COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
COMMONWEALTH KEYSTONE BUILDING
400 NORTH STREET, HARRISBURG, PA 17120

BUREAU OF
INVESTIGATION
&
ENFORCEMENT

January 8, 2020

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

Re: Pennsylvania Public Utility Commission v.
Wellsboro Electric Company
Supplement No. 125 to Tariff Electric – Pa. PUC No. 8
Docket No. R-2019-3008208
I&E Main Brief

Dear Secretary Chiavetta,

Enclosed please find the Bureau of Investigation and Enforcement's (I&E) **Main Brief** in the above-captioned proceeding.

Copies are being served on active parties of record as evidenced in the attached Certificate of Service. Should you have any questions or concerns, please do not hesitate to contact me.

Sincerely,

John M. Coogan
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JMC/ac
Enclosure

cc: Honorable Steven K. Haas (*ALJ, PUC Harrisburg*)
Honorable Benjamin J. Myers (*ALJ, PUC Harrisburg*)
Per Certificate of Service

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2019-3008208
	:	
Wellsboro Electric Company	:	

MAIN BRIEF OF THE BUREAU OF INVESTIGATION AND ENFORCEMENT

John M. Coogan
Prosecutor
PA Attorney ID No. 313920

Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
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Dated: January 8, 2020

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I. INTRODUCTION

A. History of the Proceeding

On July 1, 2019, Wellsboro Electric Company ("Wellsboro" or "Company"), filed Supplement No. 125 to Tariff Electric Pa. P.U.C. No. 8 which proposed an annual distribution revenue increase of $1,419,610 (27.7%), to become effective August 30, 2019. Wellsboro used the Fully Projected Future Test Year ("FPFTY") as the basis for its rate increase request.[1] Also on July 1, 2019, Wellsboro filed a Petition for Waiver of Filing Requirements Under 52 Pa. Code § 53.53 ("Petition"), requesting waiver of the informational requirements for general rate increase requests in excess of $1,000,000 as set forth in 52 Pa. Code § 53.53 of the Commission's regulations. The Commission's Bureau of Investigation and Enforcement ("I&E"), the Pennsylvania Office of Consumer Advocate ("OCA"), and the Pennsylvania Office of Small Business Advocate ("OSBA") filed both a Joint Answer in opposition to Wellsboro's Petition, as well as a Motion of the Joint Statutory Advocates to Reject the Base Rate Filing ("Joint Motion to Reject") on July 22, 2019.[2] On July 29, 2019, Wellsboro filed its Answer to the Joint Motion to Reject. On July 31, 2019, Wellsboro filed revised schedules and tariff pages with a revised annual distribution revenue increase of $999,967 (19.5%), without withdrawing the Petition or waiving its rights to appeal the staff determination. On August 8, 2019,

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1 The FPFTY ends December 31, 2020, the future test year ("FTY") ended December 31, 2019, and the historic test year ("HTY") ended December 31, 2018. Wellsboro Statement No. 1, p. 2.

2 I&E and OSBA entered their appearances in this proceeding on July 19, 2019 and July 22, 2019, respectively. OCA filed a Formal Complaint on August 5, 2019.

the Commission denied Wellsboro's Petition for Waiver of Filing Requirements Under 52 Pa. Code § 53.53.

On August 29, 2019, pursuant to 66 Pa. C.S. § 1308(d), the Commission ordered suspension of the proposed tariff changes until March 30, 2020, unless permitted by Commission Order to become effective at an earlier date. The Commission directed that the case be assigned to the Office of Administrative Law Judge for Alternative Dispute Resolution, if possible, and scheduling of hearings as may be necessary for the Administrative Law Judge to render a Recommended Decision. On September 9, 2019, the Company filed a tariff suspension, voluntarily suspending its proposed tariff to April 29, 2020. A Prehearing Conference was held on September 13, 2019 at 10:00 a.m., before Administrative Law Judges Steven K. Haas and Benjamin J. Myers ("ALJs").

Pursuant to the procedural schedule agreed to at the Prehearing Conference, the parties exchanged direct, rebuttal, and surrebuttal testimony, as well as oral rejoinder outlines. I&E served the following testimony and exhibits:

- I&E Statement No. 1, I&E Exhibit No. 1, I&E Statement No. 1-SR, and I&E Exhibit No. 1-SR, the prepared direct and surrebuttal testimony and exhibits of I&E witness D.C. Patel, who addressed the Company's operating and maintenance expenses, and overall revenue requirement;

- I&E Statement No. 2, I&E Exhibit No. 2, and I&E Statement No. 2-SR, the prepared direct and surrebuttal testimony and exhibit of I&E witness Anthony Spadaccio, who addressed the Company's rate of return request;

- I&E Statement No. 3, I&E Exhibit No. 3, and I&E Statement No. 3-SR, the prepared direct and surrebuttal testimony and exhibit of I&E witness Ethan Cline, who addressed the Company's rate base and rate structure requests.

Full evidentiary hearings were held December 16 and 17, 2019, in Harrisburg. I&E files this Main Brief pursuant to the procedural schedule established in this case.

B. Burden of Proof

The Company carries the burden of proof to show its rate proposal is just and reasonable.[3] Wellsboro must satisfy its burden of proof by presenting a preponderance of evidence.[4] A preponderance of the evidence is evidence that is more convincing, by even the smallest amount, than that presented by another party.[5] In base rate cases, the Commission has affirmed the utility's burden to establish the justness and reasonableness of every component of its rate request.[6] The burden of proof does not shift to parties challenging a requested rate increase.[7] Additionally, the Company must produce substantial evidence to satisfy its burden.[8] Substantial evidence is "such relevant and competent evidence having a rational probative force which a reasonable mind might accept as adequate to support a conclusion."[9] Thus, Wellsboro must affirmatively prove the justness and reasonableness of each element of each of its claims.

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[3] *See* 66 Pa.C.S. § 315(a); *Irwin A. Popowsky v. Pa. P.U.C.*, 674 A.2d 1149 (Pa. Cmwlth. 1996).
[4] *Samuel J. Lansberry, Inc. v. Pa. P.U.C.*, 578 A.2d 600 (Pa. Cmwlth. 1990).
[5] *Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1950).
[6] *See, e.g., Pa. P.U.C. v. PPL Electric Utilities Corporation*, 2012 WL 6758304 (Pa. P.U.C. 2012); *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, 2004 WL 2314523 (Pa. P.U.C. 2004).
[7] Id.
[8] *See Brockaway Glass v. Pa. P.U.C.*, 437 A.2d 1067 (Pa. Cmwlth. 1981); *Lower Frederick Township v. Pa. P.U.C.*, 409 A.2d 505 (Pa. Cmwlth. 1980).
[9] *Dutchland Tours, Inc. v. Pa. P.U.C.*, 337 A.2d 922, 925 (Pa. Cmwlth. 1975).

II. SUMMARY OF ARGUMENT

A. Statement of the Questions Involved

Question: Has Wellsboro met its obligation to present a preponderance of substantial evidence to demonstrate each element of each of its claims in its base rate increase proposal is just and reasonable?

Suggested Answer: No. I&E expert witnesses have provided testimony demonstrating certain claims are not just and reasonable. Therefore, Wellsboro's proposal should only be approved to the extent consistent with and as modified by I&E's analyses and recommendations presented below.

B. Summary

I&E avers Wellsboro has failed to fully carry its burden of proof with respect to its proposed revenue increase of $999,967. To the contrary, I&E's presentation of expert witness testimony at a full evidentiary hearing demonstrates that Wellsboro should receive a revenue increase of no more than $719,538. I&E's recommendation is based upon specific adjustments offered by I&E witnesses, as set forth herein and summarized in Table I (Income Summary), Table II (Summary of I&E Adjustments), and Table III (Rate of Return).[10]

1. Rate Base

I&E witness Ethan Cline's provided testimony regarding three issues related to rate base: Construction Work in Progress ("CWIP"), Materials and Supplies, and Cash Working Capital ("CWC"). I&E and the Company agree that CWIP should be removed

[10] Tables I, II, and III are attached at Appendix A.

from the FPFTY rate base as originally filed. The Company also agreed with I&E witness Cline's adjustment to Materials and Supplies based on a 13-month average. However, I&E recommends the Commission adjust the Company's CWC allowance downwards to reflect I&E's recommendations regarding expenses.

2. Revenues

Based on use of a three-year average, I&E witness Cline recommends revenue from Forfeited Discounts increase by $1,734, and the Company include revenue from Forfeited Discounts equal to the percentage of sales the Company is ultimately granted the opportunity to recover through rates by the Commission.

3. Expenses

I&E witness D.C. Patel recommends downward adjustments to Wellsboro's as-filed expense claims for Operations Supervision and Engineering Expense, Maintenance Supervision and Engineering Expense, Miscellaneous Distribution Expense, Regulatory Commission Expense, Safety and Communication Expense, Maintenance of Overhead Lines, Office Supplies and Expenses, and Rate Case Expense. As demonstrated by I&E witness Patel, Wellsboro did not provide an adequate basis to prove these particular expense claims are just and reasonable. Additionally, I&E strongly opposes Wellsboro's attempt to wholesale undermine I&E's individual expenses analyses by claiming updated expense figures for <u>all</u> accounts in Company rebuttal testimony cancel out I&E's recommendations. Although I&E did consider updates to expenses it recommended adjustments to in direct testimony, Company rebuttal testimony updating other expenses not subject of non-company direct testimony should be disregarded. An attempt to introduce late-filed claims in rebuttal testimony is a violation of due process principles and Commission regulations.

4. Fair Rate of Return

I&E witness Anthony Spadaccio calculates a fair rate of return for Wellsboro is 6.53%. I&E witness Spadaccio adopted Wellsboro witness Dylan D'Ascendis's capital structure and cost of long-term debt. Therefore, the sole issue in dispute is a fair return on common equity. I&E witness Spadaccio calculated a 8.10% return on equity. As endorsed by the Commission, I&E witness Spadaccio's analysis primarily relies on his Discounted Cash Flow ("DCF") analysis, with use of the Capital Asset Pricing Model ("CAPM") as a comparison.

I&E witness Spadaccio submits Wellsboro witness D'Ascendis significantly overstates a just and reasonable return for the Company, reflecting a 10.30% return on equity. First, Wellsboro witness D'Ascendis uses a flawed proxy group. Second, Wellsboro witness D'Ascendis improperly gives other methods equal weighting to his DCF analysis. The Commission has clearly stated the DCF method should be the primary method to determine cost of common equity. Additionally, as part of his flawed used of various methods, Wellsboro witness D'Ascendis inappropriately (1) relies upon proprietary software to perform a flawed predictive risk premium ("PRPM") analysis;[11] (2) compares Wellsboro to competitive, non-regulated companies;[12] (3) estimates a risk-free rate based on 30-year U.S. Treasury Bonds as part of his CAPM analysis; (4) uses an

[11] As explained by I&E witness Spadaccio, PRPM is a type of risk premium ("RP") analysis.

[12] As explained by I&E witness Spadaccio, such analysis is a blend of the Comparable Earnings ("CE") approach into the DCF, RP, and CAPM methods.

empirical capital asset pricing model to adjust his CAPM results upward; and (5) claims a market-to-book ratio above 1.0 should discount the DCF method. Finally, Wellsboro witness D'Ascendis unjustly claims the Company's return on equity should be adjusted upwards by 1.25% - 100 basis points for a size adjustment, and 25 basis points as a performance factor adjustment. I&E witness Spadaccio submits evidence demonstrating a size adjustment for Wellsboro and the utility industry generally is inappropriate. Regarding a performance factor adjustment, I&E witness Spadaccio opines, for any company, true management effectiveness is earning a higher return through its efficient use of resources and cost cutting measures. Further, I&E witness Spadaccio states Wellsboro should not be granted additional basis points for doing what it is required to do in order to provide adequate, efficient, safe, and reasonable service.

5. Taxes

I&E's various recommendations have a flow-through impact on the Company's taxes for the FPFTY as depicted in the attached Table I.

6. Customer Rate Structure

Based on Wellsboro's cost of service study, I&E recommends rate class POL be allocated neither an increase nor decrease under proposed rates. Instead, the proposed reduction to POL should be reallocated to the MSL and CS rate classes. Both rate classes have a relative rate of return of more than 1.0, indicating those classes are generating revenue greater than its cost to serve.

Wellsboro's rate structure proposal also includes shifting a portion of demand charges into the customer charge, which increases the residential customer charge from the present rate of $10.79 to its proposed $13.40 (24.2%). Wellsboro characterizes this proposal as alternative ratemaking. I&E opposes Wellsboro's proposal for two reasons. First, demand charges are appropriately not included in the customer charge because the customer charge is limited to the direct costs associated with billing an individual customer. In contrast, if demand charges are recovered through the customer charge, customers will be sent an inaccurate message that usage does not affect distribution system costs. Second, simply because Wellsboro's characterizes its proposal as "alternative ratemaking", does not make it valid under either Act 58 or Commission regulations. Instead, Wellsboro's proposal violates several important ratemaking principles retained under alternative ratemaking. Specifically, Wellsboro's proposal creates negative incentives regarding efficiency, is contrary to cost of service principles, does not consider customer impacts, and does not avoid unnecessary capital investments.

If the Commission grants less than Wellsboro's requested increase, the Commission should proportionally scale-back rates based upon the cost of service study including customer charges, usage rates, and rate classes only if they received a proposed increase, with the exception of rate class MBL, which would be moved further away from its cost of service if it received a scale-back.

7. Miscellaneous Issues

I&E witness Cline recommends the Company provide the Commission's Bureaus of Technical Utility Services and I&E an update to certain schedules no later than April 1, 2020 and April 1, 2021, reflecting capital expenditures, plant additions, and retirements by month for the FTY and FPFTY, respectively. I&E witness Cline explained, while the FPFTY allows projections, there should be verification of the projections. Although Wellsboro stated such information can be verified in the next base rate filing, in addition to I&E, the Commission has expressed interest to verify this information, and has broad authority to require such informational filings on a more frequent basis. Additionally, other utilities have consistently agreed to, and the Commission has approved, settlement terms regarding submission of similar reporting requirements.

III. ISSUES RESOLVED AMONG THE PARTIES

Regarding the as-filed FPFTY rate base claim, I&E and the Company agree that CWIP should be removed, and Materials and Supplies should be based on a 13-month average. I&E and Wellsboro also agree on the Company's capital structure and cost of long-term debt used in the rate of return analysis.

IV. RATE BASE

A. Deductions from Rate Base – Construction Work in Progress

The Company's rate base claim includes $59,971 of Construction Work in Progress ("CWIP") based on the December 31, 2018 financial statements and estimated to be the same in the FTY and FPFTY.[13] I&E witness Ethan Cline recommended that the $59,971 CWIP claim be rejected.[14] CWIP allows a utility to recover costs for plant additions that will be completed and in service within six months of the end of the test year. The Company elected to use a FPFTY ending December 31, 2020, which includes

[13] Wellsboro Exhibit_(HSG-1), Schedule C1-6(W), line 5; Wellsboro Statement No. 1, pp. 16-17.
[14] I&E Statement No. 3, p. 10.

projections of plant in service and depreciation that will be recovered in rates during that twelve-month period. However, the Company indicated that all but one of its CWIP projects were estimated to be completed in the FTY; therefore they should already be part of the FPFTY rate base claim.[15] Accordingly, I&E argued that these projects should be included in the Company's FPFTY claim for depreciated original plant in service, not CWIP.[16] To that end, I&E witness Cline stated that if the Company did not accurately reflect the projects included in its CWIP claim in either the FTY and FPFTY, the Company should revise its claim for original cost plant in service, accumulated depreciation, and annual depreciation expense in rebuttal testimony to properly reflect the completed and pending projects during the appropriate test year.[17] The Company accepted I&E's recommended adjustment in rebuttal testimony; therefore, the $59,971 CWIP claim should be removed from the FPFTY rate base reflected in the original filing.[18]

B. Deductions from Rate Base – Materials and Supplies

The Company claimed $245,607[19] for Materials and Supplies in the FPFTY based on the December 31, 2018 financial statements and estimated to be the same in the FTY and FPFTY.[20] The Company did not adequately support this claim because I&E reviewed the Company's monthly Materials and Supplies balances from January 2016

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15 I&E Statement No. 3, pp. 10-11.
16 I&E Statement No. 3, p. 10.
17 I&E Statement No. 3, p. 10-11.
18 Wellsboro Statement No. 1-R, p. 6. To be clear, because the Company accepted I&E's CWIP adjustment in rebuttal, the total rate base figures reflected in I&E's tables at the attached Appendix A do not reflect further downward adjustments for I&E's CWIP recommendation.
19 Wellsboro Exhibit_(HSG-1), Schedule C1-6(W), line 10.
20 Wellsboro Statement No. 1, pp. 16-17.

through June 2019 and determined that the Company's claimed $245,607 did not appear as an actual balance or as an average.[21] I&E recommended an allowance based on the most recent 13-month average of actual inventories, which resulted in a $35,389 reduction to the Company's claim.[22] I&E witness Cline stated that using the recommended 13-month average "is appropriate because it is long enough to smooth out any abnormalities but is short enough so that it does not include stale data."[23] The Company accepted I&E's recommended adjustment in rebuttal testimony;[24] therefore, the Company's Materials and Supplies allowance reflected in the original filing should be reduced by $35,389 from $245,607 to $210,218.[25]

C. Deductions from Rate Base – Cash Working Capital

The Company claimed $388,475 for Cash Working Capital ("CWC"), which was later revised to $362,964.[26] For ratemaking purposes, CWC is the capital needed to operate a utility between the rendition of service and the receipt of revenues in payment for services rendered.[27] In short, CWC covers the lag between the payment of operating expenses and the receipt of revenues from ratepayers. All cash-based expenses are included in the Company's overall CWC claim; therefore, any adjustments to the Company's O&M expense claims impact the CWC allowance. I&E ultimately

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21 I&E Statement No. 3, p. 7.
22 I&E Statement No. 3, pp. 7-8.
23 I&E Statement No. 3, p. 8.
24 Wellsboro Statement No. 1-R, p. 6.
25 Id.; I&E Statement No. 3, p. 7. To be clear, because the Company accepted I&E's CWIP adjustment in rebuttal, this reduction to rate base has already been incorporated into the total rate base figure of $14,614,186 reflected in I&E's tables at the attached Appendix A.
26 Wellsboro Exhibit HSG-1, Schedule C1-6(W); Wellsboro Exhibit HSG-1-R, Schedule C1-6R(W); I&E Statement No. 1-SR, p. 31.
27 I&E Statement No. 1, p. 27.

recommended that Wellsboro's O&M expense claims be reduced by $135,463, which reduces the Company's CWC allowance by $16,933.[28] Because I&E's recommended expense adjustments are prudent for the reasons discussed herein, the CWC allowance of $371,542 ($388,475 - $371,542)[29] is reasonable.

D. Conclusion

Based upon the foregoing, I&E recommends a total $102,293 deduction from Wellsboro's claimed rate base in its original filing. This deduction to rate base reflects I&E's recommended disallowance of CWIP and a reduction to Materials and Supplies and CWC allowances. To be clear, the tables attached to I&E's Appendix A only reflect a recommended reduction to rate base of $16,933 for CWC because Wellsboro's rebuttal position for rate base of $14,614,186 already incorporates a downward adjustment for CWIP and Materials and Supplies as recommended by I&E.[30]

V. REVENUES

A. Forfeited Discounts

I&E recommends that revenue from Forfeited Discounts claimed by Wellsboro be increased by $1,734 from $35,443 to $37,177 for the FPFTY ending December 31, 2020. Additionally, I&E recommends that the Company include revenue from Forfeited Discounts equal to the percentage of sales the Company is ultimately granted the opportunity to recover through rates by the Commission.[31]

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28 I&E Statement No. 1-SR, p. 32.
29 I&E Statement No. 1-SR, p. 32.
30 I&E Statement No. 3-SR, p. 4.
31 I&E Statement No. 3-SR, pp. 10-11.

I&E witness Cline's recommendation is based on average actual Forfeited Discount revenues for 2016, 2017, and 2018 expressed as a percent of sales revenues.[32] Wellsboro witness Howard Gorman agreed that Forfeited Discounts are likely to increase with higher revenue. However, he also stated that Uncollectible Accounts are likely to increase approximately the same amount and, therefore any difference is likely immaterial and I&E's recommended adjustment should be rejected.[33] I&E witness Cline rejected Mr. Gorman's rationale. The Company did project increases in its Uncollectible Accounts in the original filing,[34] so failure to offset this increase by the anticipated growth in Forfeited Discounts is inappropriate.[35] I&E therefore continues to recommend that the Company include revenue from Forfeited Discounts equal to the percentage of sales the Companies are ultimately granted the opportunity to recover through rates by the Commission.[36]

VI. EXPENSES

A public utility is entitled to recover all of its reasonably incurred expenses necessary to provide service to customers.[37] Accordingly, Operating and Maintenance ("O&M") expenses, if properly incurred, may justly inform a rate increase proposal. However, if expenses are unreasonable, e.g., overstated, abnormal, unnecessary, or simply have not been incurred for the test year, they should not be relied upon. As

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32 Specifically, 0.264% x $14,091,744 = $37,177. I&E Statement No. 3, p. 20; I&E Exhibit No. 3, Schedule 8.
33 Wellsboro Statement No. 1-R, p. 7.
34 Wellsboro Exhibit_(HSG-1), Schedule C1-1(W).
35 I&E Statement No. 3-SR, p. 11.
36 I&E Statement No. 3-SR, p. 11.
37 *Butler Township Water Company v. Pa. P.U.C.*, 473 A.2d 219, 221 (Pa. Cmwlth. 1984); *UGI Corp. v. Pa. P.U.C.*, 410 A.2d 923, 932 (Pa. Cmwlth. 1980); *Western Pennsylvania Water Company v. Pa. P.U.C.*, 422 A.2d 906, 908 (Pa. Cmwlth. 1980).

explained above, the Company has the burden of proof regarding the justness and reasonableness of each expense.

A. Total O&M Expenses

In a typical rate case proceeding, a non-company party may, and typically does, challenge specifically identified O&M expenses and recommend an adjustment. However, Wellsboro seeks to fundamentally change the manner in which the parties, and by extension, the Commission, reviews and approves companies' O&M expense claims. Simply put, Wellsboro believes it is appropriate to update each and every O&M expense throughout the course of proceedings, including those expenses parties have not addressed in direct testimony. In this proceeding, Wellsboro introduced updates to essentially all of its O&M expenses in rebuttal testimony.[38] Wellsboro then points to the updates as a basis to invalidate non-company parties' O&M recommendations.[39] This position renders non-company parties' review of O&M expenses in a rate case essentially meaningless. Following Wellsboro's practice to its logical conclusion, the Company would simply be allowed to update all of its O&M expenses at hearings and any non-company position to the contrary would be summarily repudiated.

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[38] Wellsboro Statement No. 1-R, p. 4.

[39] Wellsboro's witnesses Howard S. Gorman, Byron Farnsworth, Jr., and Jill Campbell objected to I&E's recommended O&M adjustments generally. I&E Statement No. 1-SR, p. 5 (citing Wellsboro Statement No. 1-R, pp. 3-5; Wellsboro Statement No. 6-R, pp. 4-5; and Wellsboro Statement No. 5-R, pp. 2-3). I&E witness Patel addressed each of their specific objections in surrebuttal testimony. I&E Statement No. 2-SR, pp. 5-10. I&E specific recommended adjustments to O&M expenses immediately follow this section. In rejoinder testimony, Wellsboro witnesses Gorman and Farnsworth confirmed the Company's continuing general objection to individual O&M adjustment recommendations. Tr., pp. 74-76 (Gorman), 176-177 (Farnsworth).

Wellsboro cites no authority for its position other than appeals to "fairness" and "appropriateness".[40] To the contrary, there is clear legal authority to reject Wellsboro's claimed rationale. First, introducing new claims after non-company parties have addressed the companies' direct position is a violation of due process principles.[41] The concern is simple: parties have not and will not have the opportunity to evaluate late-brought claims. To be clear, I&E's position as explained in the sections below did take into account Wellsboro's rebuttal testimony as it relates to specific claims I&E evaluated in direct testimony. But to voluminously and constantly change the Company's O&M position leaves non-company parties in a hopeless position as to issues not addressed in non-company direct testimony. Second, and relatedly, there are clear Commission regulations that a party cannot introduce evidence in rebuttal phase that should have been included in the party's case-in-chief or substantially varies from the party's case-in-chief.[42] I&E avers Wellsboro's attempt to wholesale revise its O&M position in rebuttal testimony, rather than specifically respond to non-company parties' specific O&M adjustment recommendations, is a prohibited attempt to introduce evidence that should have been introduced in direct testimony.

In addition to being procedurally improper, Wellsboro's position creates factual inaccuracies. In rejoinder testimony, Wellsboro witness Gorman confirms presentation of FPFTY O&M costs is based on an escalation of FTY expenses, and does not remove

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[40] *See, e.g.*, Wellsboro Statement No. 1-R, p. 3.

[41] *See, e.g.*, *Pa. P.U.C. v. City of Lancaster – Sewer Fund*, 2007 WL 517134 (Pa. P.U.C. 2007) (Commission agreed with ALJ "new claims brought in on rebuttal are improper, unfair and a violation of due process").

[42] 52 Pa. Code §§ 5.243(e)(2)-(3).

non-recurring costs and plant activities.[43] But, as Wellsboro witness Gorman also correctly states, "the Company must support each claim made in its rate application."[44] In direct testimony, I&E made recommendations regarding expenses not properly supported by the Company or properly calculated based on information provided by the Company and based on I&E witness Patel's analysis as an expert witness.[45] As I&E witness Patel appropriately opines, an overall adjustment to O&M expenses is not a more accurate method of determining a Company's allowable O&M expenses. [46] Instead, the proper way to analyze a Company's overall O&M expenses is by analyzing individual expense claims.[47] Accordingly, I&E witness Patel recommended disallowance of the total change made to Administrative and General Expense of $204,093 ($1,187,484 - $983,291) made by Wellsboro witness Gorman's between direct and rebuttal testimony,[48] and instead continues to offer the below individual expense adjustments.

It is also important to realize Wellsboro's argument would not be limited to this proceeding only. To the contrary, O&M expenses are a common point of dispute in rate cases. If the Commission allowed this practice here, it will set a very dangerous precedent that would likely be cited by any other utility company where O&M expenses are scrutinized. This will fatally handicap non-company parties' ability to evaluate individual expense accounts. Therefore, the Commission should reject Wellsboro's

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43 Tr., pp. 104-106.
44 Wellsboro Statement No. 1-R, p. 3.
45 I&E Statement No. 1-SR, p. 7.
46 I&E Statement No. 1-SR, p. 7.
47 I&E Statement No. 1-SR, p. 7.
48 Wellsboro Exhibit HSG-1, Schedule C1 (W) and Exhibit HSG-1R, Schedule C1 (R).

attempt to wholesale revise its O&M expenses in rebuttal testimony, and should instead evaluate the merits of the non-company parties' O&M positions.

B. Operations Supervision and Engineering Expense

In direct testimony, I&E witness Patel recommended a $27,724 reduction to a $106,704 total Operations Supervision and Engineering Expense (Account 580).[49] Wellsboro's claim for this expense was based on its FTY estimation.[50] Therefore, adopting Wellsboro's analysis, I&E witness Patel's recommendation was based on six months of annualized actual FTY expenses plus a 3% increase for employee payroll and benefits expense.[51]

Wellsboro witnesses Gorman, Farnsworth, and Campbell disagreed with I&E witness Patel's method of adjusting O&M expenses in general.[52] However, Wellsboro witness Gorman did provide an updated claim for Account 580 of $86,662 in rebuttal testimony based on a nine-month annualization of FTY actual expenses adding a 3% increase for inflation to determine the revised FPFTY claim.[53] While somewhat greater than I&E witness Patel's position, the updated data does support I&E's position that the claim is overstated.[54] Therefore, I&E accepts Wellsboro's revised claim of $86,662, or a $20,042 reduction to a $106,704 total Operations Supervision and Engineering Expense.[55]

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49 I&E Statement No. 1, p. 10.
50 I&E Statement No. 1, pp. 10-11; I&E Exhibit No. 1, Schedule 2, p. 1.
51 I&E Statement No. 1, pp. 10-11. ($38,340 x 2) x 1.03 = $78,980.
52 I&E Statement No. 1-SR, p. 15 (citing Wellsboro Statement No. 1-R, pp. 3-5; Wellsboro Statement No. 6-R, pp. 4-5; and Wellsboro Statement No. 5-R, pp. 2-3).
53 Wellsboro Statement No. 1-R, p. 4.
54 I&E Statement No. 1-SR, p. 17.
55 I&E Statement No. 1-SR, p. 18.

C. Maintenance Supervision and Engineering Expense

I&E recommends Wellsboro reduce its claim for Maintenance Supervision and Engineering Expense of $80,232 by $14,957, to $65,275.[56] In direct testimony, I&E witness Patel recommended a reduction to this expense of $19,571.[57] I&E's recommendation was based on six months of annualized actual FTY expenses ($58,894) plus a 3% increase for employee payroll and benefits expense.[58]

Wellsboro witnesses Gorman and Campbell disagreed with I&E witness Patel's method of adjusting O&M expenses in general.[59] However, Wellsboro witness Gorman updated Wellsboro's claim from $80,232 to $65,275 in rebuttal testimony based on annualizing nine months of FTY actual expenses adding a 3% increase for inflation to determine the FPFTY revised claim.[60] Wellsboro witness Farnsworth thereby responded that using I&E's methodology of adjustment based on annualizing six months of actual FTY expense, I&E's adjustment of $19,571 would be reduced to $14,957 if it is calculated based on a nine-month annualization of FTY expense.[61]

Because I&E's recommendation was based on an annualization of this expense for the Company's FTY, which has now been updated, I&E witness Patel accepted Mr. Farnsworth's recommendation for a reduction to Maintenance Supervision and Engineering Expense to be calculated based on updated nine months of actual FTY

56 I&E Statement No. 1-SR, p. 19.
57 I&E Statement No. 1, p. 12.
58 I&E Statement No. 1, p. 13.
59 I&E Statement No. 1-SR, p. 18 (citing Wellsboro Statement No. 1-R, pp. 3-5; and Wellsboro Statement No. 5-R, pp. 2-3). The witnesses' general objections, and I&E's response, are summarized above in the Total O&M expenses section.
60 Wellsboro Statement No. 1-R, p. 4.
61 I&E Statement No. 1-SR, p. 19 (citing Wellsboro Statement No. 6-R, pp. 8-9).

expense.[62] Therefore, I&E recommends a reduction of $14,957 ($80,232 - $65,275) to the Company's as filed claim for Maintenance Supervision and Engineer Expense.[63]

D. Miscellaneous Distribution Expense

I&E recommends a reduction of $29,016 to Miscellaneous Distribution Expense claim of $219,007.[64] I&E's recommendation is based on an average of most recent three historic years' "other" expense (one of the expense categories included in the Miscellaneous Distribution Expense) because the Company's significantly increased its FPFTY other expense claim (+137.73%) over the HTY expense and this increase was not supported by the fluctuating other expense trend experienced in the last three years. Additionally, the Company's claim was based on the speculative assumption about recurrence of training expenses for new employees at an elevated pace in the FPFTY.[65]

Wellsboro witnesses Gorman, Farnsworth, and Campbell disagreed with I&E witness Patel's method of adjusting O&M expenses in general.[66] Additionally, although Company witness Gorman updated this claim from $219,007 to $232,239 based on the FTY annualization of nine months of actual expense adding a 3% increase for inflation to determine the FPFTY revised claim,[67] no witness directly rebutted the basis of I&E witness Patel's recommended adjustment to "other" expense, a sub-category of expense included in FPFTY Miscellaneous Distribution Expense. I&E witness Patel's

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62 I&E Statement No. 1-SR, p. 19.
63 I&E Statement No. 1-SR, p. 19.
64 I&E Statement No. 1, p. 15.
65 I&E Statement No.1, pp. 15-16.
66 I&E Statement No. 1-SR, p. 20 (citing Wellsboro Statement No. 1-R, pp. 3-5; Wellsboro Statement No. 6-R, pp. 4-5; and Wellsboro Statement No. 5-R, pp. 2-3). The witnesses' general objections, and I&E's response, are summarized above in the Total O&M expenses section.
67 Wellsboro Statement No. 1-R, p. 4.

recommended allowance for other expense is based on an average of the last three years' actual expense to smooth out highs and lows of the expense trend and moderate the Company's speculative assumption about recurring employee training expense included in the other expense category.[68] Therefore, I&E continues to recommend a reduction of $29,016 to the Company's as filed claim for Miscellaneous Distribution Expense.[69]

E. Regulatory Commission Expense

I&E recommends a reduction of $68,710 for Regulatory Commission Expense claim of $107,341.[70] I&E witness Patel's recommendation was based on removal of the 2016 rate case expense amortization of $68,710 from the FPFTY Regulatory Commission Expense claim because only the current allowable rate case expenses should be normalized in the FPFTY.[71] Wellsboro witnesses Gorman, Farnsworth, and Campbell disagreed with I&E witness Patel's method of adjusting O&M expenses in general.[72] However, Wellsboro witness Gorman did provide an updated FPFTY claim of $38,631 in rebuttal testimony, removing the 2016 rate case expense amortization claim of $68,710.[73] Therefore, the Commission should accept Wellsboro's revised claim, and adjust Regulatory Commission Expense downward by $68,710.

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68 I&E Statement No. 1, pp. 15-16.
69 I&E Statement No. 1-SR, p. 22.
70 I&E Statement No. 1-SR, p. 24.
71 I&E Statement No. 1-SR, p. 23.
72 I&E Statement No. 1-SR, p. 23 (citing Wellsboro Statement No. 1-R, pp. 3-5; Wellsboro Statement No. 6-R, pp. 4-5; and Wellsboro Statement No. 5-R, pp. 2-3). The witnesses' general objections, and I&E's response, are summarized above in the Total O&M expenses section.
73 Wellsboro Statement No. 1-R, p. 4.

F. Safety and Communications Expense

In direct testimony, I&E witness Patel recommended a $10,282 reduction to Wellsboro's Safety and Communications Expense claim of $19,197.[74] I&E's recommendation was based on normalizing the tri-annual PUC-required eligible customer list mailing cost of $10,015 over three years and disallowance of the advertising expense claim of $3,605.[75]

Wellsboro witnesses Gorman, Farnsworth, and Campbell disagreed with I&E witness Patel's method of adjusting O&M expenses in general.[76] However, Wellsboro did update its claim for Safety and Communications Expense in rebuttal testimony from $19,197 to $5,013.[77] Although Wellsboro's witnesses did not directly rebut the basis of I&E witness Patel's recommended normalization of the tri-annual PUC-required eligible customer list mailing cost of $10,015 over three years and his recommended disallowance of the advertising expense claim of $3,605 included in the Safety and Communications Expense claim, the Company revised its FPFTY claim from $19,197 to $5,013, which indirectly recognizes I&E witness Patel's recommended reduction. Although the Company acknowledged this adjustment, it appears that this adjustment was also not flowed through to the rebuttal revenue requirement spreadsheet. Therefore, in

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74 I&E Statement No. 1, p. 21.
75 I&E Statement No. 1, pp. 21-22.
76 I&E Statement No. 1-SR, p. 25 (citing Wellsboro Statement No. 1-R, pp. 3-5; Wellsboro Statement No. 6-R, pp. 4-5; and Wellsboro Statement No. 5-R, pp. 2-3). The witnesses' general objections, and I&E's response, are summarized above in the Total O&M expenses section.
77 I&E Statement No. 1-SR, p. 25 (citing Wellsboro Statement No. 1-R, p. 4).

order to recognize the Company's new claim, I&E witness Patel recommends this expense category must be adjusted by $14,184 ($19,197 - $5,013).[78]

G. Maintenance of Overhead Lines

In direct testimony, I&E witness Patel recommended an allowance of $649,081 for Maintenance of Overhead Lines (Account 593), or a reduction of $20,535 ($669,616 - $649,081) to the Company's claim.[79] I&E witness Patel's recommendation was based on an average of the last three years' labor cost - maintenance lines - storm expense (Sub-Account 593.51) because the Company experienced a wide fluctuation in this expense category during 2016 through 2018 and in the first six months of 2019.[80]

Wellsboro witness Farnsworth accepted I&E witness Patel's recommendation and stated that the additional budgeted expenses of $20,000 in the FTY and $20,600 in the FPFTY are due to some-duplication of costs.[81] However, I&E witness Patel further noted Wellsboro updated its FPFTY claim for Maintenance of Overhead Lines to $580,364.[82] I&E therefore recommends a reduction of $89,252 to the Company's as filed claim of $669,616.[83]

Subsequent to hearings, Wellsboro witness Farnsworth provided a response to an on-the-record data request, stating expenses for Account 593 were $515,199.33 through November 30, 2019, and projected $81,320 in additional expenses through December

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78 I&E Statement No. 1. pp. 26-27.
79 I&E Statement No. 1. p. 23.
80 I&E Statement No. 1. pp. 24-25.
81 Wellsboro Statement No. 6-R. p. 6.
82 I&E Statement No. 1-SR. p. 28.
83 I&E Statement No. 1-SR. p. 28.

2019, for total actual-estimated Account 593 expenses of $596,519.33 for 2019.[84] I&E contends this updated information should not change I&E witness Patel's recommendation. Consistent with I&E witness Patel's analysis, annualizing $515,199.33 and escalating by 3% for 2020 would only produce a claim of $578,896.70.[85] Additionally, as OCA witness Stacy Sherwood notes, the three year average expense for Account 593 is $518,492.[86] Based on OCA's analysis, even if an additional $60,000 is added to Wellsboro's tree trimming budget for 2020,[87] total expense would only be $578,492 for the FPFTY. Therefore, I&E maintains its recommendation of $580,364 for Account 593 expense is reasonable and should be adopted by the Commission.

H. Office Supplies and Expenses

In direct testimony, I&E witness Patel recommended an allowance of $129,231 for Office Supplies and Expenses (Account 921) claim, or a reduction of $11,364 ($140,595 - $129,231) to the Company's claim.[88] I&E witness Patel's recommendation was based on the HTY expense of $125,467 plus a 3% increase for determining the FPFTY expense allowance of $129,231 to remove the impact of certain non-recoverable expense items claimed in the FPFTY.[89]

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84 Appendix E.

85 If Wellsboro witness Farnsworth projections for December 2019 are accepted, escalating Account 593 by a 3% inflation factor would only produce a FPFTY claim of $614,415($596,519.33 x 1.03 = $614,414.57).

86 OCA Statement No. 1-SR (Revised), p. 7.

87 Wellsboro witness Farnsworth claims an additional $60,000 will be required for the 2020 tree trimming budget. Wellsboro Statement No. 6-R.

88 I&E Statement No. 1, p. 26.

89 I&E Statement No. 1, pp. 26-27.

Wellsboro witnesses Gorman, Farnsworth, and Campbell disagreed with I&E witness Patel's method of adjusting O&M expenses in general.[90] However, Wellsboro witness Gorman provided an updated FPFTY claim from $140,595 to $64,367 in rebuttal testimony based on a nine-month annualization of FTY actual expense adding a 3% increase for inflation to determine the FPFTY revised claim.[91]

Although the witnesses did not directly rebut the basis of I&E witness Patel's recommendation, i.e., ratepayers should not be required to fund these expenses associated with sponsorships and entertainment,[92] the Company revised its FPFTY claim from $140,595 to $64,367, which recognized I&E witness Patel's recommended reduction to the Company's filed claim.[93] I&E therefore accepts the Company's revised claim of $64,367, and recommends the claim for Office Supplies and Expenses be reduced by $76,228 ($140,595 - $64,367).[94]

I. Rate Case Expense

The nature and types of individual expenditures that comprise a utility's allowable claim for Rate Case Expense are those directly incurred to compile, present, and defend a utility's request for a base rate increase before the Commission. The actual expenditures and estimated costs typically found in an allowable Rate Case Expense claim include legal fees for outside counsel, fees to outside consultants, and the cost of printing,

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90 I&E Statement No. 1-SR, p. 29 (citing Wellsboro Statement No. 1-R, pp. 3-5; Wellsboro Statement No. 6-R, pp. 4-5; and Wellsboro Statement No. 5-R, pp. 2-3). The witnesses' general objections, and I&E's response, are summarized above in the Total O&M expenses section.

91 Wellsboro Statement No. 1-R, p. 2.

92 I&E Statement No. 1, pp. 26-27.

93 I&E Statement No. 1-SR, p. 30.

94 I&E Statement No. 1-SR, p. 30.

document assembly, and postage.[95] In this proceeding, Wellsboro's total rate case expense claim is $326,000 normalized over three years, resulting in an annual rate case expense claim of $108,667 ($326,000 ÷ 3) .[96]

The Commission characterizes rate case expense as a normal operating expense that should be accorded the same rate-making treatment as any other normalized expense.[97] To determine the length of normalization,[98] the Commission has looked to the average number of months between a company's rate case filings.[99]

Wellsboro's claimed 36-month normalization period is not supported by the Company's historic filing frequency.[100] Based upon Wellsboro's actual filing history,

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95 I&E Statement No. 1, p. 5.

96 I&E Statement No.1, p. 6 (citing Wellsboro Exhibit HSG-1, Schedule C1(W), ln. 22).

97 *See Pa. P.U.C. v. Apollo Gas Co.*, 54 Pa. PUC 358, 373 (Pa. P.U.C. 1980).

98 Normalization is the accounting and ratemaking practice of reflecting non-recurring expenses as an annual expense.

99 I&E Statement No. 1, p. 4; *See, e.g., Pa. P.U.C. v. City of DuBois – Bureau of Water*, Docket No. R-2016-2554150, pp. 65-66 (Order Entered March 28, 2017) (reconsideration of rate case expense claim denied by Order entered May 18, 2017); *Pa. P.U.C. v. Emporium Water Company*, Docket No. R-2014-2402324, p. 50 (Order Entered January 28, 2015); *Popowsky v. Pa. P.U.C.*, 674 A.2d 1149, 1154 (Pa. Cmwlth. 1996); *Pa. P.U.C. v. Borough of Media Water Works*, 1990 WL 10702673 (Pa. P.U.C. 1990). It should be noted, in 2012, the Commission granted PPL Electric Utilities Corporation ("PPL") permission to normalize its rate case expense over a 24-month period based on the expected timing of future base rate case filings. *Pa. P.U.C. v. PPL Electric Utilities Corporation*, Docket No. R-2012-2290597, pp. 47-48 (Order Entered December 28, 2012). That particular base rate case was filed on March 30, 2012; however, PPL did not file its next base rate case until March 31, 2015, which was 36 months after the 2012 rate case filing. The 12-month discrepancy between PPL's projection in 2012 when it would next file and its actual filing date of the subsequent rate case shows that future projections are unreliable when determining an appropriate normalization period for the rate case expense. I&E's recommended normalization period in 2012 PPL proceeding was a 32-month interval based on the Company's historic filing frequency. I&E Statement No. 2, pp. 13-14 at Docket No. R-2012-2290597. The I&E recommendation in that instance produced a much more accurate result than the Company's stated future intention to file a rate case.

100 I&E Statement No. 1, p. 7.

I&E witness Patel calculated a 48-month average as follows:[101]

DOCKET NO.	DATE FILED	TIME ELAPSED
R-2019-3008208	July 1, 2019	➢ 34 mos.
R-2016-2531551	August 31, 2016	➢ 75 mos.
R-2010-2172662	June 2, 2010	➢ 37 mos.
R-00072350	April 30, 2007	

I&E's recommended 48-month normalization period results in an annual rate case expense allowance of $81,500 (($326,000 ÷ 48 months) x 12 months), which is a reduction of $27,167 ($108,667 - $81,500) to the Company's claim.[102]

Wellsboro witnesses Gorman and Farnsworth disagree with I&E's reliance on historical filing frequency. The witnesses claim limited prospects for load growth; increase in solar and combined heat and power ("CHP"); change in industry generally; continuing tree trimming, capital replacements, and other reliability enhancing projects; and significance of the time period since the last rate filing.[103]

I&E submits these factors do not merit deviation from the Commission's endorsed practice of reviewing historical filing frequency. Tree trimming and normal capital replacements are routine operational costs, and the cost of such activities are normally

[101] (34 + 75 + 37) ÷ 3.

[102] I&E Statement No. 1, p. 7.

[103] Wellsboro Statement No. 1-R, pp. 5-6; Wellsboro Statement No. 6-R, pp. 5-6. In oral rejoinder testimony, Wellsboro witness Gorman generally referred to the companies' subject of his consolidated testimony at hearings (i.e., Wellsboro, Citizens' Electric Company of Lewisburg, and Valley Gas, Inc.) when he stated "some of them talk about coming in [for the next base rate filing] a year or two". However, besides being contrary to Wellsboro's position regarding Rate Case Expenses, he provides no basis to verify his statement, and offered no clarification when questioned. Tr., pp. 86, 122.

forecast in the annual budget.[104] The Company's expectation about customers' installation of solar and CHP projects and consequent revenue losses in the years following the rate case is speculative in nature.[105] Wellsboro's claims of limited prospects for load growth and change in industry generally are conclusory statements that lack sufficient support. And finally, as commonly found by the Commission, the Company's reliance on the time elapsed since its last case is limited and not a representative consideration of the Company's overall recent historic filing record.[106]

In summary, Wellsboro's concerns are unfounded and speculative, and Wellsboro's claimed three year normalization period would result in an unreasonable increase in rates. Therefore, the Commission should adopt I&E's recommended disallowance of $27,167 for Rate Case Expense.

VII. FAIR RATE OF RETURN

A. Introduction

A rate of return allows payment to a utility's debt holders with interest and fair compensation for its equity shareholders. Rate of return is expressed as the amount of revenue an investment generates in the form of net income and is usually expressed as a percentage of the amount of capital invested over a given period of time. Rate of return is one of the components of the revenue requirement formula.[107] In *Bluefield Water*

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104 I&E Statement No. 1-SR. p. 12.
105 I&E Statement No. 1-SR. p. 13.
106 I&E Statement No. 1. p. 7.
107 I&E Statement No. 2. p. 2. The revenue requirement used RR = E + D + T + (RB x ROR). where RR = Revenue Requirement: E = Operating Expense: D = Depreciation Expense: T = Taxes: RB = Rate Base: and ROR = Overall Rate of Return. Id., pp. 2-3.

Works & Improvements Co. v. Public Service Comm. of West Virginia[108] and *Federal Power Commission v. Hope Natural Gas Co.*[109] the U.S. Supreme Court expressed the legal standards for determining rates of return.

In *Bluefield,* the U.S. Supreme Court stated:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[110]

The U.S. Supreme Court affirmed these principles in *Hope Natural Gas,* stating:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[111]

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108 262 U.S. 679 (1923) ("*Bluefield*").
109 320 U.S. 591 (1944) ("*Hope Natural Gas*").
110 *Bluefield*, 262 U.S. 679, 692-93.
111 *Hope Natural Gas*, 320 U.S. 591, 603.

Therefore, the principles followed by regulators through the U.S. to measure a fair rate of return include the following:

- A utility is entitled to a return similar to that being earned by other enterprises with corresponding risks and uncertainties, but not as high as those earned by highly profitable or speculative ventures;

- A utility is entitled to a return level reasonably sufficient to assure financial soundness;

- A utility is entitled to a return sufficient to maintain and support its credit and raise necessary capital;

- A fair return can change (increase or decrease) along with economic conditions and capital markets.[112]

In accordance with these principles, I&E witness Anthony Spadaccio recommends the following rate of return for Wellsboro:

Type of Capital	Ratios	Cost Rate	Weighted Cost Rate
Long-Term Debt	49.33 %	4.98 %	2.46 %
Preferred Stock	0.62 %	4.00 %	0.02 %
Common Equity	50.05 %	8.10 %	4.05 %
Total	100.00 %		6.53 %[113]

I&E witness Spadaccio accepts Wellsboro's both hypothetical capital structure and Wellsboro's claimed cost rates of long-term debt. However, I&E witness Spadaccio rejects Wellsboro's method for calculating return on common equity. Instead, I&E witness Spadaccio calculates his recommended return on equity pursuant to the Discounted Cash Flow ("DCF") methodology frequently used by the Commission while

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[112] I&E Statement No. 2, pp. 3-4. *See also Pennsylvania Gas & Water Company v. Pa. P.U.C.*, 341 A.2d 239, 249-252 (Pa. Cmwlth. 1975).

[113] I&E Statement No. 2-SR, p. 7.

using the Capital Asset Pricing Model ("CAPM") as an alternate means to verify the reasonableness of his return.

B. Capital Structure

I&E accepts Wellsboro's claimed hypothetical capital structure. Although the Company's claimed capital structure is hypothetical, I&E witness Spadaccio agrees with Wellsboro witness D'Ascendis that the actual capital structures are too far out of line as compared with I&E's proxy groups. Therefore, I&E witness Spadaccio recommends using the Companies' claimed hypothetical capital structures, as they fall within the range of I&E witness Spadaccio's proxy group's 2018 capital structures, using the most recent information available at time of his analysis. This 2018 range contains long-term debt ratios ranging from 43.63% to 72.47% and equity ratios ranging from 27.53% to 56.37%, with a five-year average of 54.93% for long-term debt and 45.07% for common equity.[114]

C. Cost of Long-Term Debt

I&E accepts Wellsboro's claimed cost rate of long-term debt, 4.98%. I&E witness Spadaccio opines the Company's claimed cost rate of long-term debt is reasonable as it is representative of the industry and falls within his proxy group's implied long-term debt cost range of 4.04% to 5.84% with an average implied long-term debt cost of 4.84%.[115] Therefore, I&E recommends using the Company's claimed cost rate of long-term debt.

[114] I&E Statement No. 2. pp. 15-17: I&E Exhibit No. 2. Schedule 3.
[115] I&E Exhibit No. 1. Schedule 4.

D. Return on Common Equity

1. Introduction

As recommended by I&E witness Spadaccio, an 8.10% return on common equity, based upon I&E witness Spadaccio's use of a similarly-situated proxy group of companies, best balances the interests of the ratepayers and the Company.

2. Proxy Group

A proxy (or barometer) group is a group of companies that act as a benchmark for determining the utility's rate of return. A proxy group is also typically used because using data exclusively from one company may be less reliable than using a group of companies because the data for one company may be subject to short-term anomalies that distort its return on equity. Use of a proxy group smooths these potential anomalies. Use of a proxy group also satisfies the long-established principle of utility regulation that seeks to provide the utility the opportunity to earn a return equal to that of similar risk enterprises.[116]

I&E witness Spadaccio selected his proxy group based on the following criteria:[117]

1. Fifty percent or more of the company's revenues must be generated from the regulated electric utility industry;

2. The company's stock must be publicly traded;

3. Investment information for the company must be available from more than one source, which includes Value Line;

4. The company must not be currently involved in an announced merger or material acquisition at the time of this analysis;

[116] I&E Statement No. 2, pp. 9-10.
[117] I&E Statement No. 2, pp. 9-10.

5. The company must have four consecutive years of historic earnings data;

6. The company must be operating in a state that has a deregulated electric utility market.

I&E witness Spadaccio's proxy group comprises Ameren Corp.; American Electric Power Company Inc.; CMS Energy Corp.; Consolidated Edison Inc.; Duke Energy Corp. New; Entergy Corp.; Eversource Energy; FirstEnergy Corp.; IDACORP Inc.; NorthWestern Corporation; PNM Resources, Inc.; Portland General Electric Co.; PPL Corporation; and Xcel Energy, Inc.[118]

3. I&E's Discounted Cash Flow Analysis

Although there are four methods commonly presented to estimate the cost of common equity,[119] I&E witness Spadaccio uses the DCF method applied to his proxy group of similar utilities to calculate a fair return on equity. I&E witness Spadaccio's analysis is in accordance with the Commission historical use the DCF as the primary methodology to determine a utility's cost of equity.[120]

In sum, the DCF is the "dividend discount model" of financial theory, which maintains that the value (price) of any security or commodity is the discounted present

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[118] I&E Statement No. 2, p. 11.

[119] The four include the DCF Model, the CAPM, the Risk Premium ("RP") Method, and the Comparable Earnings ("CE") Method. I&E Statement No. 2, p. 18. I&E witness Spadaccio provided a brief overview of each method. I&E Statement No 2, pp. 18-19.

[120] *See Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division,* Docket No. R-2017-2640058 (Order Entered October 25, 2018) ("*UGI Utilities, Inc. – Electric Division*"), pp. 104-106, 121; *Pa. P.U.C. v. City of DuBois – Bureau of Water*, Docket No. R-2016-2554150 (Order Entered March 28, 2017) ("*City of DuBois – Bureau of Water*"), pp. 96-98; *Pa. P.U.C. v. PECO Energy Co.*, 87 Pa. PUC 184, 212 (Pa. P.U.C. 1997); *Pa. P.U.C. v. Philadelphia Suburban Water Co.*, 71 Pa. PUC 593, 623-32 (Pa. P.U.C. 1989); *Pa. P.U.C. v. Western Pennsylvania Water Co.*, 67 Pa. PUC 529, 559-70 (Pa. P.U.C. 1988); *Pa. P.U.C. v. Consumers Pennsylvania Water Company – Roaring Creek Division*, 87 Pa. PUC 826 (Pa. P.U.C. 1997). *Pa. P.U.C. v. City of Bethlehem*, 84 Pa. PUC 275, 304-05 (Pa. P.U.C. 1995); *Pa. P.U.C. v. Media Borough*, 77 Pa. PUC 446, 481 (Pa. P.U.C. 1992).

value of all future cash flows. The DCF model assumes that investors evaluate stocks in the classical economic framework, which maintains that the value of a financial asset is determined by its earning power, or its ability to generate future cash flows.[121]

The DCF recognizes the time value of money, is forward-looking, and has wide-spread regulatory acceptance. I&E witness Spadaccio confirms the reasonableness of his DCF calculation with a comparison to the CAPM results because the Commission has expressed an interest in having results from another methodology as a point of comparison. While the CAPM is also forward-looking, and is based on the concept of risk and return, it and the other methodologies have flaws that should discount their use as primary determinants.[122]

I&E witness Spadaccio recommends a cost of common equity of 8.10%. This recommendation includes a dividend yield of 3.41% and a recommended growth rate of 4.69%.[123] I&E witness Spadaccio's analysis uses a spot dividend yield, a 52-week dividend yield, and earnings growth forecasts. I&E witness Spadaccio employs the standard DCF model formula, $K = D_1/P_0 + g$, where K = the cost of equity, D_1 = the dividend expected during the year; P_0 = the current price of the stock; and g = the expected growth rate. When a forecast of D_1 is not available, D_0 (the current dividend) must be adjusted by ½ the expected growth rate in order to account for changes in the dividend paid in period 1.[124]

121 I&E Statement No. 2, p. 18.
122 I&E Statement No. 2, pp. 18-23.
123 I&E Statement No. 2, p. 27.
124 I&E Statement No. 2, p. 25.

a) Dividend yields

A representative yield must be calculated over a time frame sufficient to avoid short-term anomalies and stale data. I&E witness Spadaccio's dividend yield calculation places equal emphasis on the most recent spot (3.24%) and 52-week average (3.57%) dividend yields resulting in an average dividend yield of 3.41%.[125]

b) Growth rates

I&E witness Spadaccio used earnings growth forecasts to calculate his expected growth rate. His earnings forecasts are developed from projected growth rates using 5-year estimates from established forecasting entities for his proxy group of companies, yielding an average 5-year growth forecast of 4.69%.[126]

c) Comparison to CAPM

I&E witness Spadaccio analysis of a return on equity using the CAPM methodology uses the standard CAPM formula $K = R_f + \beta(R_m - R_f)$, where K = the cost of equity, R_f = the risk-free rate of return; β = beta, which measures the systematic risk of an asset, and R_m = the expected rate of return on the overall stock.[127]

For his CAPM analysis, I&E witness Spadaccio chose the risk-free rate of return (R_f) from the projected yield on 10-year Treasury Bonds as the most stable risk-free measure. With this choice, I&E witness Spadaccio balanced out issues related to use of long term bonds and short term T-Bills.[128] For his beta, I&E witness Spadaccio used the

125 I&E Statement No. 2, p. 26.
126 I&E Statement No. 2, pp. 26-27.
127 I&E Statement No. 2, p. 28.
128 I&E Statement No. 2, p. 29.

average of the betas from the Value Line Investment Survey.[129] To arrive at a representative expected return on the overall stock market, I&E witness Spadaccio reviewed Value Line's 1700 stocks and the S&P 500 Index. The result of the overall stock market returns based on I&E witness Spadaccio's CAPM analysis is 11.49%.[130] This, in turn, yields a cost of equity result of 7.59%.[131]

I&E witness Spadaccio gave no specific weight to his CAPM results because of his concerns that unlike the DCF, which measures the cost of equity directly by measuring the discounted present value of future cash flows, the CAPM measures the cost of equity indirectly and can be manipulated by the time period used.[132] However, I&E submits that for purposes of providing another point of comparison, the 7.59% CAPM analysis confirms the reasonableness of I&E witness Spadaccio's 8.10% return under his DCF calculation.[133]

E. Wellsboro's Proposed Return on Common Equity

Wellsboro witness D'Ascendis relies on the DCF, CAPM, RP, and CE methodologies in presenting his recommended return on equity. Based upon the use of

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[129] I&E Statement No. 2, p. 29.
[130] I&E Statement No. 2, p. 30.
[131] I&E Statement No. 2, p. 31.
[132] I&E Statement No. 2, p. 32. I&E witness Spadaccio's presentation of a CAPM analysis serves as a check on his DCF analysis. For the reasons set forth in I&E witness Spadaccio's direct testimony, the DCF model should be used as the primary method in determining a fair return on equity.
[133] In rebuttal testimony, Wellsboro witness D'Ascendis provided analysis disputing various data sources relied upon by I&E witness Spadaccio in his CAPM analysis. Wellsboro Statement No. 2-R, pp. 26-27. As I&E witness Spadaccio explains, even if Wellsboro witness D'Ascendis' recommended return on the overall market rate was accepted by I&E, the CAPM result would only adjust from 7.59% to 8.09%, validating I&E's DCF result of 8.10%. I&E Statement No. 2-SR, p. 16.

his proxy groups, Wellsboro witness D'Ascendis calculates the following equity returns:[134]

Measure	Electric Proxy Group
DCF	8.27%
RP	9.57%
CAPM	8.82%
CE	9.43%
Indicated Cost of Equity	**9.05%**

In addition to calculating an average return on equity of 9.05%, Wellsboro witness D'Ascendis's recommended common equity cost rate reflects size and performance factor adjustments. Specifically, Wellsboro witness D'Ascendis recommends both a 100 basis points upwards adjustment to reflect his claim that Wellsboro has higher business risk due to its small size relative to his proxy group, and a 25 basis points upwards adjustment as a performance factor.[135]

I&E witness Spadaccio opposes Wellsboro witness D'Ascendis's calculated return on equity for several reasons. First, as stated below in the discussion of proxy groups, Wellsboro witness D'Ascendis's selected proxy group is flawed in that ten of his selections fail to meet Wellsboro witness Spadaccio's criteria. Second, Wellsboro witness D'Ascendis gives undue weight to the CAPM, RP and CE methods. Third, Wellsboro

134 Wellsboro Exhibit_(DWD-1R), Schedule DWD-1R, Page 2 of 2.
135 Wellsboro Statement No. 2, pp. 44-45.

witness D'Ascendis's adjustments for size and a performance factor are unsupported and inappropriate.

1. Wellsboro's Flawed Proxy Group

Wellsboro witness Dylan D'Ascendis selected his proxy group based on the following criteria:[136]

1. They were included in the Electric Utility Eastern, Western, or Central of *Value Line's Standard Edition* (February 15, 2019; January 25, 2019; and March 15, 2019);

2. They have 70% or greater of fiscal year 2017 total operating income derived from, and 70% or greater fiscal year 2017 total assets attributable to, regulated electric distribution operations;

3. At the time of preparation of this testimony, they had not publicly announced that they were involved in any major merger or acquisition activity (*i.e.*, one publicly traded utility merging with or acquiring another);

4. They have not cut or omitted their common dividends during the five years ended 2017 or through the time of preparation of this testimony;

5. They have *Value Line* and Bloomberg Professional Services adjusted betas;

6. They have positive *Value Line* five-year dividends per share growth rate projections; and

7. They have *Value Line*, Reuters, Zacks, or Yahoo! Finance consensus five-year earnings per share growth rate projections.

Wellsboro witness D'Ascendis's proxy group identified in direct testimony included 19 companies: ALLETE, Inc.; Alliant Energy Corporation; Ameren Corporation; American Electric Power, Inc.; AVANGRID, Inc.; Avista Corporation; Dominion Energy, Inc.; Duke Energy Corporation; Edison International; El Paso Electric

[136] Wellsboro Statement No. 2, p. 12.

Company; Eversource Energy; IDACORP, Inc.; North Western Corporation; OGE Energy Corporation; Otter Tail Corporation; Pinnacle West Capital Corporation; PNM Resources, Inc.; Portland General Electric Co.; and Xcel Energy, Inc.[137]

In direct testimony, I&E witness Spadaccio disputes I&E witness D'Ascendis's proxy group. In direct testimony, I&E witness Spadaccio noted, while both proxy groups contain nine of the same companies, I&E witness D'Ascendis' Electric Utility Proxy Group includes ten companies that I&E does not use.[138]

I&E witness Spadaccio excluded ten companies Wellsboro included in their proxy group for the following reasons:

- ALLETE, Inc., Alliant Energy Corporation, Avista Corporation, Edison International, OGE Energy Corporation, and Pinnacle West Capital Corporation did not meet his criterion that they operate in a state with a deregulated electric utility market.

- Dominion Energy, Inc. and Otter Tail Corporation were excluded since they violate I&E witness Spadaccio's criterion that fifty percent or more of the company's revenues must be generated from the regulated electric utility industry.

- AVANGRID, Inc. does not have five consecutive years of historic earnings data from Value Line.

- El Paso Electric Company because the entire company is being acquired by J.P. Morgan Investment Management Inc.'s Infrastructure Investments Fund.[139]

In rebuttal testimony, Wellsboro witness D'Ascendis removed Dominion Energy,

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[137] Wellsboro Statement No. 2-R, p. 4.

[138] Additionally, I&E's proxy group includes five companies Wellsboro does not use: CMS Energy Corp.; Consolidated Edison Inc.; Entergy Corp.; FirstEnergy Corp.; and PPL Corporation. I&E Statement No. 2, pp. 11-12.

[139] I&E Statement No. 2, p. 13.

Inc., AVANGRID, Inc., and El Paso Electric Company after re-running his selection criteria.[140] However, ALLETE, Inc., Alliant Energy Corporation, Avista Corporation, Edison International, OGE Energy Corporation, Pinnacle West Capital Corporation, and Otter Tail Corporation remain part of Wellsboro's proxy group. I&E witness Spadaccio's objection to use of these companies remains, and the Commission should use I&E witness Spadaccio's proxy group as most comparable to Wellsboro in developing an appropriate cost of equity.

2. Wellsboro's Flawed Equal Weighting and Use of DCF, CAPM, RP, and CE

After forming his proxy group, Wellsboro witness D'Ascendis calculated common equity costs with data inputs specific to these companies using the DCF, RP, and CAPM methods.[141] By contrast, I&E witness Spadaccio recommended using the DCF method as the primary method to determine the cost of common equity and using the results of the CAPM as a comparison to the DCF results.[142]

As explained above, I&E witness Spadaccio's analysis is consistent with the methodology commonly endorsed by the Commission in base rate proceedings, and should be approved here. Just recently, the Commission affirmed reliance primarily on

140 Wellsboro Statement No. 2-R, pp. 3-4. Wellsboro witness D'Ascendis also removed use of Ameren Corporation, a company I&E witness Spadaccio uses in his proxy group. Additionally, Wellsboro witness D'Ascendis added two new companies to his proxy group, Entergy Corporation and FirstEnergy Corporation. Wellsboro Statement No. 2-R, p. 4. I&E witness Spadaccio also uses these two companies in his proxy group.

141 I&E Statement No. 2, p. 34.

142 I&E Statement No.2, p. 20.

the DCF and rejected giving equal weight to the other methodologies. In *City of Dubois – Bureau of Water*, the Commission stated:

> [T]he City's cost of equity in this proceeding should be based upon the use of the DCF methodology, with the other methodology results used as a check on the reasonableness of the DCF results. 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 the DCF, such as the CAPM and RP methods, as a check upon the reasonableness of the DCF derived equity return calculation, tempered by informed judgement. We are not persuaded by the arguments of the City that we should assign equal weight to the multiple methodologies.[143]

In *UGI Utilities, Inc. – Electric Division*, the Commission stated:

> The ALJs adopted the positions of I&E and the OCA that the DCF method should be the primary method used to determine the cost of common equity, and that the results of the CAPM should be used as a comparison to the DCF results. The ALJs found no reason to deviate from these preferred methods in this proceeding. Therefore, the ALJs recommended against the use of the RP and CE methods proffered by UGI. Further, the ALJs noted that the companies analyzed under the CE model are too dissimilar to a regulated public utility company. R.D. at 60, 76, 81-82 …[W]e shall adopt the positions of I&E and the OCA and shall base our determination of the appropriate cost of equity on the results of the DCF method and shall use the CAPM results as a comparison thereto. As both Parties noted, the use of the DCF model has historically been our preferred methodology. This was recently affirmed in *Pa. PUC, et. al v. City of Dubois-Bureau of Water*, Docket No. R-2016-2554150, *et. al.* (Order entered March 28, 2017). Like the ALJs, we find no reason to deviate from the use of this method in the instant case. Accordingly, we shall deny UGI's Exceptions on this issue.[144]

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143 *City of DuBois – Bureau of Water*, pp. 96-97.
144 *UGI Utilities, Inc. – Electric Division*, pp. 103-106.

As endorsed by the Commission, I&E witness Spadaccio did use the CAPM method as a comparison to the DCF results. However, there are disadvantages associated with the CAPM and it should not be used as a primary method.[145] The CAPM is a less reliable model because it measures the cost of equity indirectly and risk premiums vary depending on the debt and equity being compared. The CAPM uses U.S. Treasury Bonds and, typically, the return of the S&P 500 as proxies for the risk-free rate and overall market return, respectively. However, its result can be manipulated based on the inputs used; therefore, it introduces a greater amount of subjectivity with respect to determining the cost of equity of a given company.[146] CAPM has also been subject to criticism from academic literature.[147]

I&E witness Spadaccio excluded the RP method from his analysis because it is a simplified version of the CAPM and, in addition to being subject to the same faults listed above, the RP method does not recognize company-specific risk through beta.[148] Finally, I&E witness Spadaccio excluded the CE method from his analysis because the choice of which companies are comparable is subjective, and it is debatable whether historic accounting values are representative of the future. Moreover, the Commission has long

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145 I&E Statement No. 2, p. 21.

146 I&E Statement No. 2, pp. 21-22.

147 I&E Statement No. 2, pp. 22-23. By contrast, I&E witness Spadaccio cites academic literature supporting use of the DCF. I&E Statement No. 2-SR, pp. 11-12 (citing Brealey, Richard A., et al. *Principles of Corporate Finance*, Concise Edition, McGraw-Hill/Irwin, 2011, p. 82 ("[B]oth utilities and regulators work hard to estimate the cost of equity accurately. They've noticed that utilities are mature, stable companies that are tailor-made for application of the constant-growth DCF formula")).

148 I&E Statement No. 2, p. 23.

recognized the problem with this method, and as a result, its historical usage in this regulatory forum has been minimal.[149]

Wellsboro witness D'Ascendis cites two Orders to claim the Commission has considered multiple cost of equity models.[150] I&E avers Wellsboro witness D'Ascendis is incorrect in both counts. First, in *Columbia Water*, the Commission specifically states that it used the DCF method as the foundation in determining the cost of equity.[151] Second, in *Emporium Water*, the Commission simply summarized the recommendations presented by OCA, I&E, and the Company. It did not specifically comment on which model(s) it relied on.[152] Accordingly, the Commission should reject Wellsboro's equal weighting of various models, and endorse use of the DCF method, with CAPM used as a comparison.

a) Inappropriate Use of PRPM and Proprietary Software

Wellsboro witness D'Ascendis inappropriately relied upon Eviews©[153] statistical software to perform a predictive risk premium analysis ("PRPM"). I&E witness Spadaccio objects to Wellsboro witness D'Ascendis's PRPM on several bases. First, the PRPM does not solve the problem of the RP method because it is still an indirect measure of the cost of equity and it uses historic data that may not represent the current or future economic conditions. Second, the PRPM is not a commonly used method and cannot be evaluated or recreated without purchasing the Eviews© software. Relatedly, the required

[149] I&E Statement No. 2, p. 23.
[150] Wellsboro Statement No. 2-R, p. 9-10 (citing *Pa. P.U.C. v. Emporium Water Company*, Docket No. R-2014-2402324 (Order Entered January 28, 2015) ("*Emporium Water*"); *Pa. P.U.C. v The Columbia Water Company*, Docket No. R-2013-2360798 (Order Entered January 23, 2014) ("*Columbia Water*")).
[151] *Columbia Water*, p. 43.
[152] *Emporium Water*, pp. 34-35.
[153] Wellsboro Statement No. 2, pp. 20-21.

use of specialized software that, to I&E witness Spadaccio's knowledge, is proprietary and requires a substantial fee for a user license.[154] I&E avers it is inappropriate to require non-company witnesses to purchase this software simply to recreate Wellsboro witness D'Ascendis's flawed analysis. Accordingly, I&E recommends the Commission reject the Company's RP and PRPM approaches.

b) Inappropriate Comparison to Non-Regulated Companies

I&E asserts Wellsboro's comparison to non-regulated companies is inappropriate and should be disregarded by the Commission.[155] Wellsboro witness D'Ascendis implies his comparison is appropriate because, in the landmark *Hope* and *Bluefield* cases, the U.S. Supreme Court did not specify that comparable risk companies had to be utilities.[156] Although *Hope* and *Bluefield* did not state a utility may only earn a return similar to other utilities, it is clear a utility may not earn a return as high as those earned by highly profitable or speculative ventures.[157] As explained below, Wellsboro witness D'Ascendis's non-regulated proxy group consistently produces higher returns than the utility proxy group.[158] Therefore, he has not convincingly demonstrated his analysis shows his non-regulated proxy group is an appropriate comparison.

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154 Wellsboro Statement No. 2, pp. 32-33.

155 Wellsboro witness D'Ascendis assembled a proxy group consisting of six non-price regulated firms which he asserts are comparable in terms of total risk to the Electric Utility Proxy Group. Wellsboro Statement No. 2, pp. 36-37. After forming his proxy group of six non-price regulated firms, Wellsboro witness D'Ascendis calculated common equity costs with data inputs specific to these companies using the DCF, RP, and CAPM methods. Wellsboro Exhibit DWD-1, Schedule DWD-7 and Wellsboro Statement No. 2, p. 40.

156 Wellsboro Statement No. 2, p. 4; Wellsboro Statement No. 2-SR, p. 44.

157 *Bluefield*, 262 U.S. at 692-93.

158 By contrast, I&E witness Spadaccio has only relied on comparison to utilities, which clearly satisfies the rules set forth in *Hope* and *Bluefield*.

If the non-price regulated company proxy group is truly similar in total risk to Wellsboro, correspondingly, I&E witness Spadaccio opined he expected to see similar results in the calculation of the DCF, RP, and CAPM model return on equities between the Electric Utility and Non-Price Regulated Company proxy groups used by Wellsboro witness D'Ascendis. Instead, the Non-Price Regulated Company proxy groups results were higher for all three methods.[159]

I&E witness Spadaccio further opines the process of choosing a proxy group of non-utility companies similar in risk to Wellsboro is highly speculative and subjective.[160] Additionally, the Commission has ruled on the use of the CE approach, specifically, the use of non-utility companies in comparable groups, and stated:

> The use of nonregulated companies as a comparable group for regulated firms requires numerous unsupportable assumptions which results in a highly speculative finding.[161]

More recently, in *UGI Utilities, Inc. – Electric Division*, the Commission criticized use of the CE approach, stating:

> With respect to the CE method...this cost of equity method utilizes data for non-regulated firms. Thus, by its very nature, determining which companies are comparable is entirely subjective. In addition, the record indicates that the companies UGI utilized in its CE group results in the selection of companies such as Coca-Cola Company, Kellogg Company, and Walmart Stores, Inc.....Each of these companies operate in industries that are very different from a utility company and have significantly more competition,

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159 I&E Statement No. 2, pp. 35-36. OCA witness David Habr similarly notes "[Wellsboro witness] D'Ascendis's non-price regulated proxy groups were systematically higher than the average common equity costs for his electric and gas proxy groups." OCA Statement No. 3-SR, pp. 4-5.

160 I&E Statement No. 2, p. 35. I&E witness Spadaccio characterizes Wellsboro witness D'Ascendis's analysis of non-regulated companies as a blend of the CE approach into the DCF, RP, and CAPM methods. Id.

161 *Pa. P.U.C. v. Philadelphia Electric Co.*, 33 PUR 4th 319, 341 (Pa. P.U.C. 1980).

> which would require a higher return for the associated additional risk. [162]

In summary, consistent with Commission precedent and established ratemaking principles, I&E recommends rejection of all analyses performed by the Company which used the non-regulated price company proxy group to calculate Wellsboro's return on equity in this proceeding.

c) Inappropriate Risk-Free Rate

I&E witness Spadaccio recommends the Commission reject Wellsboro witness D'Ascendis's method of calculating the risk-free rate[163] used for his CAPM analysis.[164] Wellsboro witness D'Ascendis's claim is based upon expected yields on 30-year U.S. Treasury Bonds and long-term projections for the years 2020 to 2024 and 2025 to 2029.[165] I&E witness Spadaccio has multiple criticisms.[166] First, long-term Treasury Bonds have substantial maturity risk associated with the market risk and the risk of unexpected inflation and normally offer higher yields to compensate investors for these risks. Using the 10-year Treasury Note is more appropriate to balance the short-term volatility risk and the long-term inflation risk.

Second, the further out into the future one projects, the less reliable the information becomes. Using the projection for 2025-2029 is an unreliable measure and this should not be included in the risk-free rate. The Companies' FPFTY ends December

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[162] *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Order Entered October 25, 2018), p. 105.

[163] Wellsboro witness D'Ascendis's original filed risk-free rate was 3.36%. Wellsboro Statement No. 2, p. 33 and Exhibit DWD-1, Schedule DWD-5, p. 1. In rebuttal testimony, Wellsboro witness D'Ascendis updated his risk-free rate to 2.64%. Wellsboro Exhibit DWD-1R, Schedule DWD-1R, p. 42.

[164] I&E Statement No. 2, p. 37.

[165] Wellsboro Statement No. 2, p. 36.

[166] I&E Statement No. 2, pp. 36-38.

31, 2020, and, in I&E witness Spadaccio's opinion, using an estimated risk-free rate that is 6 to 10 years beyond the test year is unreasonable and unnecessary.

Third, the Commission has recognized the 10-year Treasury Note as the superior measure for the risk-free rate by stating the following: [167]

> We agree with I&E and the ALJs that using the yield on the 10-year Treasury Note provides a better measure of the risk-free rate of return than using the yield on the 30-year Treasury Bond, as recommended by UGI. In our view, using the 10-year Treasury Note balances the shortcomings of the short-term T-Bill and the 30-year Treasury Bond. Although long-term Treasury Bonds have less risk of being influenced by federal policies, they have substantial maturity risk associated with the market risk. In addition, long-term Treasury Bonds bear the risk of unexpected inflation.

Last, Wellsboro witness D'Ascendis' calculation of the risk free rate based on the 30-year U.S Treasury bond is no longer representative of U.S. interest rate market conditions. The Federal Reserve stated in its press release of September 18, 2019 that the Federal Open Market Committee decided to lower the target range for the federal funds rate to 1-3/4 to 2 percent. The purpose of the rate cut is to achieve sustained expansion of economic activity, strong labor market conditions, and to hold inflation at about 2 percent.[168] For all these reasons, I&E recommends the Commission reject Wellsboro witness D'Ascendis's use of 30-Year Treasury Bonds for CAPM analysis.

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[167] *UGI Utilities, Inc. – Electric Division*, p. 99.
[168] I&E Statement No. 2, p. 38.

d) Inappropriate Use of ECAPM Analysis

I&E witness Spadaccio objects to Wellsboro witness D'Ascendis's use of an empirical capital asset pricing model ("ECAPM") to adjust his CAPM results upward.[169] Specifically, I&E witness Spadaccio asserts ECAPM merely adds a measure of subjectivity to the CAPM as an attempt to refine its predicted Security Market Line ("SML") through an additional factor that corrects none of the underlying problems of the model.[170]

I&E witness Spadaccio explains ECAPM is a modified version of the CAPM which attempts to address the belief that actual risk versus return correlation is flatter than what is predicted by the CAPM. The implication is that the CAPM under-estimates returns with lower levels of risk and over-estimates the returns associated with higher levels of risk. The model entails assigning 25% weight to the market beta and 75% weight to the individual company or proxy group. It is assumed that the resulting flattened SML addresses the claimed inaccuracy of the CAPM.[171]

Wellsboro witness D'Ascendis claims that numerous tests of the CAPM have confirmed the validity to which security returns and betas are related, and further suggests that the actual SML defined by the CAPM is not as steeply sloped as the predicted SML.[172] I&E witness Spadaccio rejects this rationale. While some studies indicate that the CAPM inaccurately defines the SML, the degree to which the CAPM

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169 I&E Statement No. 2, pp. 38-39.
170 I&E Statement No. 2, p. 39.
171 I&E Statement No. 2, pp. 39-40.
172 Wellsboro Statement No. 2, p. 32. Thereby implying beta does not accurately measure systematic risk. I&E Statement No. 2, p. 39.

requires adjustment is variable. As stated above, the ECAPM merely adds a measure of subjectivity to the CAPM. Additionally, the additional layer of subjectivity introduced by ECAPM only provides a stronger basis to rely on the DCF, as I&E witness Spadaccio has done, as the primary method to calculate a utility's cost of equity.[173] Therefore, the Commission should reject Wellsboro witness D'Ascendis's reliance on an ECAPM analysis.

e) Inappropriate Use of Market-to-Book Ratios

I&E witness Spadaccio rejects Wellsboro witness D'Ascendis criticism that the market based DCF understates the return required by investors.[174] Wellsboro witness D'Ascendis claims this understatement exists because the market-to-book ratio for the proxy group companies is above 1.0.[175] I&E witness Spadaccio explains the flaw in Wellsboro witness D'Ascendis's claim as follows:[176]

> Although, there are differences between the book value and market value of electric utilities, Mr. D'Ascendis' assertion that the difference causes the DCF to undervalue the rate of return assumes that investors are unaware of the difference. The forecasted growth rates used in the DCF are set by analysts based on current conditions and what they expect the future could be for the stock. As Mr. D'Ascendis points out, the current market-to-book ratios for the electric utility proxy group are extraordinarily high compared with the ten-year average. In this scenario, no rational investor would invest in a utility stock that has been trading above book value for several years and be surprised that rates continue to be set based on the book value capital structure. A market-to-book

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173 I&E Statement No. 2, p. 39. In rebuttal testimony, Wellsboro witness D'Ascendis introduces an article claiming to support use of the ECAPM. Wellsboro Statement No. 2-R, pp. 27-29. As I&E witness Spadaccio explains, this use of the article takes it out of its central context of invalidating the CAPM method and does not conclude the ECAPM solves any of CAPM's flaws. I&E Statement No. 2-SR, pp. 18-19.

174 I&E Statement No. 2-SR, pp. 12-13.

175 Wellsboro Statement No. 2-R, pp. 12-13.

176 I&E Statement No. 2-SR, pp. 9-10.

> ratio of above 1.0 for utility stocks reflects their value in the market and implies that investors expect future cash flows to be more valuable than the historical accounting value of the company. Since the stock market is impacted by regulatory policies, and the economic and financial conditions, a market-to-book ratio could be less than 1.0 when the stock market is in a depression, or a company is experiencing under-performance, so it is inappropriate to evaluate DCF results with the market-to-book ratio.

Simply put, Wellsboro witness D'Ascendis has not demonstrated investors expect utility returns to be set on a different basis than book value. As OCA witness Habr similarly states: [177]

> The regulatory purpose for establishing a new cost of common equity is to assure that customers only pay for the costs incurred to provide the utility service and that company shareholders have the opportunity to earn the current cost of common equity on their investment in the utility company as measured by the book value of common equity. Any regulatory impact on the utility's [market-to-book] ratio is related to the relationship between the utility's cost of common equity and the return investors' [sic] expect the utility to earn on its book value common equity.

Accordingly, as recommended by I&E witness Spadaccio, the Commission should reject Wellsboro witness D'Ascendis's criticism of the DCF model through analysis of market-to-book ratios.

3. Wellsboro's Inappropriate Equity Adjustments

Wellsboro witness D'Asecndis's rate of return recommendations are also overstated by his assignment of several inappropriate equity adjustments to Wellsboro.

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[177] OCA Statement No. 3-SR, pp. 1-2 (emphasis added). OCA witness Habr similarly rejects Wellsboro witness D'Ascendis's criticism.

a) Unsupported Size Adjustment

In addition to the inflated return on equity resulting from Wellsboro witness D'Ascendis's faulty methods described above, Wellsboro witness D'Ascendis proposes a 100-basis point addition to his indicated common equity cost rate because he opines that smaller companies are less able to cope with significant events affecting sales, revenues or earnings.[178] Additionally, Wellsboro witness D'Ascendis argues that loss of revenue from a few larger customers would have a greater effect on a small company.[179] To support his claim, Wellsboro witness D'Ascendis quotes three sources of technical literature,[180] and attempts to quantify his size adjustment by comparing Wellsboro to companies listed on the New York Stock Exchange ("NYSE"), American Stock Exchange ("AMEX"), and NASDAQ. [181]

I&E witness Spadaccio rebutted Wellsboro witness D'Ascendis's claims by citing the variance year-to-year of returns for large- and small-capitalization stocks listed on the NYSE, AMEX, and NASDAQ.[182] I&E witness Spadaccio also opines Wellsboro witness

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178 Wellsboro Statement No. 2, p. 41.
179 Wellsboro Statement No. 2, pp. 41-42.
180 *Duff & Phelps 2019 Valuation Handbook guide to Cost of Capital - Market Results Through 2018*, Wellsboro Statement No. 2, p. 42; "*The Capital Asset Pricing Model: Theory & Evidence*" authored by Fama and French, Wellsboro Statement No. 2, p. 42; and also quotes Professor Eugene Brigham, Wellsboro Statement No. 2, p. 43.
181 Wellsboro Statement No. 2, p. 45.
182 I&E Statement No. 2-SR, pp. 23-24 (citing Ibbotson *Stocks, Bonds, Bills & Inflation: 2015 Yearbook*, pp. 100, 109, 112 ("While the largest stocks actually declined in 2001, the smallest stocks rose more than 30%. A more extreme case occurred in the depression-recovery year of 1933, when the difference between the first and 10th decile returns was far more substantial. The divergence in the performance of small- and large- cap stocks is evident. In 30 of the 89 years since 1926, the difference between the total returns of the largest stocks (decile 1) and the smallest stocks (decile 10) has been greater than 25 percentage points.... In four of the last 10 years, large-capitalization stocks (deciles 1-2 of NYSE/AMEX/NASDAQ) have outperformed small-capitalization stocks (deciles 9-10). This has led some market observers to speculate that there is no size premium. But statistical evidence suggests that periods of underperformance should be expected.... Because investors cannot predict when small-cap returns will be higher than large-cap returns, it has been argued that they do not expect higher rates of return for small stocks.")).

D'Ascendis's size adjustment is unnecessary because none of the technical literature he cites supporting investment adjustments related to the size of a company is specific to the utility industry; therefore, such an adjustment is not appropriate.[183] In *UGI Utilities, Inc. – Electric Division,* the Commission rejected use of technical literature not specific to the regulated utility industry to support a size adjustment.[184]

Specific to the utility industry, I&E witness Spadaccio cites an article stating a size adjustment for risk is not applicable to utility companies.[185] In the article "Utility Stocks and the Size Effect: An Empirical Analysis," Dr. Annie Wong concludes:

> The objective of this study is to examine if the size effect exists in the utility industry. After controlling for equity values, there is some weak evidence that firm size is a missing factor from the CAPM for the industrial but not for utility stocks. This implies that although the size phenomenon has been strongly documented for the industrials, the findings suggest that there is no need to adjust for the firm size in utility rate regulation.[186]

Wellsboro witness D'Ascendis attempts to refute Dr. Wong's study by citing a review of her study authored by Thomas M. Zepp.[187] As explained by I&E witness Spadaccio, Dr. Zepp's article does not contain credible enough evidence to refute Dr. Wong's findings. First, it simply speculates on other possible reasons for her results and references the results of two other studies. The first study, completed by California

[183] I&E Statement No. 2, p. 41.

[184] *UGI Utilities, Inc. – Electric Division*, p. 100. Relatedly, when asked whether he had performed a specific analysis why it would be appropriate for the Company to receive a size adjustment when UGI Electric did not, Wellsboro witness D'Ascendis did not point to any particular illustrative analysis comparing the two companies, but generally stated UGI Electric was a larger company than Wellsboro and referred back to his testimony analysis on the subject. Tr., pp. 59-60, 63-65.

[185] I&E Statement No. 2, pp. 41-42.

[186] Wong, Annie, "Utility Stocks and the Size Effect: An Empirical Analysis" *Journal of the Midwest Finance Association* (1993), pp. 95-101.

[187] Wellsboro Statement No. 2-R, pp. 33-34.

Public Utilities Commission Staff in 1991, is not included in the article, and, therefore, Dr. Zepp's opinions cannot be properly evaluated. Dr. Zepp also draws his conclusions about an entire industry based on the second study, which examines the effects of size on only four water utility companies.[188] Additionally, Dr. Zepp admitted the limited relevance of the two studies, stating "*to the extent that water utilities are representative of all utilities*, there is support for smaller utilities being more risky than larger ones".[189] Wellsboro witness D'Ascendis could not provide independent verification of the relevance of the studies because he had not read the studies himself.[190] Although Wellsboro witness D'Ascendis performs his own study, he admits it has limited explanatory power.[191] I&E therefore recommends the Commission deny Wellsboro's claimed size adjustment.

b) Wellsboro's Inappropriate and Unsupported Performance Factor Adjustment

Wellsboro witness D'Ascendis recommends an upward adjustment of 25 basis points to his cost of common equity recommendation as a result of testimony presented by Wellsboro witness Farnsworth.[192] Wellsboro witness D'Ascendis states his recommendation is based on 66 Pa. C.S. § 523. While it is correct 66 Pa C.S. § 523 may be the basis for a performance factor adjustment claim, Section 523 does not mandate Wellsboro receive a performance factor adjustment. Section 523 states the Commission

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188 I&E Statement No. 2-SR, p. 22.

189 Wellsboro Statement No. 2-R, pp. 33-34 (emphasis added, citing Zepp, Thomas M. "Utility Stocks and the Size Effect --- Revisited", *The Quarterly Review of Economics and Finance*, 43 (2003)).

190 Tr., p. 62.

191 I&E Statement No. 2-SR, p. 24 (citing Wellsboro Statement No. 2-R, pp. 35-36).

192 Wellsboro Statement No. 2, pp. 45-46.

shall *consider* a utility's performance. Additionally, Section 523 contains no mandate to award additional points, only that any adjustments will be to "specific components of the utility's claimed cost of service as [the Commission] may determine to be proper and appropriate".[193]

I&E witness Spadaccio opines, ultimately, for any company, true management effectiveness is earning a higher return through its efficient use of resources and cost cutting measures. The greater net income resulting from growth, cost savings, and true efficiency in management and operations is available to be passed on to shareholders. Further, I&E witness Spadaccio states Spadaccio should not be granted additional basis points for doing what it is required to do in order to provide adequate, efficient, safe, and reasonable service,[194] i.e., the requirements of 66 Pa. C.S. § 1501. Therefore, I&E recommends the Commission reject Wellsboro's unwarranted performance factor adjustment.[195]

F. Overall Rate of Return

The Company's proposed overall rate of return is 7.14%.[196] I&E's proposed overall rate of return is 6.53%.[197] I&E submits that the evidence in this proceeding does not support the inputs that went into the development of Wellsboro's proposed return on

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193 66 Pa.C.S. § 523(a).

194 I&E Statement No. 2, pp 43-44.

195 If the Commission disagrees, I&E witness Spadaccio alternately recommends the Commission award no more than five basis points to the Company on its return on equity for management effectiveness, consistent with its decision in *UGI Utilities, Inc. – Electric Division*. I&E Statement No. 2-SR, p. 26.

196 Although Wellsboro witness D'Ascendis claims he can support a 10.30% cost of equity for both Companies, Wellsboro's revised revenue request includes an overall rate of return claim of 7.14%, which only supports a claim of 9.31% for the cost of equity. Wellsboro Exhibit HSG-1R, Schedule C1 (R), ln 31.

197 I&E Statement No. 2-SR, p. 29.

equity or overall rate of return, and therefore the I&E's proposed overall return of 6.53% should be adopted.

G. Conclusion

Wellsboro's claimed rate of return overstates Wellsboro's need for a revenue increase. Wellsboro's requested rate of return is not supported by a reasonable measure of returns in today's market. The evidence demonstrates that Wellsboro's claim for a return on equity of 10.30% and an overall rate of return of 7.14% overstates what reasonable investors should expect from a regulated public utility and is not necessary for Wellsboro to safely and reliably provide electric distribution service to its ratepayers.

When adjusted by I&E to more reasonable levels that approximate expected returns in today's economy for similarly-situated EDCs, Wellsboro's evidentiary support for its $999,967 rate increase is substantially reduced. As demonstrated by I&E witness Spadaccio, the appropriate overall rate of return that will result in just and reasonable rates is 6.53% with an included 8.10% cost rate of common equity.

VIII. TAXES

I&E's various recommendations have a flow-through impact on the Company's taxes for the FPFTY as depicted in the attached Table I.

IX. CUSTOMER RATE STRUCTURE

A utility's rate structure reflects how a proposed revenue increase will be allocated among rate classes. Under Section 1304 of the Public Utility Code, the rate structure cannot either advantage or disadvantage a class, or contain an unreasonable difference in rates.[198] To survive a challenge under Section 1304, a utility must show any difference can be justified by the difference in costs to deliver service to each class.[199]

A. Allocated Cost of Service Study

I&E makes various recommendations based on Wellsboro's cost of service study as explained below.

B. Revenue Allocation

The Company's proposed revenue distribution is presented in the following table:

Wellsboro Proposed Revenue Distribution[200]				
Class	**Present Rates**	**Proposed Rates**	**Increase**	**Increase Percent**
RS	$2,619,792	$3,260,144	$640,352	24.4%
RSAE	$25,825	$33,052	$7,227	28.0%
NRS	$390,322	$457,008	$66,686	17.1%
NRH	$1,395	$1,794	$399	28.6%
CS	$1,322,797	$1,464,105	$141,308	10.7%
CSH	$1,109	$1,425	$316	28.5%
IS	$656,296	$814,885	$158,589	24.2%
MSL	$20,906	$21,151	$245	1.2%
POL	$86,066	68,891	($17,175)	-20.0%
EU	$7,813	$90,042	$2,009	25.7%
Total	**$5,132,322**	**$999,957**	**$6,132,278**	**19.5%**

I&E witness Cline made two recommendations regarding revenue allocation. First, he recommended that the POL rate class be allocated no increase or decrease under

[198] 66 Pa.C.S. § 1304. Accordingly, if there is a reasonable basis for a difference, a utility may charge different rates for different classes of customers. *See Peoples Natural Gas Company v. Pa. P.U.C.*, 409 A.2d 446 (Pa. Cmwlth. 1979).

[199] *Philadelphia Suburban Water Company v. Pa. P.U.C.*, 808 A.2d 1044, 1060 (Pa. Cmwlth. 2002).

[200] I&E Statement No. 3, p. 22.

proposed rates. Second, he recommended that the excess $17,175 in revenue reallocated from the POL rate class be allocated as follows: (1) the first $245 is allocated to the MSL class and (2) the remaining $16,930 be applied to the CS rate class.[201]

I&E witness Cline's recommendations were based on analyzing how the rate of return for each class compares to the system average rate of return. As I&E witness Cline explained, in general, a relative rate of return that provides revenue equal to its cost to serve would have a relative rate of return equal to 1.0.[202] If a rate class has a relative rate of return of less than 1.0, that class is not generating sufficient revenue to recover the costs the utility spends to serve that class. If a rate class has a relative rate of return of greater than 1.0, that class is generating revenue greater than its cost to serve.[203]

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201 I&E Statement No. 3, p. 26.
202 I&E Statement No. 3, p. 21.
203 I&E Statement No. 3, p. 23.

I&E witness Cline presented the following analysis to indicate relative rate of return by class under Wellsboro's proposal:[204]

Wellsboro Relative Rates of Return		
Class	**At Present Rates**	**At Proposed Rates**
RS	(0.40)	0.76
RSAE	(2.66)	(0.02)
NRS	0.98	1.00
NRH	(6.16)	(1.36)
CS	4.17	1.62
CSH	(6.79)	(1.63)
IS	0.42	0.84
MSL	7.09	2.08
POL	12.42	2.37
EX	(0.23)	0.86
Total	**1.00**	**1.00**

[204] I&E Statement No. 3, p. 24.

Additionally, I&E witness Cline demonstrated Wellsboro's proposal would change subsidies between classes as follows:[205]

Wellsboro Subsidy Given (Received)			
Customer Class	**Under Present Rates**	**Under Proposed Rates**	**Reduction in Subsidy**
RS	($174,438)	($112,351)	36%
RSAE	($6,217)	($6,634)	(7%)
NRS	($306)	$1	100%
NRH	($1,294)	($1,628)	(26%)
CS	$172,673	$129,325	25%
CSH	($1,477)	($1,903)	(29%)
IS	($21,924)	($22,976)	(5%)
MSL	$4,846	$3,278	32%
POL	$28,593	$13,078	54%
EX	($455)	($191)	58%
Total	**$0**	**$0**	

The relative rate of return for the CS, MSL, and POL rate classes are greater than 1.0, and the Company proposes a revenue reduction to the POL class and rate increases for the MSL and CS classes such that the relative rate of returns are moved closer to 1.0.[206] Although I&E witness Cline agreed with Wellsboro witness Gorman that rate classes MSL and CS should move closer to a relative rate of return of 1.0, he disagreed with the proposed decrease in revenue for the POL rate class.[207] Instead, POL should be allocated

[205] I&E Statement No. 3, p. 25.
[206] I&E Statement No. 3, p. 24.
[207] I&E Statement No. 3, p. 26.

no increase or decrease, and the excess $17,175 in revenue should be allocated as follows: (1) the first $245 is allocated to the MSL class, which results in no increase in rates for that class, and (2) the remaining $16,930 ($17,175 - $245) be applied to the CS rate class, resulting in an overall CS class increase of $124,378 ($141,308 - $16,930). The resulting change in percent increase, relative rates of return, and subsidy received and given for the CS, MSL, and POL classes are shown as follows:[208]

Change in Percent Increase (I&E Ex. No. 3, Sch. 10 line 38)		
Rate Class	Company As-Filed	I&E Recommended
CS	10.7%	9.4%
MSL	1.2%	0.0%
POL	(19.9%)	0.0%

Change in Relative Rate of Return (I&E Ex. No. 3, Sch. 10, lines 33-34)			
Rate Class	Present Rate	Company As-Filed	I&E Recommended
CS	4.17	1.62	1.57
MSL	7.09	2.08	2.08
POL	12.42	2.37	3.54

Change in Subsidy Received (Given) (I&E Ex. No. 3, Sch. 10, lines 8, 40-41)		
Rate Class	Company As-Filed	I&E Recommended
CS	25%	31%
MSL	32%	36%
POL	54%	15%

208 I&E Statement No. 3, pp. 26-27.

I&E witness Cline recommended the CS and MSL classes be credited the revenue from the POL class because they are the only two other rate classes whose relative rate of return were above 1.0.[209] I&E witness Cline explained his rationale for his recommendation regarding the POL class as follows:[210]

> Rather than decreasing the rates of the POL now only to increase rates again in a future rate proceeding, my proposal to not increase rates for the POL class offers additional rate stability for customers and allows costs to "catch up" to rates more gradually. Furthermore, by not decreasing the rates of the POL class, the excess revenue can be credited to the MSL and CS classes and facilitate additional movement towards a relative rate of return of 1.0, as shown above. This is a more reasonable method for reducing the relative rate of return for the POL, CS, and MSL rate classes and does not negatively affect any of the Company's other rate classes. While my recommendation does not move the POL class towards a relative rate of return of 1.0 as much as the Company's proposal, the movement from 12.46 under present rates to 3.54 under my recommended allocation still represents significant movement. It is for this reason and the benefit to the CS and MSL rate classes discussed above that my recommendation is more reasonable than the Company's proposed allocation.

The OCA and OSBA agreed with I&E witness Cline's recommendation that rate class POL not be allocated a rate decrease and the OSBA agreed with his re-allocation recommendation.[211] However, OCA witness Jerome Mierzwa disagreed with the allocation of the excess $17,175 revenue from the POL class. The Company did not agree with either of I&E witness Cline's recommendations, stating the Company does not

[209] I&E Statement No. 3, p. 28.
[210] I&E Statement No. 3, p. 28.
[211] OCA Statement No. 4-R, p. 2 and OSBA Statement No. 1-R, pp. 4-5.

accept that no class should receive a decrease and continues to support moving classes closer to cost of service.[212]

After considering other parties' positions, I&E maintains its recommendations are most reasonable. First, regarding his recommendation not to reduce rates for the POL class, I&E witness Cline reiterated his rationale, explaining his proposal offers additional rate stability for customers; allows costs to "catch up" to rates more gradually, rather than decreasing rates now, just to likely increase them later; and moves classes MSL and CS closer to a relative rate of return of 1.0.[213] Second, although OCA did agree revenue reduction to the POL should be disallowed, I&E witness Cline's recommendation for reallocation is more reasonable. Specifically, to address the concerns explained above, I&E witness Cline's recommendation provides relief to the only two rate classes who relative rates of return are above 1.0. By contrast, OCA's recommendation would provide relief to classes whose relative rates of return are below 1.0, i.e., classes not generating sufficient revenue to recover the costs the utility spends to serve those class.[214] Therefore, the Commission should adopt I&E witness Cline's recommendations regarding revenue allocation.

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212 Wellsboro Statement No. 1-R, p. 8.
213 I&E Statement No. 3-SR, p. 13.
214 I&E Statement No. 3-SR, pp. 13-14.

C. Rate Design

1. Customer Charge - Proposal

The Company's proposed increases to the customer charges are as follows:

Wellsboro Proposed Class Customer Charges

Rate	Pres Cust Chrg	Prop'd Cust Chrg	% Increase[215]
RS	$10.79	$13.40	24.2%
RSAE	$10.79	$13.40	24.4%
NRS	$12.22	$13.40	9.7%
NRH	$12.22	$13.40	9.7%
CS	$32.03	$35.00	9.3%
CSH	$45.81	$58.00	26.6%
IS	$67.98	$85.00	25.0%

Wellsboro's proposal allows it to receive greater revenue recognition from fixed monthly charges with less contribution from usage charges by including demand-related costs in the customer charges, which are based on a customer cost analysis.[216] Wellsboro witness Gorman states it is appropriate to recover demand-related costs in customer charges because the Company incurs distribution system costs based on the number of customers connected to the system and the peak demand the system is designed to serve.[217] In response, I&E witness Cline opines:

> It is correct that the energy charge does not perfectly reflect demand-related costs imposed on the system. However, an energy charge is far superior to allocating demand-related costs to all residential customers equally through the fixed customer charge. An investment may be considered a fixed

[215] I&E Statement No. 3, p. 29.
[216] I&E Statement No. 3, p. 29.
[217] I&E Statement No. 3, p. 30.

cost once it is in service, but that does not dictate the manner in which the fixed cost should be recovered through rates. The specific fixed costs recovered through the customer charge have historically been limited to the direct costs associated with billing an individual customer. Each individual customer requires a meter to determine their usage and a bill to show them what they owe. Therefore, as an example, there is a direct correlation between number of customers and the cost of meters. There is no direct relationship between the number of customers and the size or the cost of poles, conductors, or transformers. Those items are instead common costs that should be billed to the customer class through volumetric rates, which is the method that the Commission has approved in the past.

A utility's past capital investments are depreciated over time and revenues collected through rates must be sufficient to eventually allow the company to recover these past investments. While past capital investments are fixed in the sense that they cannot be avoided, some future capital investments can be avoided if customers reduce their energy consumption and peak demands. Inevitably, the utility will have to make new capital investments to accommodate load growth or distribution lines to be upgraded. Rate design has a role to play in sending appropriate price signals to guide customers' energy consumption. When customers are provided with variable rates that reflect these costs, they can choose to reduce their usage of the system to avoid these costs. In contrast, if revenues are recovered through fixed charges, customers are sent an inaccurate message that their usage does not affect distribution system costs.[218]

[218] I&E Statement No. 3, pp. 30-31.

Accordingly, I&E witness Cline's proposed customer charges should be limited to what can be supported by the Company's customer cost analysis as follows:

I&E Proposed Class Customer Charges

Rate	Pres Cust Chrg	Cust Cost Analy	Prop'd Cust Chrg	I&E Proposed[219]
RS	$10.79	$11.92	$13.40	$12.00
RSAE	$10.79	$11.92	$13.40	$12.00
NRS	$12.22	$11.92	$13.40	$12.22
NRH	$12.22	$11.92	$13.40	$12.22
CS	$32.03	$20.71	$35.00	$32.03
CSH	$45.81	$20.71	$58.00	$45.81
IS	$67.98	$97.55	$85.00	$85.00

Specifically, I&E witness Cline's recommendation is based on the Company's customer cost analysis which shows that the RS and RSAE class customer charges should only be increased to $12.00 and that there is no cost basis for increasing the NRS, NRH, CS, and CSH classes from their existing customer charges.[220]

Wellsboro witness Gorman disagreed with I&E's position, arguing I&E witness Cline's statement that past capital investments are fixed undermines I&E's position.[221] Additionally, Wellsboro witness Gorman stated Company's costs to maintain the system do not change even as customers implement net metering and reduce their total kWh usage, because those customers may return to their old usage levels at any point and that

[219] I&E Statement No. 3, p. 37.
[220] I&E Statement No. 3, p. 37.
[221] Wellsboro Statement No. 1-R, p. 9.

it is therefore reasonable for some of those costs to be recovered as demand related in the monthly fixed charge.[222]

I&E witness Cline responded, stating past capital investments are different from proposed or future capital investments. Past capital investments are necessarily fixed because they are already in existence. The ability to avoid future capital investments exists if customers reduce their energy consumption and peak demands. Therefore, Wellsboro witness Gorman is incorrect that I&E witness Cline's statement regarding past capital investments supports including demand costs in the fixed charge and moving to a demand-based or time-of-use rate structure for all customers.[223] The critical point is that *future* capital investment can be avoided by retaining appropriate demand charges.

2. Customer Charge – Alternative Ratemaking

In addition to his own rationale, Wellsboro witness Gorman cites Act 58 of 2017 ("Act 58") as well as the goals outlined by the Commission in its Final Proposed Policy Order entered on July 18, 2019 at Docket No. M-2015-2518883 ("Policy Order")[224] and indicated that the Company's proposed adjustment to the customer charge should be considered "alternative ratemaking" and accepted by the Commission.[225] Wellsboro witness Gorman also cites the 14 factors listed in the Policy Order and his rationale how Wellsboro's customer charge proposal satisfies each factor.[226]

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222 Wellsboro Statement No. 1-R, p. 9.
223 I&E Statement No. 3-SR, p. 15.
224 Since submission of direct testimony, the Commission's Final Policy Statement has been codified at 52 Pa. Code §§ 3302-3303.
225 Wellsboro Statement No. 1, pp. 31-32.
226 Wellsboro Statement No. 1, pp. 40-42. I&E avers Wellsboro witness Gorman does not raise any new arguments relevant to Act 58 or the Commission's Policy Order in rejoinder testimony not already provided in his written testimony. Tr., pp. 81-83.

I&E witness Cline disagrees with Wellsboro witness Gorman that the 14 factors are satisfied. I&E witness Cline addresses each of the 14 factors,[227] but primarily disagrees with Wellsboro's proposal based on the following concerns:

- Efficiency and energy conservation: The Company's proposal would have a detrimental effect on customer incentives to employ efficiency measures and distributed energy resources. Customer utilization of resources is determined by the price signals customers receive through their bill. A higher fixed charge and lower usage charge serves to dampen those price signals because changes in usage have less effect on a customer's bill. For instance, a customer would be less likely to purchase more expensive energy efficient appliances if the benefits are not reflected in their utility bills.

- Low-income customers: Low-income customers who are also low usage customers will experience a higher percentage increase to their bill than under traditional Commission approved rate making.[228] Additionally, the Company's proposal does not include any specific consumer protections.

- Cost causation: The proposed rate design does not align revenues with cost causation principles, because demand costs should not be counted as fixed costs. Additionally, Wellsboro's proposed rate design does not reduce intraclass cost-shifting. Rate design is based on the revenue allocations determined through the use of the cost of service study. Rates individually have no impact on intraclass cost-shifting as long as the demand portion of the rate is allocated to each class appropriately.

I&E witness Cline does acknowledge that the rate proposal promotes revenue stability for the Company and provides some insulation for reduction in usage that may

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227 I&E Statement No. 1, pp. 34-36.
228 I&E Exhibit No. 3, Schedule 11.

be caused by efficiency efforts. However, I&E witness Cline opines revenue stability for the utility must be balanced against affordability and conservation concerns.[229]

In summary, simply because the Company characterizes its proposal as "alternative ratemaking" does not mean it is valid under either Act 58 or the Commission's Policy Order.[230] Although the Commission rejected a one-size-fits-all approach for alternative ratemaking,[231] I&E submits the Commission has maintained certain core utility ratemaking principles that Wellsboro's proposal violates. Specifically, consistent with the 14 factors cited above, the Commission regulations promulgated by the Policy Order plainly state the Commission's policy regarding alternative ratemaking is to promote efficient use of energy sources; avoid unnecessary future capital investments; and "reflect the sound application of cost of service principles, establish a rate structure that is just and reasonable, and consider customer impacts".[232] I&E witness Cline demonstrates how each of these principles are discouraged by Wellsboro's proposal. Regarding efficiency, a higher fixed charge and lower usage charge discourages customers' from adopting efficiency measures. Further, Wellsboro views its proposal as just the first step to shifting more of the demand charge to the customer

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229 I&E Statement No. 3. p. 35.

230 As summarized by the Commission, while Act 58 provided the Commission express authority to approve alternative ratemaking methodologies, it did not expressly determine which alternative rate methodologies, if any, are to be used. *Implementation of Act 58 of 2018 Alternative Ratemaking for Utilities*, Docket No. M-2018-3003269, p. 3 (Order Entered April 25, 2019).

231 Policy Order, p. 7.

232 52 Pa. Code § 69.3301. The 14 factors considered by I&E witness Cline and Wellsboro witness Gorman are now found at 52 Pa. Code § 69.3302.

charge.[233] Regarding capital costs, future capital investments <u>can</u> be avoided if customers reduce their energy consumption and peak demands, i.e., the demand portion of their bill. By contrast, the customer charge has historically been limited to the direct costs associated with billing an individual customer because those costs are typically unavoidable on an individual basis. Regarding cost of service principles, Wellsboro's proposal clearly violates its cost of service study by assigning demand charges to the customer charge. Last, Wellsboro's proposal contains no specific customer protections. For all these reasons, I&E submits Wellsboro's proposal is not just and reasonable.

Wellsboro primarily justifies its proposal by reference to reliability. Although reliability may have some bearing on the Commission's analysis,[234] the multiple concerns cited above clearly outweigh this singular consideration. Therefore, the Commission should reject Wellsboro's proposal to assign a potion of demand charge to customer charge, and should instead adopt I&E witness Cline's recommendations, which are in accord with the Company's cost of service study.

D. Scale Back of Rates

If the Commission grants less than the Company's requested increase, I&E recommends that the Commission proportionally scale-back rates based upon the cost of

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233 Wellsboro Statement No. 1, p. 44 ("[I] it would be reasonable to include the cost of additional kW of demand, based on the proportion of customers reaching certain levels of demand. In my view, including 0.10 kW-month of demand-related costs in the residential monthly charge is an appropriate first step for Wellsboro. The Commission could increase this in future cases based on the percentage of the customers that it deems appropriate and on principles of gradualism").

234 In addition to rejecting a one-size-fits-all approach, Commission regulations also include "...ensuring fixed utilities receive adequate revenue to maintain the safe, secure and reliable operation of their distribution systems." 52 Pa. Code § 69.3301.

service study, including customer charges and usage rates only if they received a proposed increase.[235]

OSBA witness Brian Kalcic disagreed with I&E witness Cline's recommendation that all rate classes receiving an increase should participate in any required scale back. OSBA witness Kalcic stated that the RSAE, NRH, and CSH rate class should not be included in any scale back because these classes would make little or no progress toward cost of service.[236] I&E witness Cline disagrees with OSBA witness Kalcic's objection. Making even a little progress towards cost of service is a reasonable basis to include these rate classes in a scale back of rates while making no progress is not a harmful outcome.[237] Therefore, the Commission should adopt I&E's proposal regarding a scale back of rates.

E. Summary

I&E's revenue allocation, customer charge, and scale back proposals are based on sound Commission ratemaking policies and precedent and should be adopted.

X. MISCELLANEOUS ISSUES

A. Reporting Requirements

I&E recommends that the Company provide the Commission's Bureaus of Technical Utility Services ("TUS") and I&E with an update to Wellsboro Exhibit_(HSG-1), Schedule C3(W) no later than April 1, 2020, under this docket number, which should include actual capital expenditures, plant additions, and retirements by month for the

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235 I&E Statement No. 3, p. 38.
236 I&E Statement No. 3-SR, p. 17 (citing OSBA Statement No. 1-R, p. 5).
237 I&E Statement No. 3-SR, p. 18.

twelve months ending December 31, 2019. An additional update should be provided for actuals through December 31, 2020, no later than April 1, 2021.[238]

I&E witness Cline explained the importance of providing these filings as follows:

> [T]here is value in determining how closely Wellsboro projected investments in future facility comport with the actual investments that are made by the end of the FTY and FPFTY. Determining the correlation between Wellsboro's projected and actual results will help inform the Commission and the parties in Wellsboro's future rate cases. The updates are important because, as previously explained, through the use of the FPFTY, Wellsboro is requiring ratepayers to pay a return on its projected investment in future facilities that are not in place and providing service at the time the new rates take effect, but also are not subject to any guarantee of being completed and placed into service. While the FPFTY provides for such projections, there should be verification of the projections. Therefore, requiring the Company to provide updates demonstrating that actual investments comport with projections used in setting rates in the FPFTY provides the Commission with actual data to gauge the accuracy of Wellsboro's projected investments in future proceedings as has become common practice among Pennsylvania utilities as the use of the FPFTY has gained prevalence.[239]

Wellsboro responded to I&E witness Cline's recommendation, stating:

> [t]he Commission has not yet implemented comprehensive regulations concerning the obligations for public utilities utilizing the FPFTY. The Company should not be burdened with additional filing requirements unless those requirements are part of regulations applicable to all EDCs. The information requested by I&E can be addressed in the Company's next base rate case.[240]

238 I&E Statement No. 3-SR. pp. 4-7.
239 I&E Statement No. 3. p. 13.
240 Wellsboro Statement No. 6-R. p. 9.

I&E witness Cline acknowledged that the Commission has not yet implemented comprehensive regulations concerning use of the FPFTY.[241] However, I&E has routinely recommended, and the Commission has approved, these same reporting requirements in multiple other base rate proceedings that utilized a FPFTY.[242] Additionally, in *UGI Utilities, Inc. – Electric Division,* the Commission indicated the need to ascertain the accuracy of the FPFTY projections. Specifically, the Commission stated "Section 315(e) of the Code… authorizes a Commission audit of the FPFTY results after the fact to determine whether they were accurate…".[243] By adopting I&E's recommendation, the Commission's Bureaus of Technical Utility Services and I&E will have the information and opportunity required to review the accuracy of the Company's projections.[244]

Wellsboro identifies no legal impediment to requiring such updates. To the contrary, the Public Utility Code provides the Commission broad power to require informational filings from utilities.[245] Additionally, the fact that there are no current regulations regarding the FPFTY does not preclude the Company from filing the

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241 I&E Statement No. 3-SR, p. 5.

242 Use of the FPFTY was signed into law in February 2012 and I&E recommended this reporting requirement in the first rate case that used the FPFTY (Columbia Gas of Pennsylvania, Inc.'s 2012 base rate filing). Since that time, I&E has typically recommended this reporting requirement in rate cases that employed a FPFTY; therefore, it has been recommended and approved in numerous Commission orders in the seven years since Act 11 was passed. I&E Statement No. 3, pp. 9-12; S*ee, e.g., Pa. P.U.C. v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-2012-2321748 (Order Entered May 23, 2013) (approving Joint Petition for Settlement including similar reporting requirement terms); *Pa. P.U.C. v. Pennsylvania-American Water Company*, Docket No. R-2013-2355276 (Order Entered December 19, 2013) (approving Joint Petition for Settlement including similar reporting requirement terms); *Pa. P.U.C. v. PPL Electric Utilities Corporation*, Docket No. R-2015-2469275 (Order Entered November 15, 2015) (approving Joint Petition for Settlement including similar reporting requirement terms); *Pa. P.U.C. v. UGI Penn Natural Gas, Inc.*, Docket No. R-2016-2580030 (Order Entered August 31, 2017) (approving Joint Petition for Settlement including similar reporting requirement terms); *Pa. P.U.C. v. Duquesne Light Company*, Docket No. R-2018-3000124 (Order Entered December 20, 2018) (approving Joint Petition for Settlement including similar reporting requirement terms).

243 *UGI Utilities, Inc. – Electric Division*, p. 26.

244 I&E Statement No. 3-SR, p. 6.

245 66 Pa.C.S. § 505.

requested updates. If anything, it demonstrates that this type of reporting is needed until such regulations are implemented. Without a reasonable basis to withhold important information many other Pennsylvania utilities have agreed to provide, I&E continues to recommend reporting requirements outlined by I&E witness Cline.

XI. CONCLUSION

Wellsboro has failed to bear its burden of proof with respect to each and every element of its proposed $999,967 rate increase. The Company's proposal must be amended to reflect the necessary and appropriate adjustments proposed by the Bureau of Investigation & Enforcement fixed utility financial analyst and engineer witnesses. For the reasons stated herein, the Bureau of Investigation & Enforcement respectfully requests the Administrative Law Judges and the Commission to adopt its recommendations in this proceeding, which include adjustments and modifications as supported herein and reflected on the attached I&E tables.

Respectfully submitted,

John M. Coogan
Prosecutor
PA Attorney ID No. 313920

Bureau of Investigation and Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Dated: January 8, 2020

APPENDIX A

Wellsboro Electric Company
R-2019-3008208

TABLE I
INCOME SUMMARY

	12/31/20 Proforma Present Rates	INVESTIGATION & ENFORCEMENT Adjustments	Present Rates	Allowances	Proposed
	$	$	$	$	$
Operating Revenue	5,234,499	1,734	5,236,233	719,538	5,955,771
Deductions:					
O&M Expenses	2,983,310	-135,463	2,847,847	0	2,847,847
Depreciation	1,366,345	0	1,366,345		1,366,345
Taxes, Other	321,712	102	321,814	42,453	364,267
Income Taxes:					
Current State	52,448	13,693	66,141	67,641	133,782
Current Federal	99,236	25,910	125,146	127,983	253,129
Deferred Taxes	37,200	0	37,200		37,200
ITC	0	0	0		0
Total Deductions	4,860,251	-95,758	4,764,493	238,077	5,002,570
Income Available	374,248	97,492	471,740	481,461	953,201
Measure of Value	14,614,186	-16,933	14,597,253	0	14,597,253
Rate of Return	2.56%		3.23%		6.53%

Wellsboro Electric Company
R-2019-3008208

Table II - Summary of I&E Adjustments

Issues	Rate Base	Revenues	Expenses	Depr.	Taxes Other	Current FIT	Current PACNI	Combined Deferred Inc Taxes	ITC	Revenue Impact of Adjustments
MEASURE OF VALUE:										
CWC	-16,933									-1,852
Revenues:										
Operating Revenue (Late Payment)		1,734	0		102	308	163			-1,735
Expenses:										
Rate Case Expense			-27,167			5,135	2,714			-28,871
Operations Supervision and Engineeing			-20,042			3,788	2,002			-21,299
Maintenance Supervision and Engineeing expense			-14,957			2,827	1,494			-15,895
Miscellaneous Distribution Expense			-29,016			5,485	2,899			-30,834
Regulatory Commission Expense			-68,710			12,988	6,864			-73,018
Safety and Communications Expense			-14,184			2,681	1,417			-15,073
Maintenance of Overhead Lines			-89,252			16,871	8,916			-94,848
Office Supplies and Expenses			-76,228			14,409	7,615			-81,007
Wellsboro adjusments (Rebuttal)			204,093			-38,578	-20,389			216,889
Company Rebuttal Variance			112			-21	-11			119
Depreciation:										
Taxes Other:										
Income Taxes:										
Deferred Taxes										
ITC										
Interest Synchronization						-4	-2			-9
Total Additions / Deductions	-16,933	1,734	-135,352	0	102	25,889	13,682	0	0	-147,233
										-133,228
Company Measure of Value	14,814,186									-280,461
I&E Measure of Value	14,597,253									999,999
										719,538

Table III
Rate of Return

Per Company

	Structure	Cost	Weighted Cost
Total Debt	49.33	0.0499	2.46
Long Term Debt	49.33	0.0498	2.46
Short Term Debt	0.00	0.0000	0.00
Preferred Stock	0.62	0.0400	0.02
Common Equity	50.05	0.0931	4.66
TOTAL	100.00		7.14

Per Staff

	Structure	Cost	Weighted Cost
Total Debt	49.33	0.0499	2.46
Long Term Debt	49.33	0.0498	2.46
Short Term Debt	0.00	0.0000	0.00
Preferred Stock	0.62	0.0400	0.02
Common Equity	50.05	0.0810	4.05
TOTAL	100.00		6.53

APPENDIX B

APPENDIX B

PROPOSED FINDINGS OF FACT

Rate Base

1. The Company's rate base claim includes $59,971 of Construction Work in Progress ("CWIP") based on the December 31, 2018 financial statements and estimated to be the same in the FTY and FPFTY. Wellsboro Exhibit_(HSG-1), Schedule C1-6(W), line 5; Wellsboro Statement No. 1, pp. 16-17.

2. The Company indicated that all but one of its CWIP projects were estimated to be completed in 2019. I&E Statement No. 3, pp. 10-11.

3. The Company accepted I&E's recommended adjustment that the $59,971 CWIP claim should be removed from the FPFTY rate base as originally filed. Wellsboro Statement No. 1-R, p. 6.

4. The Company claimed $245,607 for Materials and Supplies in the FPFTY based on the December 31, 2018 financial statements and estimated to be the same in the FTY and FPFTY. Wellsboro Exhibit_(HSG-1), Schedule C1-6(W), line 10; Wellsboro Statement No. 1, pp. 16-17.

5. The Company's claim for Materials and Supplies is not an actual balance or average. I&E Statement No. 3, p. 7.

6. An allowance for Materials and Supplies based on the most recent 13-month average of actual inventories results in a $35,389 reduction to the Company's claim. I&E Statement No. 3, pp. 7-8.

7. The Company accepted I&E's recommended adjustment for Materials and Supplies, therefore, the Company's allowance reflected in the original filing should be reduced by $35,389 from $245,607 to $210,218. Wellsboro Statement No. 1-R, p. 6.

8. The Company claimed $388,475 for Cash Working Capital ("CWC"), which was later revised to $362,964. Wellsboro Exhibit_(HSG-1), Schedule C1-6(W); I&E Exhibit No. 1-SR, Schedule 1, p. 3; Wellsboro Exhibit HSG-1-R, Schedule C1-6R(W); I&E Statement No. 1-SR, p. 31.

9. For ratemaking purposes, CWC is the capital needed to operate a utility between the rendition of service and the receipt of revenues in payment for services rendered. I&E Statement No. 1, p. 27.

10. A reduction of $135,463 to O&M expense claims reduces the Company's CWC allowance by $16,933. I&E Statement No. 1-SR, p. 24.

Revenues

11. The average actual Forfeited Discount revenues for 2016, 2017, and 2018 expressed as a percent of sales revenues is 0.264%. I&E Statement No. 3, p. 20; I&E Exhibit No. 3, Schedule 8.

12. The Company's filing projected increases in Uncollectible Accounts, but not Forfeited Discounts. Wellsboro Exhibit_(HSG-1), Schedule C1-1(W); I&E Statement No. 3-SR, p. 11.

Expenses

13. Wellsboro introduced updates to essentially all of its O&M expenses in rebuttal testimony. Wellsboro Statement No. 1-R, p. 4.

14. Wellsboro's presentation of FPFTY O&M costs is based on an escalation of FTY expenses, and does not remove non-recurring costs and plant activities. Tr., pp. 99-101.

15. Wellsboro's FPFTY claim for Operations Supervision and Engineering Expense would be $86,662 if based on annualized FTY expense plus a 3% inflation increase. Wellsboro Statement No. 1-R, p. 4.

16. Wellsboro's FPFTY claim for Maintenance Supervision and Engineering Expense would be $65,275 if based on annualized FTY expense plus a 3% inflation increase. Wellsboro Statement No. 1-R, p. 4.

17. Wellsboro's FPFTY claim for Miscellaneous Distribution Expense would be $13,317 if based on an average of the last three years' actual expense. I&E Statement No. 1, p. 16.

18. Wellsboro's FPFTY claim for Regulatory Commission Expense would be $38,631 after removing the 2016 rate case expense amortization claim of $68,710. Wellsboro Statement No. 1-R, p. 4.

19. Wellsboro's FPFTY claim for Safety and Communications Expense would be $8,915 if based on normalizing the tri-annual PUC-required eligible customer list mailing cost over three years and disallowing advertising expense claim. I&E Statement No.1, pp. 21-22.

20. Wellsboro's FPFTY claim for Safety and Communications Expense is $5,013. Wellsboro Statement No. 1-R, p. 4.

21. Additional budgeted expenses of $20,000 in the FTY and $20,600 in the FPFTY for Maintenance of Overhead Lines reflect duplication of costs. Wellsboro Statement No. 6-R, p. 6.

22. Wellsboro's FPFTY claim for Maintenance of Overhead Lines would be $578,896.70 if based on annualized FTY expense plus a 3% inflation increase. Appendix E.

23. The three-year average expense for Maintenance of Overhead Lines is $518,492. OCA Statement No. 1-SR (Revised), p. 7.

24. Wellsboro's FPFTY claim for Office Supplies and Expenses is $64,367. Wellsboro Statement No. 1-R, p. 2.

25. The average time between Wellsboro's last four rate case filings is 48 months. I&E Statement No. 1, p. 7.

26. Wellsboro's claim for Rate Case Expense for the FPFTY would be $81,500 if normalized over a period of 48 months. I&E Statement No. 1, p. 7.

27. Tree trimming and normal capital replacements are routine operational costs, and the cost of such activities are normally forecast in the annual budget. I&E Statement No. 1-SR, p. 12.

Fair Rate of Return

28. Rate of return is one of the component of the revenue requirement formula, which is RR = E + D + T + (RB x ROR), where RR = Revenue Requirement; E = Operating Expense; D = Depreciation Expense; T = Taxes; RB = Rate Base; and ROR = Overall Rate of Return. I&E Statement No. 2, pp. 2-3.

29. Wellsboro's hypothetical capital structure includes 49.33% Long-Term Debt, 0.62% Preferred Stock, and 50.05% Common Equity. I&E Statement No. 2, p. 8; I&E Exhibit No. 2, Schedule 1.

30. Wellsboro's cost of long-term debt is 4.98%. I&E Statement No. 2, p. 8; I&E Exhibit No. 2, Schedule 1.

31. Using a DCF analysis, Wellsboro's cost of common equity is 8.10%, which includes a dividend yield of 3.41% and a recommended growth rate of 4.69%. I&E Statement No. 2, pp. 8, 27; I&E Exhibit No. 2, Schedule 1.

32. Using a CAPM analysis, Wellsboro's cost of common equity is 7.59%. I&E Statement No. 2, p. 31.

33. Based on the hypothetical capital structure, cost of long-term debt, preferred stock, and cost of common equity, Wellsboro's rate of return is 6.53%. I&E Statement No. 2-SR, p. 29.

34. Returns for large- and small-capitalization stocks vary from year-to-year. I&E Statement No. 2-SR, pp. 23-24.

35. A size adjustment to return on equity is not applicable to utility companies. I&E Statement No. 2, pp. 41-42.

Customer Rate Structure

36. A relative rate of return that provides revenue equal to its cost of serve would have a relative rate of return equal to 1.0. I&E Statement No. 3, p. 21.

37. If a rate class has a relative rate of return of less than 1.0, that class is not generating sufficient revenue to recover the costs the utility spends to serve that class. I&E Statement No. 3, p. 23.

38. If a rate class has a relative rate of return of greater than 1.0, that class is generating revenue greater than its cost to serve. I&E Statement No. 3, p. 23.

39. The relative rate of return for the CS, MSL, and POL rate classes are greater than 1.0. I&E Statement No. 3, p. 24.

40. A customer charge is limited to the direct costs associated with billing an individual customer. I&E Statement No. 3, pp. 30-31.

APPENDIX C

APPENDIX C

PROPOSED CONCLUSIONS OF LAW

1. The Company carries the burden of proof to show its rate proposal is just and reasonable. 66 Pa.C.S. § 315(a); *Irwin A. Popowsky v. Pa. P.U.C.*, 674 A.2d 1149 (Pa. Cmwlth. 1996).

2. Wellsboro must satisfy its burden of proof by presenting a preponderance of evidence. *Samuel J. Lansberry, Inc. v. Pennsylvania Public Utility Commission*, 578 A.2d 600 (Pa. Cmwlth. 1990).

3. A preponderance of the evidence is evidence that is more convincing, by even the smallest amount, than that presented by another party. *Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1950).

4. In base rate cases, the Commission has affirmed the utility's burden to establish the justness and reasonableness of every component of its rate request. *Pa. P.U.C. v. PPL Electric Utilities Corporation,* 2012 WL 6758304 (Pa. P.U.C. 2012)*; Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, 2004 WL 2314523 (Pa. P.U.C. 2004).

5. The burden of proof does not shift to parties challenging a requested rate increase. *Pa. P.U.C. v. PPL Electric Utilities Corporation,* 2012 WL 6758304 (Pa. P.U.C. 2012)*; Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, 2004 WL 2314523 (Pa. P.U.C. 2004).

6. The Company must produce substantial evidence to satisfy its burden of proof. *Brockaway Glass v. Pa. P.U.C.*, 437 A.2d 1067 (Pa. Cmwlth. 1981); *Lower Frederick Township v. Pa. P.U.C.*, 409 A.2d 505 (Pa. Cmwlth. 1980).

7. Substantial evidence is "such relevant and competent evidence having a rational probative force which a reasonable mind might accept as adequate to support a conclusion." *Dutchland Tours, Inc. v. Pa. P.U.C.*, 337 A.2d 922, 925 (Pa. Cmwlth. 1975).

Expenses

8. A public utility is entitled to recover all of its reasonably incurred expenses necessary to provide service to customers. *Butler Township Water Company v. Pa. P.U.C.,* 473 A.2d 219, 221 (Pa. Cmwlth. 1984); *UGI Corp. v. Pa. P.U.C.*, 410 A.2d 923, 932 (Pa. Cmwlth. 1980); *Western Pennsylvania Water Company v. Pa. P.U.C.*, 422 A.2d 906, 908 (Pa. Cmwlth. 1980).

9. Introducing new claims after non-company parties have addressed the companies' direct position is a violation of due process principles. *Pa. P.U.C. v. City of Lancaster – Sewer Fund*, 2007 WL 517134 (Pa. P.U.C. 2007).

10. A party cannot introduce evidence in rebuttal phase that should have been included in the party's case-in-chief or substantially varies from the party's case-in-chief. 52 Pa. Code §§ 5.243(e)(2)-(3).

11. Wellsboro's attempt to wholesale revise its O&M position in rebuttal testimony, rather than specifically respond to non-company parties' specific O&M adjustment recommendations is a prohibited attempt to introduce evidence that should have been introduced in direct testimony. *Pa. P.U.C. v. City of Lancaster – Sewer Fund*, 2007 WL 517134 (Pa. P.U.C. 2007); 52 Pa. Code §§ 5.243(e)(2)-(3).

12. The Commission characterizes rate case expense as a normal operating expense that should be accorded the same rate-making treatment as any other normalized expense. *Pa. P.U.C. v. Apollo Gas Co.*, 54 Pa. PUC 358, 373 (Pa. P.U.C. 1980).

13. To determine the length of rate case expense normalization, the Commission looks to the average number of months between a company's rate case filings. *Pa. P.U.C. v. City of DuBois - Bureau of Water*, Docket No. R-2016-2554150, pp. 65-66 (Order entered March 28, 2017) (reconsideration of rate case expense claim denied by Order entered May 18, 2017); *Pa. P.U.C. v. Emporium Water Company*, Docket No. R-2014-2402324, p. 50 (Order entered January 28, 2015); *Popowsky v. Pa. P.U.C.* 674 A.2d 1149, 1154 (Pa. Cmwlth. 1996); *Pa. P.U.C. v. Borough of Media Water Works*, 1990 WL 10702673 (Pa. P.U.C. 1990).

Fair Rate of Return

14. A utility is entitled to a return similar to that being earned by other enterprises with corresponding risks and uncertainties, but not as high as those earned by highly profitable or speculative ventures. *Bluefield Water Works & Improvements Co. v. Public Service Comm. of West Virginia*, 292 U.S. 679 (1923); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Pennsylvania Gas & Water Company v. Pa. P.U.C.*, 341 A.2d 239, 249-252 (Pa. Cmwlth. 1975).

15. A utility is entitled to a return level reasonably sufficient to assure financial soundness. *Bluefield Water Works & Improvements Co. v. Public Service Comm. of West Virginia*, 292 U.S. 679 (1923); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Pennsylvania Gas & Water Company v. Pa. P.U.C.*, 341 A.2d 239, 249-252 (Pa. Cmwlth. 1975).

16. A utility is entitled to a return sufficient to maintain and support its credit and raise necessary capital. *Bluefield Water Works & Improvements Co. v. Public Service Comm. of West Virginia*, 292 U.S. 679 (1923); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Pennsylvania Gas & Water Company v. Pa. P.U.C.*, 341 A.2d 239, 249-252 (Pa. Cmwlth. 1975).

17. A fair return can change (increase or decrease) along with economic conditions and capital markets. *Bluefield Water Works & Improvements Co. v. Public Service Comm. of West Virginia*, 292 U.S. 679 (1923); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Pennsylvania Gas & Water Company v. Pa. P.U.C.*, 341 A.2d 239, 249-252 (Pa. Cmwlth. 1975).

18. The PUC historically uses the DCF as the primary methodology to determine a utility's cost of equity. *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division,* Docket No. R-2017-2640058 (Order Entered October 25, 2018), pp. 104-106, 121; *Pa. P.U.C. v. City of DuBois – Bureau of Water*; Docket No. R-2016-2554150 (Order Entered March 28, 2017), pp. 96-98; *Pa. P.U.C. v. PECO Energy Co.*, 87 Pa. PUC 184, 212 (Pa. P.U.C. 1997); *Pa. P.U.C. v. Philadelphia Suburban Water Co.*, 71 Pa. PUC 593, 623-32 (Pa. P.U.C. 1989); *Pa. P.U.C. v. Western Pennsylvania Water Co.*, 67 Pa. PUC 529, 559-70 (Pa. P.U.C. 1988); *Pa. P.U.C. v. Consumers Pennsylvania Water Company – Roaring Creek Division*, 87 Pa. PUC 826 (Pa. P.U.C. 1997). *Pa. P.U.C. v. City of Bethlehem)*, 84 Pa. PUC 275, 304-05 (Pa. P.U.C. 1995); *Pa. P.U.C. v. Media Borough*, 77 Pa. PUC 446, 481 (Pa. P.U.C. 1992).

19. The PUC disfavors comparisons to non-utility companies for rate of return analysis. *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division,* Docket No. R-2017-2640058 (Order Entered October 25, 2018), p. 105; *Pennsylvania Public Utility Commission v. Philadelphia Electric Co.* 33 PUR 4th 319, 341 (Pa P.U.C. 1980).

20. The PUC recognizes the 10-year Treasury Note as the superior measure for the risk-free rate. *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division,* Docket No. R-2017-2640058 (Order Entered October 25, 2018), p. 99.

21. The PUC does not recognize technical literature not specific to the regulated utility industry to support a size adjustment to return on equity. *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division,* Docket No. R-2017-2640058 (Order Entered October 25, 2018), p. 100.

22. The Commission shall consider a utility's performance, and does not mandate award of additional points to a utility's return on equity. 66 Pa. C.S. § 523.

23. A utility must provide adequate, efficient, safe, and reasonable service. 66 Pa. C.S. § 1501.

Customer Rate Structure

24. A utility's rate structure cannot either advantage of disadvantage a class, or contain an unreasonable difference in rates. 66 Pa.C.S. §1304.

25. If there is a reasonable basis for a difference, a utility may charge different rates for different classes of customers. *Peoples Natural Gas Company v. Pa. P.U.C.*, 409 A.2d 446 (Pa. Cmwlth 1979).

26. A utility must show any difference in rates can be justified by the difference in costs to deliver service to each class. *Philadelphia Suburban Water Company v. Pa. P.U.C.*, 808 A.2d 1044, 1060 (Pa. Cmwlth. 2002).

27. Act 58 of 2017 set forth statutory standards for alternative ratemaking, but does not expressly determine which alternative rate methodologies, if any, are to be used. 66 Pa. C.S. § 1330; *Implementation of Act 58 of 2018 Alternative Ratemaking for Utilities*, Docket No. M-2018-3003269 (Order entered April 25, 2019), p.3.

28. Commission regulations concerning alternative distribution ratemaking mechanisms and rate designs are designed to promote efficiency, avoid unnecessary future capital investments, reflect cost of service principles, consider customer impacts, and establish a rate structure that is just and reasonable. 52 Pa. Code § 69.3301.

29. Commission regulations concerning alternative ratemaking include fourteen non-exclusive factors for consideration when determining just and reasonable alternative distribution ratemaking mechanisms and rate designs. 52 Pa. Code § 69.3302.

Miscellaneous

30. The PUC has routinely approved FTY and FPFTY reporting requirements regarding capital expenditures, plant additions, and retirements by month. *Pa. P.U.C. v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-2012-2321748 (Order entered May 23, 2013) (approving Joint Petition for Settlement including similar reporting requirement terms); *Pa. P.U.C. v. Pennsylvania-American Water Company*, Docket No. R-2013-2355276 (Order entered December 19, 2013) (approving Joint Petition for Settlement including similar reporting requirement terms); *Pa. P.U.C. v. PPL Electric Utilities Corporation*, Docket No. R-2015-

2469275 (Order entered November 15, 2015) (approving Joint Petition for Settlement including similar reporting requirement terms); *Pa. P.U.C. v. UGI Penn Natural Gas, Inc.*, Docket No. R-2016-2580030 (Order entered August 31, 2017) (approving Joint Petition for Settlement including similar reporting requirement terms); *Pa. P.U.C. v. Duquesne Light Company*, Docket No. R-2018-3000124 (Order entered December 20, 2018) (approving Joint Petition for Settlement including similar reporting requirement terms).

31. 66 Pa. C.S. § 315(e) allows an audit of FPFTY results after the fact to determine whether they were accurate. *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division,* Docket No. R-2017-2640058 (Order Entered October 25, 2018), p. 26.

32. The PUC has broad authority to require informational filings from utilities. 66 Pa. C.S. § 505.

APPENDIX D

APPENDIX D

PROPOSED ORDERING PARAGRAPHS

THEREFORE, IT IS RECOMMENDED:

1. Wellsboro Electric Company shall not place into effect the rates contained in Supplement No. 125 to Tariff Electric Pa. P.U.C. No. 8, which have been found to be unjust and unreasonable and therefore, unlawful.

2. That Wellsboro Electric Company shall be permitted to file tariffs, tariff supplements or tariff revisions containing proposed rates, rules and regulations to increase annual revenues in the total amount of not more than $719,538.

3. That Wellsboro Electric Company tariffs, tariff Supplements or tariff revisions may be filed to be effective on at least one day's notice after entry of the Commission's Final Order, for service rendered on and after the date of entry of the Commission's Final Order in this matter.

4. That Wellsboro Electric Company shall, under this docket number, provide to the Commission's Bureaus of Technical Utility Services and Investigation and Enforcement: (1) an update to Wellsboro Exhibit_(HSG-1), Schedule C3(W) no later than April 1, 2020, including actual capital expenditures, plant additions, and retirements by month for the twelve months ending December 31, 2019; and (2) an update to Wellsboro Exhibit_(HSG-1), Schedule C3(W) no later than April 1, 2021, including actual capital expenditures, plant additions, and retirements by month for the twelve months ending December 31, 2020.

5. That Wellsboro Electric Company shall allocate the authorized increase in operating revenues to each customer class and rate schedule within each class in the manner set forth in the Recommended Decision.

6. That Wellsboro Electric Company shall comply with all directives, conclusions and recommendations in this Recommended Decision that are not the subject of individual ordering paragraphs as fully as if they were the subject of specific ordering paragraphs.

7. That, upon acceptance and approval by the Commission of the tariff supplements filed by Wellsboro Electric Company, consistent with its Final Order, the investigation at Docket R-2019-3008208 be marked closed.

8. That the complaint filed by the Office of Consumer Advocate in this proceeding at Docket Number C-2019-3011959 be dismissed and marked closed.

9. That the complaint filed by the Office of Small Business Advocate in this proceeding at Docket Number C-2019-3012589 be dismissed and marked closed.

APPENDIX E

WELLSBORO ELECTRIC COMPANY RESPONSE TO OFFICE OF CONSUMER ADVOCATE'S ON THE RECORD DATA REQUEST DOCKET NO. R-2019-3008208

OCA REQUEST Provide an update of 2019 expenses for Account 593 through November 30, 2019 and estimations of December 2019 expenses.

Response: See the following chart:

Wellsboro Electric Company

GL Account #593 – Expenses thru November 30, 2019

Summary	
Labor	$104,990.23
Overheads	$63,474.37
Others	$346,734.73
	$515,199.33

Estimated December 2019 Acct 593 expenses --

(Labor)	$23,457
(Overheads)	$15,016
(Tree trimming)	$42,847
(Total - Dec 2019 est.)	$81,320

Also, Wellsboro was missing two linemen for all of Nov. and Dec. 2019, which reduced labor and overheads for Account 593.

Response Provided by: **Jill L. Campbell, VP Finance & Administration**
Wellsboro Electric Company

Byron Farnsworth Jr., VP E&O/COO
Wellsboro Electric

Date: December 20, 2019

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2019-3008208
	:	
Wellsboro Electric Company	:	
Supplement No. 125 to Tariff Electric – Pa.	:	
PUC No. 8	:	

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Main Brief** dated January 8, 2020, in the manner and upon the persons listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party):

Served via First Class and Electronic Mail

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