The OCA submits that the ALJs correctly weighed the evidence presented and came to the right decision on this issue.

OCA Reply Exception No. 2: The ALJs Correctly Rejected The Company's Claim To Recover The Costs Of Its Proposed New Operations Center. (R.D. at 22-24; OCA M.B. at 19-21; OCA R.B. at 8-9)

In the R.D., the ALJs correctly concluded that UGI had failed to establish that its proposed new Operations Center would actually be in service at some point during the FPFTY. R.D. at 24. In Exceptions, UGI argues that it has sufficiently demonstrated that the Operations Center will be operational during the FPFTY, and that the OCA's objections to the inclusion of this Project in rate base should be disregarded because such objections only arose during the Surrebuttal phase of testimony. UGI Exc. at 18-21. The OCA submits that UGI's arguments on this issue are without merit and should be rejected.

On January 26, 2018, UGI witness Sorber provided Direct Testimony on the Company's plans for a new Electric Division Operations and Engineering Center (Operations Center). UGI St. 3 at 16-18. At that time, the proposed cost for this investment was $10 million. Id. On May 25, 2018, UGI witness Sorber provided his Rebuttal Testimony wherein he significantly modified his original testimony as to UGI's plans for its proposed Operations Center. UGI St. 3R at 17-19. The Company was now planning on looking at the purchase and remodel of an existing building, and the original cost estimate had now risen to $17.3 million. Id. After review of Mr. Sorber's Rebuttal Testimony, and after further investigation, the OCA determined that it would oppose the inclusion of the Operations Center in UGI's rate base based on the Company's substantially

changed plans, large increase in budget and also based on the fact that very little had actually been done to advance this new proposal to completion.[4] See OCA St. 1-S at 2-3.

In the R.D., the ALJs reviewed the evidence of record in this matter, including the various filed testimonies and the further evidence adduced at the hearings and agreed with the OCA that "too much uncertainty" surrounded the issue of whether the Operations Center could actually be operational during the FPFTY. R.D. at 23-24. In the OCA's view, the ALJs' decision on this matter is well grounded. It is indisputable that UGI has the burden of proof here. UGI's changing positions and lack of any substantial process toward the completion of its proposed Operations Center simply do not provide sufficient evidence to carry its burden on this issue. As such, the OCA submits that the ALJs' decision on this matter should be upheld.

OCA Reply Exception No. 3: The ALJs Properly Concluded That UGI Should Be Required To Refund To Customers The 2018 Savings Resulting From The Tax Cuts And Jobs Act. (R.D. at 90-105; OCA M.B. at 37-40; OCA R.B. at 18-19)

In the R.D., the ALJs concluded that UGI should be required to refund to customers the 2018 tax savings resulting from the Tax Cuts and Jobs Act of 2017 (TCJA). R.D. at 105. The ALJs noted that "it is appropriate to characterize this massive tax cut as nothing short of an extraordinary one-time event that is unlikely to be repeated." R.D. at 103. The ALJs found that "ordering UGI Electric to flow back the TCJA tax savings does not constitute impermissible retroactive or single issue ratemaking." R.D. at 105. The ALJs further found, "Flowing back the windfall amounts is fair, just and reasonable." R.D. at 105.

A. The ALJs Properly Classified The TCJA Savings As Both Extraordinary And Nonrecurring And Determined That Flowing Back TCJA Savings To Customers Does Not Constitute Impermissible Retroactive Or Single-Issue Ratemaking.

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[4] Contrary to UGI's assertions in its Exceptions, the OCA's course of action in this matter was entirely reasonable and appropriate considering the substantially changed circumstances between the Company's Direct and Rebuttal testimonies.

In its Exceptions, UGI claimed that flowing back TCJA savings to customers constitutes impermissible retroactive and single-issue ratemaking. UGI Exc. at 23-26. UGI argued that the ALJs improperly classified the TCJA savings as both extraordinary and non-recurring. UGI Exc. at 24, 25. UGI further argued that "a change in the tax law is not extraordinary" and is not a "one-time, non-recurring event." UGI Exc. at 24.

The process of establishing base rates is generally forward looking, without "line by line examination of the relative success or failure of the utility to have accurately projected its particular items of expense or revenue." Philadelphia Electric Co. v. Pa. PUC, 502 A.2d 722, 727-28 (Pa. Commw. 1985). An exception to this rule has been recognized where the expenses are extraordinary, substantial, and nonrecurring. Id.; see Popowsky v. Pa. PUC, 695 A.2d 448 (Pa. Commw. 1997) (Change in accounting standards imposes substantial expenses which could not have been anticipated at the time of the prior base rate case).

The significant changes in the tax law that took effect January 1, 2018, could not have been anticipated and the changes in utilities' tax expenses as a result of the TCJA are substantial. OCA witness Morgan testified that the TCJA is a "*significant* decrease in the tax rate. . . or a 40% decrease in the tax rate." OCA St. 1S at 6 (emphasis added). A change of this magnitude cannot be characterized as routine or minuscule. Moreover, UGI mischaracterizes OCA witness Morgan's testimony when it states that the TCJA is a "recurring and ongoing expense reduction that clearly does not qualify for any exception to single issue ratemaking" and that "Mr. Morgan agreed with this conclusion." UGI Exc. at 24. During the Evidentiary Hearings, when asked if the TCJA is "an ongoing recurring reduction in tax expense," OCA witness Morgan stated, "it's a new *tax rate* that's ongoing." Tr. at 150 (emphasis added). Mr. Morgan testified that the new 21% tax rate is ongoing and will be in effect in future years. Tr. at 150. Mr. Morgan did *not* testify,

however, that the over-collection of taxes is ongoing. Tr. at 150. The over-collection of taxes is a one-time, nonrecurring event that will end when the Company's rates begin to reflect the 21% tax rate, rather than the old 35% tax rate. Tr. at 150. Therefore, the TCJA savings are, contrary to UGI's claims, both extraordinary and nonrecurring.

The Commission recognized this point in its Temporary Rates Order, Tax Cuts and Jobs Act of 2017, Docket No. M-2018-2641242 (Order entered May 17, 2018) (TCJA Order). In particular, the Commission stated: "While ratemaking is generally prospective in nature, an exception to this rule applies in the case of expenses that are extraordinary, substantial *and* nonrecurring. *Philadelphia Electric Co. v. Pa. Public Utility Commission*, 502 A.2d 722 (Pa. Cmwlth. 1985). In this regard, we agree with the OCA that the TCJA tax savings represent 'an extraordinary and substantial, non-recurring reduction in utility expenses.'" TJCA Order at 15 (emphasis added). The Commission concluded there is "no legal impediment" to consideration of the TCJA's impact on the just and reasonableness of rates. Id.

The R.D. is consistent with the TCJA Order, which concludes that the TCJA tax savings are both an extraordinary and non-recurring event to which the rules against retroactive and single-issue ratemaking do not apply. In particular, the ALJs noted that "it is appropriate to characterize this massive tax cut as nothing short of an extraordinary one-time event that is unlikely to be repeated" and recognized that "the Commission considered the TCJA to represent such an extraordinary and substantial, non-recurring reduction in utility expenses." R.D. at 103, 104.

The OCA submits that the ALJs properly classified the TCJA savings as both extraordinary and nonrecurring. The OCA further submits that flowing back the TCJA savings to customers does not constitute impermissible retroactive or single-issue ratemaking. Therefore, the OCA

respectfully requests that the Commission deny UGI Exception No. 4 and adopt the ALJs' determination that the TCJA savings should be flowed back to customers.

B. The ALJs Did Not Engage In Impermissible Retroactive or Single-Issue Ratemaking And Properly Evaluated, In The Context Of This Base Rate Case, All Relevant Criteria In Determining That The TCJA Savings Constitute A Windfall To UGI.

In its Exceptions, UGI claimed that, before engaging in impermissible retroactive and single-issue ratemaking, the ALJs failed to address the Company's earnings relative to the 2018 tax savings resulting from the TCJA. UGI Exc. at 26-28. UGI argued that the ALJs incorrectly determined that the TCJA savings are a windfall to the Company. UGI Exc. at 28.

As noted above, the TCJA savings are extraordinary and non-recurring and do not constitute impermissible retroactive or single issue ratemaking. Accordingly, in the TCJA Order, the Commission ordered utilities *without* pending base rate cases to file temporary rates in the form of a negative surcharge that "reflects the annual reduction in federal tax expense and associated revenue requirement." Id. at 17. The Commission subsequently issued utility-specific orders addressing the negative surcharge for these utilities.[5] Conversely, the Commission ordered utilities *with* pending base rate cases, including UGI, to "address the effect of the federal tax rate reduction on the justness and reasonableness of the consumer rates charged during the term of the suspension period" in their respective base rate cases. Id. at 20. The Commission then consolidated the temporary rates tariff filings with the respective pending Section 1308(d) cases. Id. at 20, 21.

The ALJs' decision is consistent with the TCJA Order, which directs utilities with pending base rate cases to address issues relating to the TJCA savings in the context of those base rate cases. The ALJs recognized that the Commission "noted that UGI Electric did have a base rate

[5] UGI argued that the ALJs should have looked to the Commission's subsequent Order addressing PPL's negative surcharge. UGI Exc. at 27. The OCA notes that this Order pertains to a company without a pending base rate case, while the Commission directed that the impact of the TCJA on UGI's rates be addressed in the present base rate case.

case pending, and that a determination on flow back should wait until that case has concluded." R.D. at 104. The ALJs properly evaluated the issue of the TCJA savings in the context of this base rate case and concluded, based on record evidence, that UGI should flow back the TCJA savings to customers in order to ensure just and reasonable rates. R.D. at 104-105. In the R.D., the ALJs stated, "Although UGI Electric was provided with an opportunity to try to avoid flow back of the TCJA tax savings due to the pending rate case, we are unpersuaded by UGI Electric's arguments that it should be allowed to retain that money." R.D. at 104.

With regard to earnings, the record shows that the earnings presented by UGI do not support the claim that it is unreasonable to require the flow back of the TCJA savings. For instance, I&E witness Wilson disagreed that the Company's rate of return at present rates for the FTY was 4.83%. I&E St. 1 at 32. I&E witness Wilson testified that, as I&E witness Kubas determined, there is "apparent manipulation by the Company to portray lower historic rate of return figures." I&E St. 1 at 33; <u>see</u> I&E R.B. at 46. Further, I&E witness Kubas noted that UGI's rate of return was higher than the Company indicated. I&E St. 5 at 7. Based on the record in this proceeding, which shows that the calculation presented by UGI was understated, the ALJs were appropriately "unpersuaded . . . that [UGI] should be allowed to retain that money." R.D. at 104. Likewise, with regard to the Company's arguments regarding lower cash flow and credit ratings, the ALJs correctly determined, "we cannot agree with UGI that returning the TCJA tax savings would result in a decreased credit profile and an increased cost to obtain credit and capital." R.D. at 104.

Further, the record shows that UGI Electric calculated $212,677 as the amount of 2018 tax savings to be returned to customers, although the Company now argues that it did not receive a windfall as a result of the TCJA. OCA St. 1 at 14; I&E St. 1 at 34; UGI St. 9R at 2; <u>see</u> OCA M.B. at 40. As OCA witness Morgan and I&E witness Wilson noted, in response to discovery, UGI

explained that "the estimated tax savings was calculated by multiplying the effective tax rate pre- and post-enactment of TCJA against actual earnings before taxes for January - February 2018 plus budgeted earnings before taxes for March - September 30, 2018." OCA St. 1 at 14; I&E St. 1 at 34. Additionally, OCA witness Morgan testified, "When there is a significant decrease in the tax rate, from 35% to 21% . . . allowing a utility to retain the savings would result in a windfall to shareholders." OCA St. 1S at 6-7. Mr. Morgan also testified that "retaining the savings would result in unjust rates." OCA St. 1S at 7. Therefore, the ALJs properly determined that "[f]lowing back the windfall amounts is fair, just and reasonable." R.D. at 105.

The OCA submits that the ALJs did not engage in impermissible retroactive or single-issue ratemaking and that the ALJs properly addressed the TCJA savings in this base rate case, which included an evaluation of the Company's earnings. The OCA further submits that the ALJs properly concluded that the TCJA savings are a windfall to the Company. Therefore, the OCA respectfully requests that the Commission deny UGI Exception No. 4 and adopt the ALJs' determination that the TCJA savings should be flowed back to customers.

OCA Reply Exception No. 4: The ALJs Properly Concluded That UGI's Rate Base Should Be Reduced To Reflect Excess Accumulated Deferred Income Taxes. (R.D. at 90-107; OCA M.B. at 40-44: OCA R.B. at 19-21)

In the R.D., the ALJs concluded that "the excess ADIT should be recognized as an offset to UGI Electric's rate base." R.D. at 105. The ALJs determined that "just because the name of the account in which these funds are held changes, ratepayers should not be penalized by not including the funds in the rate base given the funds are still restricted as if they were protected ADIT." R.D. at 105; OCA St. 1 at 13.

In its Exceptions, UGI claimed that the ALJ improperly determined that excess accumulated deferred income taxes (EDIT) should be recognized as an offset to rate base.

UGI Exc. at 28-30. The Company argued that the ALJs incorrectly found that EDIT funds "were, and continue to be, ADIT funds." UGI Exc. at 30; R.D. at 107.

As OCA witness Mierzwa testified, "even though [the funds] are now placed in an account by another name, they are still treated as protected ADIT and have not been fully returned to ratepayers." OCA St. 1 at 12-13. OCA witness Mierzwa explained:

> I believe these funds should continue to be included in rate base as a reduction because, even though they are being transferred from the ADIT account to a regulatory liability account, they have not fully shed the restriction of the tax laws, and I would argue that they also have not lost their character as part of Federal tax policy. Federal tax policy made accelerated depreciation available to companies as an incentive to finance expansion. Accelerated tax depreciation means that businesses write-off (depreciate) assets quicker and since depreciation reduces taxes, the tax savings is a source of funds to the business. That source of funds can be used to pay off financing or for other general operational uses.
>
> According to the Company, the funds which now make up the regulatory liability account are primarily made up of amounts that were recorded as protected ADIT. Protected ADITs were, for the most part, derived from the use of accelerated tax depreciation. Under Code Sec. 167 and Code Sec. 168 of Federal tax regulations, regulatory commissions are restricted from flowing the tax benefits of protected ADIT to ratepayers faster than the turn around of those tax benefits. Similarly, even as they are now considered to be excess deferred taxes and transferred to a regulatory liability account, these funds are still restricted by the tax provision that now requires that they be flowed back to ratepayers using the ARAM. ARAM essentially restricts the flow back of the excess deferred taxes (the regulatory liability) before the tax benefits turn around.
>
> . . .
>
> Therefore, *just because the name of the account in which these funds are held has changed, ratepayers should not be penalized by not including the funds in rate base* given the funds are still restricted as if they were protected ADIT. It is important to note that the reason the ADITs were included in rate base was to recognize the fact that they provide a source of cost-free capital.

OCA St. 1 at 12-13 (emphasis added). Further, I&E witness Christine Wilson agrees that EDIT should be recognized as an offset to rate base. I&E St. 1SR at 38, 39. OSBA also agrees that EDIT should be reduced from rate base. OSBA M.B. at 12-16.

The ALJ properly concluded that UGI's rate base should be reduced to reflect EDIT.[6] Therefore, the OCA submits that the Commission should deny UGI Exception No. 5 and adopt the ALJs' recommendation to reduce rate base to reflect EDIT.

OCA Reply Exception No. 5: The ALJs Properly Concluded That UGI's Company Owned Services Program Transition Should Be Approved With Certain Conditions. (R.D. at 31-34; OCA M.B. at 26-27; OCA R.B. at 13)

In the R.D., the ALJs approved the full amount of the expense claim associated with UGI's proposed Company Owned Services (COS) Transition Program "under the conditions that UGI Electric is (1) prohibited from earning a profit from the program, (2) prohibited from terminating service in conjunction with the program, and (3) required to coordinate with BCS and the OCA in implementing and executing the program." R.D. at 34. The ALJs noted, "UGI Electric has already agreed to follow the three aforementioned conditions." R.D. at 34.

In its Exceptions, I&E argued that an allowance of $140,000 is more appropriate for the program. I&E Exc. at 15. I&E noted, however, that "even though I&E argues against the COS program expense, I&E is not advocating to eliminate it entirely." I&E Exc. at 15.

The OCA does not oppose the COS Transition Program and associated expenses as the program addresses a unique safety issue. OCA witness Mierzwa explained, however, that the program must be subject to certain limitations. OCA St. 4 at 28. Mr. Mierzwa testified:

> UGI should only be entitled to recover the expenses associated with the Program, and not profit in anyway. Under no circumstances should service be terminated under the Program. In addition, since the program impacts nearly 10 percent of UGI's Residential Customers, the Company should coordinate its efforts with the Commission's Bureau of Consumer Services and the OCA.

[6] The OCA submits, however, that the amount of EDIT to be deducted from rate base should be based on the average balance, $10.876 million, and that the Commission should reject the ALJs' recommendation as to the calculation of the amount of EDIT to be reduced from rate base. See OCA Exc. at 19-20.

OCA St. 4 at 28. In this regard, UGI witness Sorber testified that "the Company will not profit from this program" and that coordination with BCS and the OCA "will aid with customer acceptance and understanding of the need and potential benefits of the program." UGI St. 3R at 9, 10. Further, as the ALJs noted, "UGI Electric . . . can find other alternatives to achieve access to homes without threatening to terminate service." R.D. at 34.

The ALJs properly concluded that the COS Transition Program and associated expenses should be approved under three conditions. R.D. at 34. Therefore, the OCA respectfully requests that the Commission adopt the ALJs' determination to approve COS Transition Program and associated expenses and, importantly, apply the following conditions to the program: UGI Electric is (1) prohibited from earning a profit from the program, (2) prohibited from terminating service in conjunction with the program, and (3) required to coordinate with BCS and the OCA in implementing and executing the program. R.D. at 34.

OCA Reply Exception No. 6: The ALJs Properly Concluded That UGI's Environmental Remediation Expense Claim Should Be Rejected. (R.D. at 34-36; OCA M.B. at 28-30, OCA R.B. at 13-14)

In the R.D., the ALJs agreed with the OCA and I&E that it is "appropriate to recover the costs of the remediation from the sales proceeds rather than to pass those costs onto ratepayers." R.D. at 36. The ALJs found that "[w]ith remediation, the value of the property will certainly increase, increasing the gain that UGI Electric will receive from selling the property," and that the "expenses related to the remediation of site 'Forty Fort' can be recovered from the sales proceeds." R.D. at 36. Accordingly, the ALJs concluded that the remediation expense claim should be disallowed in its entirety and that the OCA's adjustment should be accepted. R.D. at 36.

In its Exceptions, UGI claimed that the R.D. ignores precedent and improperly reaches outside of the FPFTY. UGI Exc. at 34. The Company argued that "the building may or may not

be sold" and that, in the event of a sale, the gain on the sale of the land "belongs to shareholders." UGI Exc. at 35, 36. UGI further argued that "the environmental degradation was incurred in service to customers" and should be paid by customers. UGI Exc. at 35.

The environmental remediation, however, is being undertaken as part of the forthcoming sale of the property. See UGI St. 3 at 18, UGI St. 3RJ at 4. UGI witness Sorber testified, "As part of a . . . relocation and *sale of the existing UGI Electric warehouse property*, a minor amount of ground remediation will be required within one of the existing large warehouse buildings." UGI St. 3 at 18 (emphasis added). Mr. Sorber also testified that "the Company is conducting this remediation *in anticipation of selling the building.*" UGI St. 3RJ at 4 (emphasis added). As OCA witness Morgan explained, "without the remediation, the sale of the property would be impaired" and, therefore, "there is a direct correlation of the remediation and the salability of the property." OCA St. 1S at 5. Mr. Morgan further explained:

> Given that the property is being sold, I believe it is appropriate to recover the cost of the remediation for the sales proceeds rather than to pass those costs onto ratepayers. Given the age of the property, a gain is likely to be recognized on the apportionment of the sales price to the land. It is appropriate to reduce the gain on the land by the remediation cost because without the remediation, the value of the land on the sale would decline.

OCA St. 1 at 17. I&E witness Wilson also testified that "these costs should be removed from the cost of service, because they should be recovered from the sales proceeds." I&E St. 1SR at 6-7.

The ALJs properly determined that UGI's environmental remediation expense claim should be rejected and that the OCA's adjustment to reduce O&M expense by $139,000 should be accepted. R.D. at 36. Therefore, the OCA respectfully requests that the Commission deny UGI Exception No. 7 and adopt the ALJs' determination as to environmental remediation expense.

OCA Reply Exception No. 7: <u>The ALJs Properly Concluded That The Scale Back In This Proceeding Should Be Applied Proportionally.</u> (R.D. at 130-131; OCA M.B. at 93; OCA R.B. at 44)

In the R.D., the ALJs determined that the scale back should be applied proportionally to rates. R.D. at 131. In particular, the ALJs concluded, "As we are also recommending a lesser increase than sought by the Company, the Commission should reduce the customer charges and usage rates proportionally to the percent increase originally requested." R.D. at 131.

In its Exceptions, UGI claimed 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 any proposed increase to customer charges." UGI Exc. at 37. I&E similarly claimed that "usage rates should be scaled back prior to any scale back of the customer charge." I&E Exc. at 33.

The OCA submits that the scale back must be applied proportionally to rates. OCA witness Mierzwa testified, "In the event that UGI's authorized increase is less than its requested increase, I recommend a proportionate scale-back of the increase for each rate class." OCA St. 4 at 22. UGI's proposal attempts to place the bulk of the increase on the customer charge. As OCA witness Mierzwa stated, the $14.00 customer charge includes "costs not properly included in a customer charge," "reflects an increase that is 6.6 times the proposed increase for the average Residential class," and is "inconsistent with the principle of gradualism."[7] OCA St. 4 at 23. Accordingly, disproportionally applying the scale back such that the customer charge is not scaled back, while other rates are scaled back, is not appropriate here.

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[7] As discussed in the OCA's Exceptions, a $14.00 customer charge is unreasonable and the OCA's proposed customer charge of $8.00 should be adopted. OCA Exc. at 34-39.

The ALJs properly concluded that the scale back should be applied proportionally to rates.[8] R.D. at 131. Therefore, the OCA respectfully requests that the Commission deny UGI's Exception No. 9 as well as I&E Exception No. 19 and simultaneously apply a proportionate scale back to the customer charges and usage rates.

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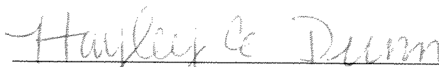
[8] As discussed in the OCA's Exceptions, UGI's CCOSS and revenue allocation are significantly flawed and the OCA's revenue CCOSS and revenue allocation should be adopted in this proceeding. OCA Exc. at 24-34. Therefore, it follows that the rate increase should be scaled back from the OCA's allocation, rather than UGI's allocation.

III. CONCLUSION

For the reasons set forth below, the OCA submits that the ALJs properly concluded that: (1) UGI's arguments intended to artificially inflate the cost of common equity are without merit and should be rejected, (2) UGI's claim to recover the costs of the proposed Operations Center should be rejected, (3) UGI should be required to refund to customers the 2018 tax savings resulting from the Tax Cuts and Job Act of 2017, (4) UGI's base rate should be reduced to reflect excess accumulated deferred income taxes, (5) UGI's Company Owned Service Transition Program should be approved with certain conditions, (6) UGI's environmental remediation expense claim should be rejected, and (7) the scale back in this proceeding should be applied proportionally. The OCA respectfully requests that the Commission deny UGI's Exceptions as well as the above-mentioned portions of I&E Exceptions and modify the R.D. in the manner set forth in the OCA's Exceptions.

Respectfully Submitted,



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