BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2019-3008212
	:	
Citizens' Electric Company of Lewisburg, PA	:	

MAIN BRIEF OF CITIZENS' ELECTRIC COMPANY OF LEWISBURG, PA

Pamela C. Polacek (PA I.D. No. 78276)
Adeolu A. Bakare (PA I.D. No. 208541)
Matthew L. Garber (PA I.D. No. 322855)
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Phone: (717) 232-8000
Fax: (717) 260-1744
ppolacek@mcneeslaw.com
abakare@mcneeslaw.com
mgarber@mcneeslaw.com

Counsel to Citizens' Electric Company of Lewisburg, PA

Dated: January 8, 2020

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I. INTRODUCTION

On July 1, 2019, Citizens' Electric Company of Lewisburg, Pennsylvania ("Citizens'" or "Company") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") Supplement No. 132 to Tariff Electric-Pa. PUC No. 14 ("Supplement No. 132"), proposing to increase annual revenues by $792,246. Citizens' Statement No. 1 – Direct Testimony of Howard S. Gorman ("Citizens' Statement No. 1"), Exhibit__(HSG-1), Schedule B6-1. In support of this filing, Citizens' submitted a Statement of Reasons, the supporting information required by 52 Pa. Code § 53.52(a), (b), and (c), and various other information.

The as-filed rate increase is approximately 16.5% of Citizens' annual distribution revenues under current rates. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule B6-4. When considering the Company's total annual revenues (distribution and generation supply), the overall as-filed increase is approximately 5.1%. *See id*.

In its Rebuttal Testimony, Citizens' subsequently revised its proposed revenue increase to approximately $701,000, reflecting rate of return and rate base adjustments to the as-filed request. Citizens' Statement No. 1-R – Rebuttal Testimony of Howard S. Gorman ("Citizens' Statement No. 1-R"), Exhibit__(HSG-1R), Schedule C1 (R).[1]

A. CITIZENS' ELECTRIC COMPANY OF LEWISBURG, PA

Citizens' is a Pennsylvania corporation with its principal office located in Lewisburg, Union County, Pennsylvania. Citizens' is an investor-owned, for-profit electric utility, wholly owned by C&T Enterprises, Inc. ("C&T"). C&T is a holding and management services company

[1] In its Rebuttal Testimony, Citizens' provided an updated Schedule C1 showing adjustments to present and proposed revenue, rate base and rate of return. *See* Citizens' Statement No. 1-R, (Exhibit__HSG-1R), Schedule C1 (R). All other schedule references are to the Company's as-filed presentation.

that currently also owns Wellsboro Electric Company ("Wellsboro") and Valley Energy, Inc. ("Valley").

Citizens' service territory is a 55-square-mile territory in and around Lewisburg, Pennsylvania. As stated in the original filing, in 2018, Citizens' served an average of 7,043 customers, of which approximately 5,871 customers were residential and approximately 1,172 were commercial, industrial, or lighting. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule B1. Citizens' received its authorization to operate as a public utility in the Commonwealth of Pennsylvania in Docket No. A-110050.

Through the instant proceeding, Citizens' requests from the Commission approval of an increase in annual distribution revenues. Citizens' conducted an analysis of whether the rates for its unbundled distribution service are sufficient to compensate the Company for the costs that it incurs to provide electric distribution service, plus a reasonable return. As part of this analysis, Citizens' segregated its revenues received from distribution service by deducting from total revenues the revenues and expenses for generation supply service. As a result of that study, the Company determined that the as-filed distribution rate increase of $792,246 per year is necessary. This analysis was conducted using 2020 as a fully projected future test year ("FPFTY"), as authorized by the Public Utility Code. As noted above, the request was adjusted to approximately $701,000 in the Company’s Rebuttal Testimony. *See* Citizens’ Statement No. 1-R

Under current rates, Citizens' earned a rate of return on its distribution business in 2018 of only 5.84%, a low return that will not support the long-term health of the Company. *See* Citizens' Statement No. 1-R, Exhibit__(HSG-1), Schedule C1 (R). By 2020, the Company's FPFTY, Citizens' return is projected to decrease to 3.97%, a level far too low under the *Hope* and *Bluefield*

Standards.[2] *See id.* If the full request is granted, the Company will be able to earn a return of approximately 7.62%. *See id.* Citizens' believes that this is an appropriate return for its regulated distribution service and is in line with the current expectations of investors in the marketplace. This is especially true for Citizens' investors because smaller utilities are generally viewed as carrying more risk because of their susceptibility to larger revenue fluctuations due to weather-related usage variations, loss of customer load, and other factors.

Since its last distribution rate increase filed in 2016, Citizens' has continued to provide high quality reliable service to customers while at the same time the costs of operating the distribution system have continued to grow. Citizens' has been systematically replacing its aging distribution infrastructure, including replacing aged poles, increasing conductor size to provide greater operating flexibility and reliability, replacing underground cable, reconductoring to increase capacity and reliability, and relocating lines for reliability improvement. Additionally, Citizens' has completed numerous small line extensions and upgrades over the last three years. Since the end of 2016, the Company will have invested over $5 million in utility plant in service by the end of the FPFTY. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C3.

Citizens' investments in reliability and infrastructure are occurring as Citizens' faces declining sales – a projected reduction in kWh of approximately 5.5%. *See id.* Sales are anticipated to decline for several reasons, including the anticipated completion of a 600 kW combined heat and power ("CHP") project by a current customer, the completion of a large solar installation at Bucknell University, the transfer of 32 customers in East Lewisburg to PPL Electric Utilities Corporation ("PPL"), and a flat residential housing market in the service territory. The aforementioned generation projects are expected to have service lives of 20-30 years. While there

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[2] *See* Section VII.A, *infra.*

is some load growth anticipated from an expansion at Evangelical Community Hospital that factored into the FPFTY forecast, no other significant load growth is expected across Citizens' territory. Additionally, Citizens' expects its customers to continue improving energy efficiency through continued proliferation and use of efficiency measures such as LED lighting, higher-efficiency appliances, and variable speed heat pumps. Finally, a slow but steady expansion of natural gas service in parts of the territory will likely result in some reduction of electric heat load as well.

The Company also is proactively addressing succession planning for its small workforce. It is expected that within the next 5 to 10 years, 11 of Citizens' current 17 employees will retire (4 administrative; 7 operations). Many of those retirements require advanced employment and training to ensure necessary skills and institutional knowledge are transferred. Citizens' incurred additional staffing and training expenses in 2018 as staffing overlaps occurred during preparations for the retirement of the President/CEO, the V.P. of Engineering & Operations was promoted to President, and a new Senior Director of Engineering & Operations was hired to fill the vacancy. The Company will incorporate additional short-term staffing overlaps during 2019 and beyond as appropriate to ensure that new hires have sufficient time to learn needed skills.

Operations and Maintenance ("O&M") costs are approximately $100,000 higher for the FPFTY when compared to the 2016 rate case. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C5-1. Most notably, Citizens' tree-trimming contractor costs have increased by approximately $60,000 due to the Emerald Ash Borer, enhanced tree growth due to wet growing seasons, and an increased focus on resolving off-right-of-way priority trees as encouraged by the Commission's Reliability and Emergency Preparedness Section of the Bureau of Technical Utility Services ("TUS"). Pole inspection costs have also increased. Remaining O&M increases are primarily due to cost increases in wages and salaries.

Above all, the proposed distribution rates will promote the continued provision of safe and reliable service by ensuring that Citizens' will earn a fair and reasonable return on the resources invested in the distribution system. Citizens' will be able to continue its capital investment in system improvements, as well as the current maintenance and replacement policies that have resulted in very safe, adequate, and reliable service for customers. The new rates will also enhance Citizens' ability to obtain capital, when necessary, to fund major system improvement projects that may be necessary in the future.

B. HISTORY OF THE PROCEEDINGS

This proceeding was initiated on July 1, 2019, when Citizens' filed Supplement No. 132 with the Commission. The Office of Consumer Advocate ("OCA") filed a Formal Complaint against Citizens' rate increase on July 30, 2019. The Office of Small Business Advocate ("OSBA") and the Bureau of Investigation and Enforcement ("I&E"), thereafter, submitted Notices of Appearance in this proceeding. Pursuant to 52 Pa. Code § 5.61(d), Citizens' elected not to file an answer to OCA's Complaint.

At its Public Meeting of August 29, 2019, the Commission suspended Citizens' proposed tariff supplement by operation of law until March 30, 2020 and instituted an investigation into this proceeding. On September 9, 2019, Citizens' filed a tariff supplement voluntarily extending the suspension period through April 29, 2019. On October 2, 2019, Citizens' filed an updated tariff supplement voluntarily extending the suspension period until May 1, 2020. The Commission assigned Administrative Law Judges ("ALJs") Steven K. Haas and Benjamin Myers to this case.

The ALJs held a Prehearing Conference on September 13, 2019, at which time a litigation schedule was developed. The Prehearing Conference was held jointly with rate cases filed by Wellsboro and Valley at Docket Nos. R-2019-3008208 and R-2019-3008209, respectively. Prior to the Prehearing Conference, on August 2, 2019, Citizens' provided the parties with its proposed

Direct Testimony. In accordance with the schedule established at the Prehearing Conference, Citizens' received Direct Testimony from OCA, I&E, and OSBA on October 15, 2019. On November 14, 2019, Citizens' submitted Rebuttal Testimony and received Rebuttal Testimony from OCA and OSBA on that same date. Citizens' presented Surrebuttal Testimony on December 4, 2019, and received Surrebuttal Testimony from OSBA, I&E, and OCA on the same date.

Evidentiary hearings were held on December 16 and 17, 2019, to establish the record; provide oral Rejoinder Testimony from Company witnesses; and to make witnesses available for cross-examination. As with the Prehearing Conference, the evidentiary hearings were held jointly for the Citizens', Wellsboro, and Valley rate proceedings. All prepared Statements and Exhibits were entered into the record by verification or by witness authentication. Company witnesses Gorman, D'Ascendis, and Kelchner were sworn in and presented oral Rejoinder Testimony and submitted to cross-examination. I&E witnesses Patel and Cline and OCA witnesses Sherwood, Morgan, and Mierzwa were sworn in and submitted to cross-examination. The testimony of all other witnesses was entered into the record by stipulation and without cross-examination.

Despite good faith efforts to resolve disputed issues via settlement, the parties were unable to reach settlement. However, a number of proposals by various witnesses were agreed upon by witnesses to opposing parties. These resolved issues are set forth in Section III of this Main Brief. Citizens' files this Main Brief to address all remaining disputed issues. As set forth more fully in this Main Brief, Citizens' proposed rate base, revenue, expenses, rate of return, and rate design are just and reasonable and should be approved by the Commission.

C. LEGAL STANDARDS

The Public Utility Code requires that a public utility's rates be just, reasonable, and do not result in unreasonable rate discrimination. 66 Pa. C.S. §§ 315(a), 1301, 1304. Where, as here, a public utility seeks a general rate increase, the utility has the burden of proving that each element of the rate increase request is just and reasonable. *Univ. of Pa. v. Pa. PUC*, 485 A.2d 1217, 1226 (Pa. Cmwlth. 1984). The Commonwealth Court has explained, however, that public utilities are not required to affirmatively defend claims that have gone unchallenged. *See Allegheny Ctr. Assoc.'s v. Pa. PUC*, 570 A.2d 149, 153 (Pa. Cmwlth. 1990) (stating "[w]hile it is axiomatic that a utility has the burden of proving the justness and reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged.").

The ultimate burden of proof does not shift from the utility seeking a rate increase; however, where a party proposes an adjustment to the utility's rate making claim, that party must present evidence or analysis that demonstrates the reasonableness of its proposed adjustment. *See e.g., Pa. PUC v. Philadelphia Electric Company,* Docket No. R-891364, *et al.*, 1990 Pa. PUC LEXIS 155 (Order dated May 16, 1990); *see also Pa. PUC v. Breezewood Tel. Co.*, Docket No. R-901666, 1991 Pa. PUC LEXIS 45, at *10 (Order dated Jan 31, 1991) (stating "the Commission has indicated that where a party proposes an adjustment to a ratemaking claim of a utility, the proposing party does bear the burden of presenting some evidence or analysis tending to demonstrate the reasonableness [sic] of the adjustment.").

Further, a party that raises an issue that is not included in a public utility's general rate case filing bears the burden of proof. *See, e.g., Pa. PUC v. Metro. Edison Co., et al.,* Docket Nos. R-00061366, *et al.,* 2007 Pa. PUC LEXIS 5, at *111-12 (Order entered Jan.11, 2007) (holding that Section 315(a) of the Public Utility Code cannot reasonably be read to place the burden of proof on utility with respect to issues the utility did not include in its general rate case filing and which, frequently, utility would oppose).

II. SUMMARY OF ARGUMENT

Citizens' requests approximately a $701,000 overall revenue increase in this proceeding. Since Citizens' last base rate case, the Company has made significant system investments, which will have increased its rate base by nearly $850,000 to almost $13 million by the end of the FPFTY.

As a small utility, Citizens' continues to excel in providing exceptional service to its customers. The Company has been systematically replacing its aging distribution infrastructure, including replacing aged poles, increasing conductor size to provide greater operating flexibility and reliability, replacing underground cable, reconductoring to increase capacity and reliability, and relocating lines for reliability improvement. Additionally, Citizens' has completed numerous small line extensions and upgrades over the last three years. These initiatives will require the Company to raise additional capital in the financial markets. Supportive regulation, through adequate rate relief, is a key component of the Company's ability to continue to invest in safe, adequate, and reliable service for its customers.

Citizens' has presented extensive evidence to support its filing. This Main Brief addresses all major aspects of the Company's rate filing, including rate base, revenues, expenses, rate of return, and rate structure in Sections IV through IX. The issues upon which the parties have agreed through testimony are stated in Section III.

Throughout this proceeding, the Company has presented extensive evidence of management efficiency and effectiveness. The Company has continued its exceptional management track record, including the following accomplishments since the last base rate case: (1) low number of customer complaints; (2) favorable customer feedback; (3) high responsiveness to customer support calls and in energizing new service locations; (4) excellent reliability metrics; (5) no reportable injuries; (6) technological improvements in customer service by offering Smarthub use to customers and providing line crews with tablets; (7) increased pole attachment billing; (8) recognition as a "Tree Line USA" utility; (9) replacement of forty percent of all the streetlights in its service area with LED lights; and (10) continued significant capital investment of approximately $1.4 million per annum. Citizens' Statement No. 4 – Direct Testimony of John Kelchner ("Citizens' Statement No. 4") at 9-12. The bottom line in determining management effectiveness is quality of service and reasonable rates. As explained further in this Main Brief, Citizens' provides top tier customer service and reliability with a small, dedicated team and, thus far, without the use of a Distribution System Improvement Charge ("DSIC"). These efforts and results should be recognized in this proceeding, as required by Section 523 and good public policy.

Notably, the evidence demonstrating Citizens' effective management and service is entirely unrebutted by the opposing parties. However, I&E and OCA have essentially ignored all of this evidence and propose a variety of adjustments that, if adopted, would eliminate most of the proposed increase. These positions are contrary to the facts of the case, and in key respects, directly contradict Commission precedent. These central disputes are summarized as follows:

A. RATE BASE

Consistent with long-standing Commission precedent and the Commission's recent holding in the UGI Order, the Company's rate base claim is based on projected balances at the end of the test year – in this case, the FPFTY. *See Pa. PUC v. UGI Utilities, Inc. – Electric Division,* Docket No. R.2017-2640058 (Order Entered October 25, 2018) ("UGI Order"). However, OCA argues that plant in service should not be calculated in this manner, instead proposing an approach that "averages" the beginning and end of FPFTY balances. OCA effectively seeks to disallow half of all plant added during the FPFTY and in conflict with the Commission's clear holding in the UGI Order. As described in Section IV, *infra*, this adjustment is fundamentally inconsistent with the plain language of the Act of Feb. 14, 2012, Pub. L. 72, No. 11 ("Act 11") and the Commission's holding in the UGI Order.

B. REVENUES

I&E and OCA both oppose Citizens' present rate revenue claims. I&E argues that Citizens' understates its FPFTY customer count, and OCA opposes the reduction of sales and revenue from a solar installation that is expected to be completed in 2020. I&E fails to account for limited customer growth, and OCA grossly overstates the impact of a local zoning matter on the completion date of the solar installation. I&E and OCA fail to address the fact that Citizens' faces declining sales, adding to its need for rate relief. As further set forth in Section V, *infra*, the Company's revenue projections are reasonable and should be accepted by the Commission.

C. EXPENSES

OCA and I&E seek reductions to numerous Company accounts using a variety of methods to understate the Company's expenditures. However, Citizens' future test year ("FTY") (2019) year-to-date data, provided up through September 30, 2019, in Rebuttal Testimony, shows that the Company is effectively managing to its budget. While there is some variation between accounts, the Company's expenses are tracking slightly above projections, showing the Company's expense projections are realistic and conservative. As further explained in Section VI, *infra*, the Company's expense claims should be accepted.

D. RATE OF RETURN

The Company has presented extensive data and analyses fully supporting its proposed 10.3% return on common equity and demonstrating that the 8.10% and 8.38% proposals of I&E and OCA, respectively, are woefully deficient. Of note:

1. OCA and I&E's recommended costs of common equity are outside the zone of reasonableness and, if adopted, would place the Companies below the lowest

Return on Equity ("ROE") *in the entire United States* over the past 40 years, according to a leading utility research group.

2. I&E and OCA ignore evidence establishing that their reliance solely on one ROE model would understate a fair rate of return due to present market conditions.

3. Citizens' requested rate base of approximately $12,800,000 is orders of magnitude smaller than the $1.6 *billion* rate base of the average electric utility in Citizens' proxy group granted an ROE of 9.6%. The Company has provided extensive evidence of size risk that must be reflected in an opportunity to earn a fair rate of return.

4. In accordance with the requirements of Section 523 of the Code, 66 Pa. C.S. § 523, Citizens' presented extensive evidence of excellent utility management. No party challenged any aspect of the Company's evidence—but argued the Company has been merely taking actions it is required to take pursuant to the Public Utility Code. In essence, I&E and OCA have offered only general opposition to the principle of a performance adjustment—an inadequate argument that ignores Section 523 of the Code.

As further explained in Section VII, *infra*, the deficient proposals of I&E and OCA cannot be considered reasonable or reflective of the current market climate and should be rejected by the Commission.

E. REVENUE ALLOCATION AND RATE DESIGN

Besides classification of part of secondary distribution costs as customer-related costs, no party opposed the Company's allocated cost of service study ("COSS"). Regarding revenue allocation, the Company prioritizes cost of service principles, while reflecting gradualism. The Company also proposes to begin including a small portion of demand costs (equal to the minimum demand for residential customers pursuant to the allocated class cost of service study ("ACOS")) through its residential monthly customer charges.

I&E and OCA flatly reject the inclusion of any demand or fixed costs in the customer charge, despite the fact that (1) the Company's proposed rate design adheres to cost of service principles by only including the portion of demand costs that almost customers cause; (2) the Company adhered to gradualism in this rate design; and (3) the General Assembly specifically authorized utilities to propose alternative ratemaking methodologies through the passage of Act of July 1, 1978, P.L. 598, *as amended*, added by Act of June 28, 2018, P.L. 58, 66 Pa. C.S. § 1330 ("Act 58"). As explained further in Section IX, *infra*, I&E and OCA's arguments should be rejected by the Commission.

F. CONCLUSION

The opposing parties' proposals deny meaningful rate relief to a Company that is experiencing modest to non-existent revenue growth, faces increased operating expenses, and continues to invest substantial capital in new plant and facilities necessary to provide safe and reliable service to customers. The Company has presented unrebutted evidence of superior management, a fact acknowledged by neither I&E nor OCA. The opposing parties reach an unreasonable position by: (1) defying the plain language of the Public Utility Code; and (2) ignoring long-standing Commission precedent on fundamental ratemaking issues. By correcting these errors and authorizing a reasonable return on common equity, the gap between Citizens' and the opposing parties largely disappears, demonstrating that the Company should be awarded all or nearly all of its requested rate relief. Therefore, Citizens' respectfully requests that the ALJs and the Commission deny the adjustments of the opposing parties and approve Citizens' proposed rate increase.

III. ISSUES RESOLVED AMONG ALL PARTIES[3]

A. CONSTRUCTION WORK IN PROGRESS

The Company initially proposed to add a Construction Work in Progress ("CWIP") amount of $70,492 to its FPFTY rate base total. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C2. This amount was based on the balance sheets for the historic test year ("HTY"), FTY, and FPFTY. I&E and OCA opposed the addition of CWIP for the FPFTY to rate base. I&E Statement No. 3 – Direct Testimony of Ethan H. Cline ("I&E Statement No. 3") at 10-11; OCA Statement No. 2 – Direct Testimony of Lafayette Morgan ("OCA Statement No. 2") at 4-5.

Because Citizens' CWIP projections were based on historic figures rather than specific identified projects projected to be under construction at the conclusion of the FPFTY, Citizens' accepted the removal of CWIP from rate base. Citizens' Statement No. 1-R at 13. However, Citizens' acceptance of the removal of CWIP from rate base is conditioned on the premise that plant projected to be in service by the end of the FPFTY is included in rate base, consistent with Commission precedent. *Id.* If "average" rate base figures for the FPFTY are used, as argued by OCA, the Company believes retaining its CWIP claim is appropriate. *Id.*

B. CHARITABLE CONTRIBUTIONS

Citizens' prioritizes building goodwill with customers, maintaining a positive presence in the community, and creating a vibrant, community-oriented workplace for Company employees. To that end, Citizens' makes a variety of charitable contributions to different community organizations each year in support of the local community. *See* I&E Statement No. 1 – Direct Testimony of D.C. Patel ("I&E Statement No. 1"), I&E Exhibit No. 1, Schedule 8. In HTY 2018,

[3] The rate case tables attached at Appendix A reflect any revisions that Valley accepted in its Rebuttal Testimony.

Account 426.1 expenditures totaled $25,650, and the Company projected $27,000 in charitable expenditures for the FTY and FPFTY. *Id.* Citizens' charges these charitable expenditures to Account 426.1. Citizens' Statement No. 1-R at 5.

Due to an initial misunderstanding between the parties on whether charitable contributions were included in calculating the Company's revenue requirement, I&E proposed adjustments to Citizens' revenue requirement based on Account 426.1. I&E Statement No. 1 at 20-21. However, Citizens' clarified in Rebuttal Testimony that Account 426.1 was not included in Citizens' revenue requirement. Citizens' Statement No. 1-R at 5. I&E withdrew its proposed adjustments connected to this account. I&E Statement No. 1-SR – Surrebuttal Testimony of D.C. Patel ("I&E Statement No. 1-SR") at 22.

C. RATE BASE – MATERIALS & SUPPLIES

In its initial filing, the Company proposed to add $178,276 to rate base for materials and supplies. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-6. I&E witness Cline and OCA witness Morgan proposed to use an average of the most recent 13 months of actual inventories, as shown on I&E Exhibit No. 3, Schedule 3 and OCA Schedule LKM-3. I&E Statement No. 3 at 8; OCA Statement No. 2 at 3.

On Rebuttal, the Company accepted the Advocates' 13-month methodology and reduced its claim by $4,209 to $174,067. Citizens' Statement No. 1-R at 6, 13.

D. RATE BASE – CUSTOMER DEPOSITS

In its filing, the Company proposed to deduct $106,386 from rate base for customer deposits. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-6. Instead of basing the customer deposits amount on the Company's end-of-year HTY balance, OCA proposed to use a 13-month average balance. OCA Statement No. 2 at 6. OCA proposed a $209 adjustment to the Company's claim for customer deposits. OCA Statement No. 2, Schedule LKM-4.

On Rebuttal, the Company accepted OCA's 13-month methodology and reduced its customer deposits adjustment by $209 to $106,177. Citizens' Statement No. 1-R at 13.

E. CHP PROJECT

Citizens' revenue projections include sales reductions due to the anticipated completion of 600 kW of CHP generation at one customer location; a large solar photovoltaic ("Solar PV") generation at Bucknell University; and the loss of 32 meters at East Lewisburg due to the transfer of those customers to PPL. Citizens' Statement No. 4 at 7. While increased sales are projected from an expansion underway at Evangelical Community Hospital, overall sales are projected to decline from 177,519,531 kWh in the 2016 rate case settlement to 167,748,001 in 2020. *Id.*

Initially, OCA rejected Citizens' projected elimination of 3,903,000 kWh attributable to the CHP project. OCA Statement No. 4 – Direct Testimony of Jerome D. Mierzwa ("OCA Statement No. 4") at 30. OCA witness Mierzwa argued that, due to outages or maintenance requirements, Citizens' would need to supply power to the CHP customer at times and recommended that Citizens' provide a revised reduction. *Id.*

On Rebuttal, Citizens' witness Kelchner explained that the total energy production from the CHP unit is anticipated to exceed the customer's historic usage. Citizens' Statement No. 4-R – Rebuttal Testimony of John Kelchner ("Citizens' Statement No. 4-R") at 11. Because the account is entitled to Net Metering, even if the customer takes service from Citizens' for scheduled maintenance or other outages, that usage would be netted against the excess output from the CHP unit. *Id.* As a result, service during the CHP outages is not expected to generate revenue for Citizens'. *Id*. On cross-examination, Mr. Mierzwa accepted the Company's response and withdrew his proposed adjustment. Tr. 314.

IV. RATE BASE

A. COMPANY PROPOSAL

The Company's claim for rate relief in this case is based upon data for the FPFTY ending December 31, 2020. Citizens' Statement No. 1 at 2; Citizens' Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R). In keeping with Commission regulations, Citizens' has provided detailed data for the HTY ending December 31, 2018. Citizens' Statement No. 1 at 5.

Citizens' final claimed rate base of $12,847,545 reflects all adjustments adopted by the Company in this proceeding.[4] The claimed rate base consists of:

- the original cost of its utility plant in service as of December 31, 2020
- less: accumulated depreciation; accumulated deferred income taxes ("ADIT"); excess deferred income taxes ("EDIT"); and customer deposits
- plus: CWIP; accrued pension / OBEP liability; materials and supplies; and Cash Working Capital ("CWC")

I&E proposed changes to CWIP and Materials and Supplies but did not dispute any other rate base components. Citizens' Statement No. 1-R at 6. OCA proposed adjustments to plant in service, CWIP, Materials and Supplies, Customer Deposits, Depreciation Expense, and EDIT. *Id.* at 12.

B. ORIGINAL COST UTILITY PLANT IN SERVICE

The Company's claim for original cost utility plant in service of $26,687,785 is based on projected plant in service at the end of the FPFTY. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedules C1-6, C2, C3, E-1A. OCA witnesses oppose the Company's calculation of plant in

[4] *See* Appendix A. The $12,847,336 rate base claim in the Company's Rebuttal Testimony inadvertently omitted a $209 adjustment for customer deposits proposed by OCA and accepted by the Company. *See* Citizens' Statement No. 1-R, Exhibit__(HSG-1R) Schedule C1 (R).

service at the end of the FPFTY, instead proposing an average calculation of rate base throughout the FPFTY. OCA Statement No. 2 at 4. For the reasons articulated below, these proposed adjustments should be rejected.

1. **End-of-Year vs. Average Rate Base Methodology**

The Company's claim for plant in service is based on plant projected to be in service at the end of the FPFTY – that is, December 31, 2020. The Company's approach is consistent with direction recently provided by the Commission for calculation of plant in service at the end of the FPFTY. *See* UGI Order at 23-26; *see also* 66 Pa. C.S. § 315(e). The Company's approach comports with other Commission precedent providing that rate base items should be calculated as of the end of the given test year.

OCA opposes this methodology. Instead of using an end-of-year plant in service figure, OCA proposes that the Commission calculate the Company's rate base by averaging the beginning of test year and end of test year plant balances. Specifically, OCA proposes to average the plant in service balance on December 31, 2019 ($25,502,273) with the plant in service balance at the end of the FPFTY on December 31, 2020 ($26,687,785). *See* OCA Statement No. 2, Schedule LKM-1. The result is a $592,756 downward adjustment to Citizens' claim for plant in service. *See id*.[5]

OCA's primary argument is that Citizens' new rates will go into effect before some of the costs will be incurred. OCA Statement No. 1 – Direct Testimony of Stacy L. Sherwood ("OCA Statement No. 1") at 4; OCA Statement No. 2-SR – Surrebuttal Testimony of Lafayette K. Morgan ("OCA Statement No. 2-SR") at 2. OCA appears to propose this alternative methodology based

[5] In addition to plant in service, OCA's proposed methodology also impacts other components of the Company's total claim in this proceeding, such as Accumulated Depreciation. The arguments supporting the Company's calculation of the FPFTY with regard to plant in service, and those supporting rejection of the approach utilized by OCA, extend to those other components of the Company's claim, as well. *See* Citizens' Statement No. 1-R at 13.

on the assumption that customers will be paying for plant that is not yet in service. Specifically, OCA witness Sherwood argues that Citizens' will earn a 12-month return for calendar year 2020 "on the level of plant that will not be in service until December 31, 2020." OCA Statement No. 1 at 4. OCA asks the Commission to contradict its own decision in the UGI Order, stating that OCA appealed the Commission's holding. OCA Statement No. 2-SR at 2.

As noted above, the Company's claimed plant in service, based on plant projected to be in service at the end of the FPFTY, is consistent with both the Commission's holding in the UGI Order and long-standing Commission precedent, which has uniformly approved the calculation of plant in service at a point in time, i.e. the end of the relevant test year. *See, e.g., Pa. PUC, et al. v. PPL Electric Utilities Corporation,* Docket Nos. R-2012-2290597, et al., at 12. ("We agree with PPL that rate base items...are balances to be in effect at the end of the test year.").

For the reasons set forth below, OCA's arguments explicitly contradict the Commission's holding in the UGI Order; ignore the plain language of Act 11; frustrate the General Assembly's goals in enacting Act 11. OCA's position should be rejected.

a. <u>OCA's Argument Contradicts the Commission's Decision in the UGI Order.</u>

In the UGI Order, the Commission addressed the question of whether plant in service should be calculated on the basis of an end-of-year figure or an average figure as proposed by OCA and I&E in that proceeding. The Commission held that an end-of-year plant in service number is appropriate. UGI Order at 23. In its Order, the Commission rejected arguments by the Advocates based on Section 1315 of the Code, which requires electric utility projects to be "used and useful" before being included in the rate base. As explained by the Commission:

> Section 315(e) of the Code specifically exempts application of 66 Pa. C.S. § 1315, which, for electric utilities, requires projects to be "used and useful" before being included in the rate base. The ALJs properly determined that the "used and useful"

> standard in Section 1315 *is not a bar to including all plant added during the FPFTY.*

UGI Order at 23 (emphasis added). The Commission further stated that by using an FPFTY, "a utility is essentially permitted to require ratepayers to pre-pay a return on its projected investment in future facilities." UGI Order at 24. The Commission evaluated the statute and explicitly noted that, with the FPFTY, the future facilities are not in place and providing service at the time the new rates will take effect. However, the Commission affirmed that use of an end-of-year FPFTY plant balance is appropriate under Section 315(e).

b. <u>The Plain Language of Act 11 Supports an End-of-Year Plant in Service Calculation for Both FTY and FPFTY.</u>

In 2012, the legislature enacted Act 11. Among other things, Act 11 provided for the use of an FPFTY as a new ratemaking tool in Pennsylvania, amending Section 315(e) of the Public Utility Code to state as follows:

> (e) Use of future test year.--In discharging its burden of proof the utility may utilize a future test year or a fully projected future test year, which shall be the 12-month period beginning with the first month that the new rates will be placed in effect after application of the full suspension period permitted under section 1308(d) (relating to voluntary changes in rates). The commission shall promptly adopt rules and regulations regarding the information and data to be submitted when and if a future test period or a fully projected future test year is to be utilized. Whenever a utility utilizes a future test year or a fully projected future test year in any rate proceeding and such future test year or a fully projected test year forms a substantive basis for the final rate determination of the commission, the utility shall provide, as specified by the commission in its final order, appropriate data evidencing the accuracy of the estimates contained in the future test year or a fully projected future test year, and the commission may after reasonable notice and hearing, in its discretion, adjust the utility's rates on the basis of such data. Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission may permit facilities which are projected to be in service during the fully projected future test year to be included in the rate base.

66 Pa. C.S. § 315(e). The language of Act 11 fully supports use of end of test year balances. *See id.* The Act does not contain a separate provision for the FPFTY; rather, it simply adds the

FPFTY to the existing statute authorizing use of an FTY. *See id.* For the FTY, it is standard ratemaking practice to use end of test year balances for determining plant in service. Act 11 provides no indication that the FPFTY plant balances should be calculated differently. In fact, as explained above, the Legislature (1) expressly indicated that the FPFTY may include plant projected to be in service *during* the FPFTY; and (2) specifically noted that Section 1315, which codified the "used and useful" standard, provides no bar to including in rate base all plant added during the FPFTY. *See id.* Thus, the General Assembly clearly allowed for the FPFTY to be treated the same as the FTY in calculating plant in service. OCA's arguments should be rejected.

c. **The Use of End of Test Year Plant Balances Is Consistent with the Policy Underlying Act 11.**

As affirmed in the UGI Order, one of the policies underlying Act 11 is to address regulatory lag. UGI Order at 23; *see also* Implementation of Act 11 of 2012, Docket No. M-2012-2293611, 2012 Pa. PUC LEXIS 1223 at *4-5, 7, 90 (Order entered Aug. 2, 2012) ("Act 11 Implementation Order"). It is well-known that many Pennsylvania utilities have aging infrastructure and must complete substantial capital investments to maintain safe and reliable service to ratepayers. Regulatory lag, where rate case inputs "are outdated by the time new base rates become effective," presents a challenge to fulfilling this need. Act 11 Implementation Order at *4. This problem is explicitly addressed by Act 11.

Act 11 addressed the problem of regulatory lag by establishing the FPFTY and authorizing utilities to file for a DSIC under certain conditions. *See* 66 Pa. C.S. § 1358(b)(1). The FPFTY allows utilities to develop rate filings on a *fully projected* future test year rather than a test year that will be mostly or entirely in the past at the conclusion of the rate case. The DSIC, meanwhile, is designed to recover approved and qualifying infrastructure improvements between rate cases, reducing regulatory lag and the need to file frequent base rate cases. *See, e.g.,* Act 11 Implementation Order at 90.

OCA's proposal to use an average rate base would dramatically weaken the benefits provided by the legislature in adopting Act 11. First, OCA would effectively deny half of the rate recovery by disallowing half of the additions budgeted between the end of the FTY and the end of the FPFTY. Specifically, OCA would eliminate half of the benefits of using the FPFTY by only allowing $592,756 in plant additions in 2020, where Citizens' has planned for $1,185,512 of plant additions for the FPFTY. *See* OCA Statement No. 2, Schedule LKM-1.

Second, under OCA's proposal, at some point during the first-year rates are in effect, rates will become insufficient to cover the used and useful plant placed into service during that year. In effect, this policy, if adopted, would convert a fully projected future test year to a "partially projected half test year." *See* Citizens' Statement No. 1-R at 13.

This approach is inconsistent with the purpose and policy underlying Act 11. OCA has provided no factual or legal basis for its average proposal, except that OCA is challenging the Commission's current position. OCA's position should be rejected.

d. The Company's Approach Is Internally Consistent.

In this case, the Company's approach for the FPFTY aligns with the Company's approach to the HTY and FTY. For all three test years, the Company provides rate base as of the last day of the annual period. *See* Citizens' Statement No. 1, Exhibit__(HSG-1) Schedule C1-6. This is consistent with Act 11, which mandates that all plant placed in service during the test year be used and useful in providing service in that test year.

Adopting OCA's proposed methodology would result in one approach for 2018 and 2019 data and a distinct (and incomplete) approach for 2020 – in effect treating 2020 as a partial year for rate base but full year for revenue and expenses. The OCA's approach to ratemaking is internally inconsistent and disjointed with no precedential basis. OCA's proposal should be rejected by the Commission.

e. Current Commission Policy Should Control Unless and Until It Is Overturned by a Reviewing Court.

OCA acknowledges that the Commission decided against the use of average rate base in the UGI Order but points out that the Commission decision is currently under legal challenge by OCA. OCA Statement No. 2 at 2. Regardless of the status of this issue on appeal, the Commission's current position is clear. The Company has appropriately used year end balances, consistent with the UGI Order. The OCA's proposed adjustment to rate base must be rejected.

C. ACCUMULATED DEPRECIATION

The Company's claim for rate base included an accumulated depreciation of $13,537,134 for FPFTY. Citizens' Statement No. 1, Exhibit__(HSG-1) Schedule C1-6. As described by Citizens' witness Gorman, accumulated depreciation is calculated by adding annual depreciation expense at each year-end and subtracting retirements to the previous year-end balance. Citizens' Statement No. 1 at 13.

I&E did not oppose the Company's accumulated depreciation claim. I&E Statement No. 3, Exhibit No. 3, Schedule 1. However, OCA proposed an adjustment to accumulated depreciation based on its arguments that original cost utility plant in service should be based on an average of the beginning-of-year and end-of-year FPFTY plant balances. OCA Statement No. 2 at 4. OCA's FPFTY average balance calculation of $26,095,029 resulted in a $378,420 reduction in accumulated depreciation amount, for a total accumulated depreciation of $13,158,754. OCA Statement No. 2, Schedule LKM-1.

The distinction between OCA's position and the Company's position on accumulated depreciation is a direct result of the two parties' different approaches to calculating the original cost plant in service. As stated above, the Company contends that original cost plant in service should be calculated based on the FPFTY year-end balance, consistent with the Commission's holding in the UGI Order.[6]

D. ADDITIONS TO RATE BASE

Citizens' additions to rate base include: Materials and Supplies; Accrued Pension / OPEB Liability (negative amount); and CWC. Citizens' Statement No. 1, Exhibit__(HSG-1) Schedule C1-6.

1. Materials & Supplies

As stated above, the Company agreed to a small Materials and Supplies adjustment proposed by OCA and I&E, reducing its claimed increase from $178,276 to $174,067. Citizens' Statement No. 1-R at 6.

2. Accrued Pension/OPEB Liability

In its filing, the Company proposed a reduction to rate base for Accrued Pension / OPEB liability. This reduction reflects the excess of amounts charged to expense over amounts paid. Citizens' Statement No. 1 at 14. Neither OCA nor I&E proposed any adjustments to the Company's claim. OCA Statement No. 1, Schedule SLS-3; I&E Statement No. 3 at 6.

3. Cash Working Capital

Regarding CWC, the Company claimed an increase of $342,049 to rate base. Citizens' Statement No. 1, Exhibit__(HSG-1) Schedule C1-6. The Company derived the CWC by using the widely-accepted formula of 1/8 of non-fuel cash operating costs. Citizens' Statement No. 1 at 14.

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[6] On this basis, the OCA's adjustment to Accumulated Depreciation also must be rejected. However, if the Commission reduces the Company's claim for original cost plant in service, there should be a commensurate reduction in accumulated depreciation as well.

I&E and OCA do not oppose the 1/8 method proposed by the Company. Citizens' Statement No. 1-R at 4-5. However, I&E and OCA each propose to reduce the CWC claim to reflect the respective party's proposed O&M expense adjustments. I&E Statement No. 1 at 23; OCA Statement No. 1 at 9.

While the Company opposes several O&M expense adjustments proposed by I&E and OCA, the Company agrees that CWC should be recalculated if the Commission orders any changes to the Company's claimed O&M expenses. *See* Citizens' Statement No. 1-R at 5, 12. If O&M expenses are adjusted, the Commission should use the same 1/8 method utilized by the Company, I&E, and OCA to adjust CWC.

E. DEDUCTIONS FROM RATE BASE

As outlined above, the Company deducted the following from plant in service in its calculation of rate base: Customer Deposits; ADIT; and EDIT. Citizens' Statement No. 1, Exhibit__(HSG-1) Schedule C1-6.

1. **Customer Deposits**

As stated above, OCA proposed a $209 adjustment to Customer Deposits, which the Company accepted. *See* OCA Statement No. 2 at 6; *see also* Citizens' Statement No. 1-R, at 13.

2. **ADIT and EDIT**

ADIT addresses the difference between actual tax liability for accumulated depreciation paid by Citizens' and the amount of tax expense for accumulated depreciation paid by ratepayers in the revenue requirement. Citizens' Statement No. 1 at 13-14. Federal tax expense for ratemaking purposes is calculated using straight line depreciation, while for tax purposes the Company could use the double declining balance depreciation method. EDIT, on the other hand, directly addresses the benefit the Company received by taking depreciation expense for tax purposes while the Federal corporate tax rate was 34% and the revaluation of EDIT as of

December 31, 2017, when the corporate tax rate changed from 34% to 21%. *Id*. Because the EDIT is due to the one-time change in the tax rate established through the Tax Cuts and Jobs Act ("TCJA"), it will not change over time. *Id.*

The Company's claimed rate base includes a reduction for ADIT of $94,708 for the end of the FPFTY. This amount is equal to the difference between accumulated depreciation based on Federal tax expense borne by ratepayers (i.e., based on straight line method) and accumulated depreciation based on Citizens' actual tax Federal tax expense (i.e., based on double declining balance method), times the current Federal income tax rate. Citizens' Statement No. 1 at 13-14; *see also* Citizens' Statement No. 1, Schedule C1-6, lines 27-32 and line 6.

The EDIT is calculated by taking the ADIT at December 31, 2017 (the initial effective date of Federal income tax rates under the TCJA), times the reduction in Federal income rates due to the TCJA. Citizens' Statement No. 1 at 14. The EDIT is computed on Schedule C1-6, lines 34-39 and carried up to Schedule C1-6, line 7. *Id.* The Company is amortizing the balance over the estimated remaining book life of the assets – ten years. *Id.* The EDIT balance included in rate base declines each year during this ten-year period. *Id.* The annual EDIT accretion (Schedule C1-6, line 40) is carried forward to reduce Income tax expense (Schedule C1-4, line 28). *Id.*

No party challenged the Company's calculation of ADIT; however, OCA proposed adjustments to the Company's calculation of EDIT. EDIT is fully addressed in Section VIII *infra* and will not be restated here. For the reasons explained therein, the Company's position should be adopted, and OCA's adjustments should be rejected.

F. CONCLUSION FOR RATE BASE CALCULATION

For the reasons fully explained above, the Company's final claimed rate base of $12,847,545 is reasonable and, therefore, should be approved.

V. REVENUES

Citizens' anticipated system usage is projected to decline from 178,005,729 kWh in 2018 to 167,748,001 kWh in 2020. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1. Under present rates, this will reduce distribution revenues from $5,003,249 in 2018 to $4,860,408 in 2020. *Id.* Citizens' testimony explained a variety of factors that are causing the sales decline. *See* Citizens' Statement No. 4 at 7.

In Direct Testimony, OCA challenged Citizens' FPFTY revenue calculations pertaining to a large solar generation project proposed by Bucknell University and a CHP project being developed within Citizens' service territory. I&E proposed adjustments to Citizens' customer counts and projected FPFTY revenue for Forfeited Discounts. As stated in Section III, *supra*, OCA withdrew its objection to Citizens' calculations pertaining to the CHP project. The other issues – (a) Bucknell's Solar Project; (b) customer counts; and (c) Forfeited Discounts – remain contested and are addressed below.

A. BUCKNELL SOLAR PROJECT

1. Company Revenue Reduction Claim

Bucknell University, a large electricity customer in Citizens' territory, has submitted an interconnection application to the Company to interconnect a planned large solar generation project ("Solar Project") to Citizens' distribution system. The project will be eligible for "virtual" net metering. The project is expected to be completed in 2020. In preparing its rate case, Citizens' accounted for the anticipated loss of kWh sales and revenues for various Bucknell accounts from the Solar Project.

2. OCA Proposed Adjustment

In OCA's Direct Testimony, OCA witness Mr. Mierzwa proposed that the Commission disallow Citizens' claimed reduction in revenue. OCA Statement No. 4 at 29. Relying on local news articles covering the municipal planning process for the project, Mr. Mierzwa concluded that the project had been "withdrawn" and was "unlikely" to "be placed in service prior to the conclusion of the FPFTY." *Id.* at 14, 29. Based on this assumption, Mr. Mierzwa proposed an adjustment to FPFTY revenues of $12,024 to account for continuing to provide service to Bucknell. *Id.* at 29.

As explained below, this argument by Mr. Mierzwa is in error. Current indications continue to point to an in-service date of the Bucknell Solar Project in 2020. Citizens' projections concerning loss of revenue are reasonable and well-grounded.

3. The Company Reasonably Projects the Solar Project Will Be Completed During the FPFTY.

The Company's expectations concerning the Bucknell Solar Project are based on Bucknell strategic planning, communications with Bucknell staff, and, most significantly, the active interconnection application received by Citizens' from Bucknell for the Solar Project. Citizens' has been in communication with Bucknell about the design of the Solar Project. Tr. 154. As explained by Mr. Kelchner in Rebuttal Testimony, solar projects such as the one planned by Bucknell can be placed into service in a matter of months, and a "delayed vote by a local planning Commission" 14-15 months before the end of the FPFTY "is not a material obstacle to completing a solar project by December 2020." Citizens' Statement No. 4-R at 9. Mr. Kelchner also noted that "Bucknell has not withdrawn the interconnection application submitted to Citizens'. Tr. 142-43. Accordingly, there is no indication that the delayed vote from the Planning Commission will extend the in-service date for Bucknell's solar project beyond December 2020." Citizens' Statement No. 4-R at 9.

Mr. Mierzwa's disallowance of the Solar Project, on the other hand, is not based on communications with Bucknell University, analysis of the interconnection application, or other direct factors, but on his review of two local news articles pertaining solely to the zoning approvals for the project. As explained by Mr. Kelchner on Rejoinder, Bucknell voluntarily withdrew its project from the municipal planning process (*not* from Citizens' interconnection application process) to allow East Buffalo Township to pass a zoning ordinance addressing solar projects. Tr. 139. Mr. Kelchner explained that this delay "has little chance of extending the completion date beyond the FPFTY." Citizens' Statement No. 4-R at 8. Also on Rejoinder, Mr. Kelchner testified that the Township Planning Commission approved a zoning ordinance on December 11, 2019, and recommended that the Township Board of Supervisors approve the proposed ordinance. Tr. 141, 152. The Township Board of Supervises is expected to vote on the zoning ordinance January 2020. *Id.* Mr. Kelchner also testified that he received recent communication from Bucknell affirming the project was proceeding. Tr. 142-43.

Based on the Company's direct communication with Bucknell University, the active interconnection application, and the likely approval of the zoning ordinance, the Company's projection that the Solar Project will be completed in 2020 is reasonable. The Company's revenue claim should be approved by the Commission.

4. The Company's Projections for Loss of Revenue Due to the Solar Project Are Reasonable.

In his Direct Testimony, OCA witness Mierzwa made two additional arguments regarding the Solar Project. First, Mr. Mierzwa argued that the Company's proposed FPFTY revenue should be adjusted because the solar array would not offset 100% of the Company's current revenue from Bucknell. OCA Statement No. 4 at 30. Second, Mr. Mierzwa argued that the Company will continue to recover revenue from Bucknell because the energy from the solar array would be delivered to Bucknell buildings through Citizens' distribution system. *Id.*

Mr. Mierzwa's arguments are based on erroneous assumptions. First, as explained by Mr. Kelchner, Mr. Mierzwa's assumption that "the proposed revenue reduction for lost sales to Bucknell represents 100% of Bucknell's current energy consumption" is incorrect. Citizens' Statement No. 4-R at 10. Mr. Kelchner stated:

> The Company removed only forecasted revenue losses associated with the solar array's expected energy production…. Accordingly, the Company will continue to earn revenue from Bucknell, but this revenue is already reflected in the Company's proposed FPFTY revenues.

Citizens' Statement No. 4-R at 10. Meanwhile, Mr. Mierzwa's second claim – that Citizens' will continue to derive revenue from energy delivered from the solar array to the grid – misconstrues Citizens' regulatory obligations. Under net metering regulations in the Company's Tariff and Commission regulations, Citizens' must virtually aggregate usage for all Bucknell meters located within two miles of the solar array. *See* Citizens' Tariff Rider B and 52 Pa. Code §§ 75.13-14. Therefore, the Company would be required to credit Bucknell for generation, transmission, and distribution charges commensurate with the energy output from the solar array. *Id.* Consequently, while Citizens' distribution system may be used to transfer energy from the Solar Project to other Bucknell University facilities, the Commission's regulations "do not provide any framework through which Citizens' would derive revenue from the physical delivery of energy from the solar array through its distribution system." Citizens' Statement No. 4-R at 11.

As demonstrated by the testimony of Mr. Kelchner, Citizens' approach to the Bucknell Solar Project is reasonable and well-grounded. The Company has reasonably forecasted both the in-service date of the Solar Project and the load reduction that will result. Mr. Mierzwa, on the other hand, has "merely substituted his own judgment for that of the Company" – but with insufficient information on which to make a reasonable decision. Citizens' Statement No. 1-R at 14. Mr. Mierzwa's proposed adjustments to revenue should be rejected, and the Company's projections should be approved, by the Commission.

B. CUSTOMER COUNT

Citizens' present rate revenue estimate of $4,860,408, discussed above, is derived from estimated customer counts for the FPFTY. Specifically, the Company estimates that the FPFTY will include an average customer count of 7,043 customers. Citizens' Statement No. 1, Schedule B3. In the HTY, Citizens' had an average of 7,034 customers. I&E Statement No. 3, Exhibit No. 3, Schedule 6; I&E Statement No. 3-SR – Surrebuttal Testimony of Ethan H. Cline ("I&E Statement No. 3-SR") at 13. While the Company has seen a very modest number of new connections, during the FTY, the Company lost 32 customers in the East Lewisburg area that were part of a transfer of those customers to PPL. Citizens' Statement No. 4 at 7; *see* PUC Docket No. A-2019-3008827.

I&E witness Cline proposed an adjustment to Citizens' customer count and related revenue under present rates. In Surrebuttal, after clarifying with Citizens' the appropriate data to use,[7] Mr. Cline proposed an average FPFTY customer count of 7,096 and an increase to present rate revenue of $28,032 (from $4,791,840 to $4,819,872). Mr. Cline based his projections on the average change to customer counts from 2015 to 2018 for each rate class. I&E Statement No. 3-SR, I&E Exhibit No. 3-SR, Schedule 2. Instead of a net increase of 9 customers from HTY to FPFTY, he argued that a net gain of 62 new customers was an appropriate projection. The net increase of 62 is calculated by assuming 47 net new customers per year for a 94-customer net gain from HTY to

[7] Mr. Cline noted an apparent discrepancy between two responses the Company provided regarding customer counts. The Company's responses to OCA-I-17 (I&E Exhibit No. 3, Schedule 6) differed from the Company's filing and the Company's response to I&E R&S-12-D. As explained by Mr. Gorman on Rebuttal, the numbers reflected in OCA-I-17 are correct. Citizens' Statement No. 1-R at 7.

FPFTY (47 x 2 = 94), adjusted by the 32 lost customers in FTY due to the East Lewisburg transfer to PPL (94 - 32 = 62).

Main Brief Table 1

	Company	I&E
HTY (actual)[8]	7,034	7,034
Projected 2-year Net Gain (Excluding East Lewisburg)[9]	41	94
Adjustment for East Lewisburg[10]	-32	-32
FPFTY (estimated)[11]	7,043	7,096
Projected 2-year Net Gain	9	62

While Mr. Cline's approach may be mathematically correct, it does not comport with realities in and around the community of Lewisburg and the very limited opportunities to add new customers. On Rebuttal, Mr. Kelchner described the slowed market for new housing construction in Lewisburg. Specifically, Mr. Kelchner stated:

> Mr. Cline's adjustments are based on historical customer growth but do not reflect the circumstances that will inhibit such growth in the future. A significant portion of the historical customer growth referenced in Mr. Cline's testimony came from the buildout of planned housing developments in Citizens' service territory, within which there are very few remaining lots. Additionally, there are no pending residential subdivisions scheduled for construction in the Company's service territory.

Citizens' Statement No. 4-R at 12. Mr. Kelchner then outlined the number of new residential subdivision houses added to the Citizens' system:

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[8] I&E Statement No. 3 at 16; Citizens' Statement No. 1-R at 7.

[9] *See* Citizens' Statement No. 4 at 7; Citizens' Statement No. 1-R at 7; Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule B5; and I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 2.

[10] Citizens' Statement No. 4 at 7; I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 2.

[11] Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule B5; I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 2.

Main Brief Table 2

Year	New Residential Subdivision Houses	Notes
2016	27	
2017	29	
2018	18	includes 14 in one retirement community, which is now built out
2019 (as of 10/31)	9	

Citizens' Statement No. 4-R at 12.

As indicated by these numbers, the Company has observed this declining trend in new construction firsthand. As stated by Mr. Kelchner at the hearing "But throughout the late '90s early 2000s we were able to go years and years without a rate increase because we had tremendous growth from residential subsidies. That's not the case anymore." Tr. 162.

As seen by 7-month data provided by the Company and included as I&E Exhibit No. 3, Schedule 6, the total customer count for Citizens rose by only 7 during the 7-month period from December 2018 to July 2019 – an average of only one customer gained per month (7,057 to 7,064). The loss of 32 customers in the transfer to PPL did not occur during this period, meaning 2019 is likely to show a significant net customers loss.[12] In addition to the Company's direct experience with the trend of declining new customers, the Company provided additional support from the Union County Planning Commission Annual Report ("UCPC Annual Report"). Citizens' Statement No. 4-R, Exhibit JK-4R. The UCPC Annual Report describes a significant drop in new home construction across Union County. Specifically, in 2018, only 63 new homes were permitted

[12] The transfer of East Lewisburg customers was approved on August 8, 2019. *See* Order, *Joint Application of PPL Electric Utilities Corporation and Citizens' Electric Company of Lewisburg, PA*, Docket No. A-2019-3008827 (Order entered Aug. 8, 2019).

for construction in the entire county (of which Citizens' service territory is only a part) – a 31% drop from the prior year. Citizens' Statement No. 4-R, Exhibit JK-4R at 6-7.

The UCPC Annual Report shows that Lewisburg Borough, Buffalo Township, and East Buffalo Township – which comprise most of Citizens' territory – have plans for only 20 new lots as of 2018. Citizens' Statement No. 4-R at 12-13, Exhibit JK-4R at 6-7. Mr. Kelchner concluded, "Based on the rapid drop off in new service connections in Citizens' territory, and the corresponding public information on new residential construction, I do not believe the customer growth observed by Mr. Cline will be recurring going forward." Citizens' Statement No. 4-R at 12-13.

Mr. Cline's attempt to rebut Mr. Kelchner's evidence by furnishing a June 21, 2017 Union County Housing Study ("Union County Study") is unpersuasive. *See* I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 1. As acknowledged by Mr. Cline, the Union County Study addresses a need for additional housing "units" which the report explicitly clarifies does not translate to demand for new construction. *See* Tr. 242-43; *see also* I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 1 at 32. Mr. Cline also suggests that the slowdown in construction referenced by Mr. Kelchner appears to be a temporary result of a "glut of residential properties absorbing demand" after being vacated by former Bucknell students now required to live on campus. *See* I&E Statement No. 3-SR at 9. However, the Union County Study references the student housing vacated by Bucknell students as "substandard," thereby casting doubt on Mr. Cline's speculative theory.[13] I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 1 at 33.

In light of historic trends, available year-to-date data, and the UCPC Annual Report, Citizens' estimations of customer counts are reasonable. I&E's adjustments should be rejected, and the Company's projected customer counts should be approved by the Commission.

C. FORFEITED DISCOUNTS

For 2020, the Company claimed $27,126 in revenue from Forfeited Discounts (late payment charges). Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule B6.

In response, I&E witness Cline proposed an adjustment to the Company's claim. Mr. Cline noted that Citizens' revenue claim for Forfeited Discounts was the same under both present and proposed rates. I&E Statement No. 3 at 22. Mr. Cline proposed that the Company's claim for Forfeited Discounts be increased by $3,376 to $30,502 for the FPFTY. I&E Statement No. 3 at 23.

On Rebuttal, Company witness Gorman acknowledged that Forfeited Discounts may increase with higher revenue but stated that Uncollectible Accounts expense is also likely to increase by approximately the same amount. Citizens' Statement No. 1-R at 7. Because the "differences between the two changes are likely to be immaterial," Mr. Gorman recommended that Mr. Cline's adjustment be rejected by the Commission. Citizens' Statement No. 1-R at 7.

Supporting Mr. Gorman's assertion, Uncollectible Accounts expense was projected to be $20,600 in 2019 but had reached $25,119 as of September 30, 2019. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 at 2 (identifying Uncollectible Expense as Account No. 904);

[13] At the evidentiary hearing, Mr. Cline indicated the Union County Study contained information suggesting that 90 out of 300 available homes were considered substandard. Tr. 245. A review of the Union County Study shows this to be incorrect. The study advises that 300 of the 500 *students* living off campus relocated to on-campus housing. I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 1 at 33. With regard to housing becoming available as a result of the student migration, the Union County Study noted that "a total of 90 units become available in Lewisburg" and additionally observed that a private landlord active in Lewisburg said "much of the former student housing is of substandard quality." *Id.*

see also Citizens' Statement No. 1-R at 5 (showing year-to-date ("YTD") data as of September 30, 2019, and annualized expense projection for O&M accounts). Annualized, Uncollectible Accounts expense is projected to reach $33,492, compared to the $20,600 projection. *Id.* If this trend holds true, Uncollectible Accounts expense may increase at a greater rate than revenue from Forfeited Discounts. Consequently, I&E's adjustment should be rejected.

In the alternative, if the Commission approves I&E's revenue adjustment, it should also approve a corresponding expense increase for Uncollectible Accounts.

VI. EXPENSES

In this proceeding, the Company has proposed to include expenses reasonably necessary to provide safe and reliable service to its customers in the FPFTY. *See* 66 Pa. C.S. § 1501. Under Pennsylvania law, public utilities are entitled to recover all reasonable expenses incurred in furnishing public utility service. The Commonwealth Court has stated: "The general rule is that a public utility is entitled to recover in rates those expenses reasonably necessary to provide service to its customers and to earn a fair rate of return on the investment and plant used and useful in providing service." *Butler Township Water Co. v. Pa. PUC,* 81 Pa. Cmwlth. 40, 43-44, 473 A.2d 219, 221 (1984) *("Butler Township"). See also T.W. Phillips Gas and Oil Co. v. Pa. PUC,* 81 Pa. Cmwlth. 205, 474 A.2d 355 (1984).

In reviewing the Company's proposals and the oppositional arguments from I&E and OCA, the Commission should also consider its responsibility to preserve the appropriate managerial discretion to make decisions based on the circumstances at hand. The Commission has cautioned against the tendency to weigh the prudency of managerial discretion based on information discovered after the fact. The Commission has concluded that "[t]he prudence standard enunciated by the courts requires that the Commission assess the reasonableness of utility management's decision-making based on the state of information available at the time decision had to be made without reliance upon after-discovered facts." *Pa. PUC v. Philadelphia Suburban Water Company*, 1991 Pa. PUC LEXIS 206, *9-10 (Pa. PUC October 18, 1991). Similarly, the prudence standard directly rejects the undue reliance on outcomes or results-oriented review of managerial decisions, which would find imprudence merely because an intended result was not achieved. *Pa. PUC v. Duquesne Light Co.*, 63 Pa. PUC 337, 351 (1987).

The relevant question in a base rate proceeding is whether the proposed expenses are reasonable and appropriate for the furnishing of service to customers. The range of these expenses is reflected in the Company's initial filing. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedules C1–C5. A subset of the expenses included in the Company's original filing has been challenged by I&E and OCA and are described in this Section of the Company's Main Brief. As demonstrated herein, the expenses Citizens' has included in this proceeding are reasonable and appropriate for provision of safe and reliable service to its customers. Therefore, the Company's expense claims should be approved.

A. COMPANY PROPOSAL

1. The Company's Expense Claims Are Reasonable and Should Be Approved.

To develop its expense claims, the Company analyzed HTY actual costs and the FTY budget and developed projected costs for the FPFTY. Company expenses are comprised of the following components:

- O&M costs: including Purchased electricity, Distribution expenses; Customer accounting and collection expenses; Sales and public relations expenses, and Administrative and general expenses.
- Non-operating costs: including Depreciation, Taxes other than Income; Rate case expense normalization; and Income tax Expense.

Citizens' Statement No. 1 at 9. Schedule C1 provides an overview of the Company's expenses in summary format. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1. Schedule C1-1 shows historical O&M costs on a more detailed basis, with projected changes for the FTY and the FPFTY. *Id.* at Schedule C1-1.

The Company's O&M expenses for the HTY totaled $11,243,415. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1. Subtracting purchased electricity, the distribution-only O&M total was $2,752,700. *Id.* The Company's total distribution-only O&M expense claim for the FPFTY is $2,695,066. *Id.* Total distribution-only expenses for the HTY (including depreciation and taxes other than income) were $4,055,783. *Id.* Total distribution-only expenses for the FPFTY (including depreciation and taxes other than income) are projected to be $4,236,626. *Id.*

The Company developed its FPFTY claim by adding a 3% wage, salary, and benefit inflation adjustment and other known adjustments to the O&M accounts in its FTY budget. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1. The Company's approach to budgeting recognizes that many individual accounts fluctuate on a year-to-year basis, and during the year, as different needs arise on the ground. The FTY budget makes various assumptions regarding the projects and duties that various employees will have during the FTY, and whether any internal employees will work on projects that are capitalized rather than expensed. Those projections cannot account for all contingencies, especially not on an account-by-account basis, as work needs shift between accounts. For example, the Company might shift a crew from Overhead Line Maintenance (Account No. 593) to Miscellaneous Distribution Expense (Account No. 588) for weather-related reasons. *See* Tr. 135-136, 150. On a total expense basis; however, the Company strives to operate within the budgeted total expenses.

In estimating costs for the FPFTY, the Company's management has years of experienced evaluating year-to-year changes in labor, benefits, materials, and outside contractor costs. Tr. 135, 148-149. Based on that experience, Company management advised Mr. Gorman to incorporate a conservative 3% inflation factor to the FTY budget to arrive at the FPFTY costs. This was reasonable since the 2020 budget would not be developed until late 2019, which was after the rate case was filed.

The Company believes its method of carefully developing the FTY budget, then basing its FPFTY O&M expenses on the FTY budget plus an inflation factor and other known changes is an appropriate and reasonable basis to support its FPFTY claim.

As demonstrated below, the adjustments for the FPFTY are conservative expense adjustments that reasonably project expense growth and comport with both available FTY data and long-term historic cost trends for the Company. The Company's FPFTY expense claims are reasonable, well-grounded, and are supported. The FPFTY inflation adjustment is also supported by the Company's recently developed 2020 budget.

2. Actual 9-Month FTY Expense Data Supports the Company's Full Expense Claim.

The Company tracked expenses throughout the FTY and provided updates to the other parties. In responses to discovery and in testimony, total O&M costs for the FTY were updated – both at the 6-month mark (as of June 30, 2019) and the 9-month mark (as of September 30, 2019). Because evidentiary hearings occurred near the end of the FTY, the Company was able to provide actual data to support its FTY expenses, and explain expense increases that will occur in the FPFTY (as reflected in the Company's 2020 budget).

Based on most recent YTD data (through September 30), the Company is tracking very close to its planned expenditures for 2019. In fact, as described in Mr. Gorman's Rebuttal

Testimony, annualizing the Company’s actual 9-month expenses and adding 3% for general inflations results in a projection for FPFTY O&M costs that is "*almost the same* as the costs that were claimed in the Company's FPFTY" in its filing. Citizens' Statement No. 1-R at 3.

This data demonstrates that the Company's projections not only comport with actual O&M expenses on an aggregate basis, but that the Company's expense projections for the FPFTY, as reflected in its rate filing are conservative. While some accounts are high and some are low because the operational priorities shifted during the year, the Company has effectively managed its resources to its budget. As seen in Table 2 below, the Company's expenses in the FPFTY based on annualized YTD data actually are projected to slightly exceed the Company's claim.

Main Brief Table 3

Account	2019 Actual 9 months	Annualized	FPFTY	Claim	Difference
580	91,768	122,357	126,028	144,762	(18,734)
582	8,550	11,400	11,742	8,219	3,523
583	65,889	87,852	90,488	221,111	(130,624)
584	47,015	62,687	64,567		64,567
585	3,214	4,285	4,414	8,143	(3,729)
586	14,781	19,708	20,299	16,187	4,112
587	40,043	53,391	54,992	12,491	42,502
588	201,725	268,967	277,036	275,814	1,221
589	-	-	-	494	(494)
592	272	363	374	10,469	(10,095)
593	367,362	489,816	504,510	456,019	48,491
594	999	1,332	1,372	8,870	(7,498)
595	3,584	4,779	4,922	10,396	(5,474)
596	5,063	6,751	6,953	5,485	1,468
597	-	-	-	481	(481)
902	2,516	3,355	3,455	3,539	(84)
903	327,891	437,188	450,304	469,626	(19,323)
904	25,119	33,492	34,497	20,600	13,897
920	424,031	565,375	582,336	558,085	24,251
921	77,718	103,624	106,733	109,475	(2,742)
923	47,175	62,900	64,787	81,370	(16,583)
924	7,784	10,379	10,690	10,466	224
925	19,062	25,416	26,178	26,308	(130)
926	11,931	15,908	16,385	10,300	6,085
928	46,431	61,908	63,765	0	63,765
930.2	265	353	364		364
930	56,775	75,700	77,971	95,007	(17,036)
930.1	8,484	11,312	11,651		11,651
932	103,614	138,152	142,297	131,347	10,950
	2,009,061	2,678,748	2,759,110	2,695,066	64,044
2016 Rate Case			(63,765)		(63,765)
			2,695,345	2,695,066	279

Citizens' Statement No. 1-R at 4. As seen on the table, total 2019 O&M costs are, when annualized, projected to be $2,678,748. After adding the 3% inflation factor, and removing the expense for amortization of 2016 Rate Case Expense, this results in an annualized projection for the FPFTY of $2,695,345. This is $279 greater than the Company's FPFTY claim of $2,695,066 and demonstrates the reasonable and conservative nature of the Company's expense claims.

OCA and I&E take a "mix and match" approach to adjusting accounts that results in penalizing the Company for its effective budget management. As stated by Mr. Gorman, OCA "proposed adjustments for accounts using a variety of methods, sometimes using a 3-year average, sometimes using a 2-year average, sometimes using only 2018, sometimes using the entire account, and sometimes using portions of accounts." Citizens' Statement No. 1-R at 11. Similarly, I&E made selective adjustments. *Id*. Mr. Kelchner explained his disagreement with the approach taken by OCA and I&E as follows:

> I think the approach is overly granular in that individual accounts are evaluated without consideration of the overall Company operations, and it ignores the Company's success in managing overall costs very close to its budgeted costs. For example, if the Company's actual expense for overhead line maintenance runs below budgeted costs in the Future Test Year ("FTY"), then OCA and/or I&E would propose a downward adjustment to the FPFTY. But on the other hand, if actual expenses for tree trimming run above budgeted costs for the FTY, this would not likely be considered in conjunction with the lower overhead line maintenance expense.

Citizens' Statement No. 4-R at 3-4. Mr. Kelchner explained how this granular approach raises unique challenges for Citizens':

> For a smaller utility like Citizens', this approach presents particular challenges because the Company shifts resources and priorities during the year as operational needs arise. This approach actually penalizes the Company for being responsive and for applying resources where most needed.

Id. at 4. As seen by the YTD data provided by the Company, and the testimony of Mr. Gorman and Mr. Kelchner, the Company has effectively managed its resources and conservatively projected its expenses, consistent with its managerial discretion and the needs of a smaller public utility to nimbly reallocate resources as issues arise. Consequently, the Commission should deny I&E's and OCA's expense adjustments and approve the Company's full expense claim as filed.

3. The Company's Inflation Adjustment is Reasonable, Conservative, and Consistent with Historic Cost Increases.

To develop its FPFTY expense projection, the Company considered historical expense increases and determined that increasing its FTY estimates by 3% would reasonably and conservatively account for anticipated FPFTY expense increases, primarily for wage, benefits, and salaries and for materials. While I&E did not object to the inflation adjustment, OCA fervently opposed the Company's approach. OCA criticized both the concept of a general inflation adjustment and the amount selected by the Company for its 2020 projections, claiming that general inflation adjustments should not be used because they are not "known and measurable." OCA Statement No. 2 at 7. Mr. Morgan also argued that if the Commission allows the use of an inflation adjustment, it should be based on the Gross Domestic Product-Price Index ("GDP-PI") at 2.1%, instead of the Producer Price Index ("PPI") the Company used. OCA Statement No. 2 at 8.

As discussed below, the Company's use of an inflation adjustment is a realistic approach to projecting expenses for the FPFTY. This approach is consistent with the Company's historical experience and with the increases in Citizens' 2020 budget. While fluctuations may occur on an account-by-account basis, developing FPFTY O&M expenses for this rate case filing on a general-inflation basis from a carefully crafted FTY budget is appropriate and comports with historical cost increases.

a. <u>The Company's proposed inflation adjustment for FPFTY expenses is a conservative estimate developed to reflect past experience and confirmed by the Company's 2020 Budget.</u>

Citizens' witness Gorman explained in his Rebuttal Testimony that growth in costs cannot be "known with certainty, but can be reasonably estimated." Citizens' Statement No. 1-R at 10. As further discussed by Mr. Gorman, the Company developed its rate case filing over the first half of 2019, well in advance of commencing its budgeting process for the FPFTY (*i.e.* 2020). Tr. 77.

In order to develop reasonable FPFTY claims for purposes of compiling the rate filing, the Company reviewed both inflation data and historical expense increases. Further, per the below transcript excerpt, the Company's subsequent development of its 2020 budget lends additional support to the inclusion of a 3% inflation adjustment for the FPFTY expenses.

The Company used the PPI as a guideline in forming its 3% inflation projection. OCA Statement No. 2 at 7. This percentage selected by the Company is reasonable and, as detailed below, comports with Citizens' historic trends.

Historical O&M data indicates that the Company's selection of a 3% escalator is not only appropriate, but conservative. As seen in Schedule C1-1, actual historic O&M expenses show a greater than 3% increase *every year* from 2012 to 2018 (the last year full expense data is available). Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 at 2. In other words, regardless of which year is used as a baseline (2012, 2013, 2014, 2015, 2016, or 2017), the Company's O&M expenses have increased over 3% year-over-year through 2018. It is clear that, historically, 3% is a reasonable and conservative projection of the Company's FPFTY increase in O&M costs.

Mr. Kelchner in Rebuttal Testimony affirmed the reasonableness of the 3% inflation adjustment:

> **Q. Does Citizens' expect its overall expenses to remain the same in 2020?**
>
> A. No. We are in the process of preparing our fiscal year 2020 budget. On an overall basis, we expect expenses to increase by over 3% from 2019 to 2020, with significantly higher increases in some areas (e.g. health insurance costs) being offset by management's efforts to manage costs.

Citizens' Statement No. 4-R at 4. Company witness Mr. Gorman further testified on rejoinder that the 3% inflation adjustment was developed to be a conservative estimation of future costs, knowing that costs such as healthcare would increase more than 3%. Tr. 78. Mr. Kelchner also testified on rejoinder that the Company anticipated increases to health insurance costs, employee salaries, and vendor costs – specifically referencing a notice from the Company's sole source of meter reading hardware and software support that prices would be increasing by 4-6%. Tr. 144-156.

Finally, to further validate the proposed 3% inflation adjustment for the Company' FPFTY expenses, Mr. Kelchner confirmed through the following Q&A on rejoinder that the Company's 2020 budget also reflects inflation:

> Q. Did the Company reflect inflation in the 2020 budget?
>
> A. We attempted to make the most accurate budget we could, period. So yes, we – we included what we believe is a reasonable estimate of inflation. We also included any known increases or decreases. I – I feel that's a very responsible way to develop a budget is to try to make it as accurate as you can, including the things you know about.
>
> Q. Did you have any indication that inflation in 2020 will increase the company's vendor costs?
>
> A. Several things, Mr. Gorman referred to the health insurance costs, that's – that's one thing we know about. I'm also aware that the C&T oversight committee has recommended a three percent increase across the board for employee salary, and on top of that, we have had some notices from vendors expecting prices increases for a variety of reasons. Some referring to tariff issues, some referring to the fact that the economy is pretty good, there's a little bit of an increase in demand for raw materials. But it all comes down to we do expect increases in price on several fronts.
>
> Q. Can you describe – can you describe for me the decision to increase as a - a single unit of the expected costs based on your historical experience with the company?
>
> A. No, absolutely not. It's more, in my mind, represents if you look at the expenses overall. If you look at the total picture. History serves as some guide that roughly three percent, which is where we are right now, there is certainly will be the areas that will far exceed three percent, and there most likely we be accounts that do not.

Tr. 143-145. Accordingly, the 3% inflation adjustment is supported both by the Company's historical experience, specific indicators of cost increases for the FPFTY, and the Company's development of its 2020 budget.

b. <u>An inflation adjustment is a reasonable and appropriate means of projecting FPFTY expenses.</u>

OCA's position opposing the Company's inflation adjustment should be summarily rejected. The Commission has long recognized the use of inflation factors in projecting costs. *See, e.g.,* Opinion and Order, *Pa. PUC v. Pennsylvania-American Water Co.*, Docket No. R-00038304 (Order entered Jan. 29, 2004) at 35; Opinion and Order, *Pa. PUC v. Pennsylvania-American Water Co., et al,* Docket No. R-880916 (Order entered Oct. 21, 1988) at 54. To accept OCA's position would be to assume no cost increases from the FTY to the FPFTY. This is not only inaccurate and unrealistic; it is contrary to the purpose of the FPFTY as established in Act 11.

Act 11 established the FPFTY as a ratemaking tool. By its fully "projected future" nature, the FPFTY requires utilities to propose estimates. 66 Pa. C.S. § 315(e). Because a significant portion of the Company's distribution O&M expenses is for employees, wage, benefits, and salary expense is the most significant expense for many of the accounts. Schedule C1-1 shows the escalation of wages and materials that was assumed in the FPFTY. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1, at 3-4. Knowing that expenses fluctuate on an account-by-account basis, Citizens' approach is realistic, conservative, and grounded in the Company's experience.

OCA argues that the Commission has rejected use of inflation or "attrition" factors but cites only to cases entirely inapplicable to the Company's proposal. OCA witness Morgan cites to a Philadelphia Gas Works ("PGW") rate case at Docket No. R-00061931 and a PECO Energy Company ("PECO") rate case at Docket No. R-822291 to support his claim that the PUC categorically rejects inflation adjustments of the manner proposed by Citizens'. OCA Statement No. 2-SR at 6-7. However, each of these cases is demonstrably distinct from the current circumstances. PGW, in the referenced case, was proposing to recover a 2% attrition escalator over a five-year forecast period. *Pa. PUC v. Philadelphia Gas Works*, Docket Nos. R-00061931 *et al.* (Order Entered Nov. 28, 2007), at 13-14. PECO proposed not solely an inflation adjustment to expenses, but an overall 2% increase to expense, revenue, and rate base. *Pa. PUC v. Philadelphia Electric Company*, Docket No. R-822291 (Order Entered Nov. 22, 1983), at 5. Moreover, as emphasized in the Order addressing the proposed PECO attrition factor, both of these cases pre-date Act 11, meaning the Commission's decision to deny an inflation adjustment for any forecast period would have been consistent with the Public Utility Code at the time. *See id.*

OCA's position also undercuts the purpose of the FPFTY authorized by Act 11. As explained above, one of the policies underlying Act 11 was the reduction of regulatory lag. To that end, it is appropriate for a utility to make a "fully projected future" projection for the FPFTY. In Citizens' case, the 2020 projections will be used to form the rates that must meet Citizens' expenses in 2020, 2021, and each year until Citizens' files its next rate case. To insist that the Company use 2019 data in its projections for 2020 denies Citizens' the benefits of a *fully projected* future test year. OCA's arguments should be rejected, and the Company's inflation adjustment should be approved for each O&M expense.

c. <u>3% is a reasonable escalator to project FPFTY expenses.</u>

In Direct Testimony, Mr. Morgan opposes the use of the PPI and argues that a better measure of inflation for ratemaking purposes would be the forecasted GDP-PI. OCA Statement No. 2 at 8. Mr. Morgan states that "past history is not a good predictor of future inflation" and argues that the PPI is not appropriate to forecasting operating costs for ratemaking purposes. *Id.*

Mr. Morgan's arguments on this issue miss the mark. His contention that past history is not a good predictor of future inflation conflicts with fundamental ratemaking, is entirely unsupported, and cannot be reconciled with OCA's general reliance on historical data as a predictor of the Company's future expenses. *Id.*; *see also* OCA Statement No. 1-SR – Surrebuttal Testimony of Stacy L. Sherwood (Revised) ("OCA Statement No. 1-SR") at 5. Further, Mr. Morgan provides no evidence to rebut the data showing that, normally, the Company's historical O&M expenses annually increase by at least 3%.

In summary, the Company's use of the 3% inflation rate aligns with the Commission's purposes as set forth in Act 11. It is supported by both Company testimony, long-term historical trends, and the 2020 Citizens' budget. In the alternative, if the Company's 3% inflation adjustment is not accepted by the Commission, the OCA's alternative measure of inflation should be adopted (i.e., 2.1%).

B. ADJUSTMENTS PROPOSED BY ADVOCATES

As explained above, the Company's annualized FTY data, plus the 3% inflation adjustment, fully support the Company's FPFTY O&M expense claim. While the Advocates have proposed a variety of adjustments to individual accounts, they have disputed neither the fact that Citizens' has managed its expenses close to budget, nor the fact that Citizens' expenses are tracking slightly higher than projected for 2019. For these reasons, it is appropriate to approve Citizens' expense claims in entirety.

However, to the extent the Commission does not accept the Company's primary proposal, the Company addresses specific adjustments proposed by I&E and OCA below. Any resolution of a dispute, except rate case expense, should be grossed up by the inflation adjustment per Section VI.A.3 above.

1. Maintenance of Overhead Lines / Vegetation Management (Account No. 593)

In its Direct Testimony, Citizens' included a claim for Maintenance of Overhead Lines of $456,019 for the FPFTY. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1.

Account No. 593 includes expenses for Citizens' right of way inspections, tree trimming and other vegetation management. Vegetation management is directly connected with customer service reliability. A primary reason that Citizens' costs in this account have increased relates to maintenance and repairs due to tree damage from the Emerald Ash Borer. Citizens' Statement No. 4 at 13. The Emerald Ash Borer causes impacted trees to become more of a significant risk to distribution lines. As a result of the expansion of the Emerald Ash Borer, Citizens' territory "has experienced a significant increase in the number of priority trees, particularly ash trees, which are poised to fall onto the overhead lines, resulting in unnecessary outages and damage to facilities." Citizens' Statement No. 4 at 13.

Citizens' has been meeting this increased demand with vigilance, particularly increasing its focus on identifying and remedying off right-of-way priority trees as encouraged by TUS. Citizens' Statement No. 4 at 14. Citizens' often contracts with third parties for this activity; however, the Company also faces the challenge of limited qualified vegetation contractor interest due to the relatively small sizes of Citizens' contracts. *Id.* As a result, the Company projects an increase in costs of $401,475 in the HTY to $456,019 for the FPFTY. *See* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1.

OCA, however, recommended reducing the Company's claim by $40,632 to $415,367. OCA Statement No. 1 at 5-6. OCA witness Sherwood used a three-year average methodology and argued that there has been a significant variance in vegetation management costs. OCA Statement No. 1-SR at 5. I&E proposed a reduction of $9,564 based on the sub-category of "material" expense increasing by 25.15% from the HTY to the FPFTY; Mr. Patel argued that this material expense was not justified by the most recent three years' fluctuating expenses. I&E Statement No. 1-SR at 16-17.

I&E's approach of adjusting Account No. 593 expense downward for material expense when the total expenses for Account No. 593 have exceeded projections is counterintuitive and would deprive the Company of a reasonable rate of return. In fact, as Mr. Kelchner explained, the material expense item also includes contractor costs, for which Citizens' has documented expected 2020 costs that exceed the FPFTY Claim. Tr. at 138. Citizens' provided evidence of 2020 costs that demonstrates Mr. Patel's adjustment based on the 2016-2018 historic costs is inappropriate. *See* Citizens' Statement No. 4-SR – Surrebuttal Testimony of John Kelchner ("Citizens' Statement No. 4-SR") at 6.

OCA's approach, in particular, is not a credible approach to calculating the Company's vegetation management expenses in this proceeding because there is a significant increase in costs between 2016-2018 (the years averaged) and the FPFTY claim due to additional resources that will be required to meet Citizens' regulatory obligations. On Rebuttal, Mr. Kelchner addressed OCA's claim, as follows:

> **Q. Do you agree with these adjustments?**
>
> A. No. If anything, the Company's projected costs are already conservative. The company secured very favorable bids for tree-trimming contractor services over 2018 and 2019; however, the contractor recently informed the Company that the bid was calculated incorrectly and that the contractor had incurred substantial losses in providing that service. Confidential Rebuttal Testimony Exhibit __ (JK-1R) reflects the much higher bids provided by the contractor's competitors. Please note, these bids do not indicate actual final costs as incidental time and material work is not quantified in the bid. *However, based on these competing bids and information provided by the existing contractor, it appears that future tree trimming costs will be higher than projected in the filing.* Additionally, demand for contractors in the area has escalated due to the further penetration of the Emerald Ash Borer into Pennsylvania, a factor that also drives up costs.

Citizens' Statement No. 4-R at 6 (emphasis added). Additional year-to-date data. further supports Mr. Kelchner's response. Nine-month FTY data (as of September 30, 2019), when annualized, results in FTY expenses of $489,816. With the inflation adjustment, this reaches a projected

$504,510 for the FPFTY – over $48,000 *above* the Company's FPFTY claim. Based on this projection, OCA's $40,652 disallowance is inappropriate and could jeopardize the Company's ability to provide reliable service.

In her Surrebuttal Testimony, Ms. Sherwood argues that 2020 bid responses support her approach of averaging 2016-2018 costs. OCA Statement No. 1-SR at 5. In making this argument, Ms. Sherwood references only the bid amounts, without acknowledging that the bids clearly state that certain costs to be incurred by the contractor and charged to the client are not reflected in the bid offers. *See* OCA Statement No. 1-SR at 5; *see* Highly Confidential Citizens' Statement No. 1-R, Exhibit__ (JK-1R). Mr. Kelchner addressed this in this Rebuttal Testimony, clarifying that "these bids do not indicate actual final costs as incidental time and material work is not quantified in the bid." *See* Citizens' Statement No. 4-R at 6. Ms. Sherwood's assumption that the bid amounts for tree trimming represent the Company's total tree trimming expense is inaccurate, and she materially understates the costs the Company incurs for this critical expense. *Id.* The Companies' year-to-date expense provide stronger indication of the FPFTY costs.

The Company is required to provide safe and reasonably reliable service to its customers. 66 Pa. C.S. § 1501. The Company must also carefully monitor the reliability of its system and to file regular reports to the Commission regarding outages and other metrics. 52 Pa. Code §§ 57.191-57.197. Vegetation management is a critical tool for reducing outages and ensuring safe and reliable service. OCA's historic average approach to vegetation management expense fails to reflect the increased expense of a growing vegetation management crisis. OCA's adjustment ignores the clear evidence presented in this proceeding and does not reflect a logical or coherent approach to projecting actual vegetation management expense. OCA's adjustment should be rejected, and the Company's position should be adopted.

2. Operations Supervision & Maintenance Expense (Account No. 580)

The Company's claim for Account No. 580 is $144,762. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1. I&E witness Patel proposes a reduction of $21,644 for a total allowance of $123,118. I&E Statement No. 1-SR at 10-11. I&E bases this argument on the average of 2016-2018 after removing "the one-time additional payroll cost of $53,998" due to employee overlap, plus a 3% increase for payroll and benefits. *Id.*

Mr. Patel's proposed adjustment should be rejected. As explained by Mr. Kelchner in Direct Testimony, Citizens' is preparing to address a significant number of retirements in the upcoming years. Citizens' Statement No. 4 at 15. As stated by Mr. Kelchner:

> As with many electric utilities, Citizens' must address the pressures of an aging workforce. It is expected that within the next 5 to 10 years, 11 of Citizens' current 17 employees will have retired. Of the 11 retirees, 4 will be in the administrative area, and 7 will be in the operations area. Citizens' management team has been entrusted by the shareholders, customers and the Commission to provide safe and reliable service at a fair cost. To address this core responsibility and the potentially negative impact from failure to plan, we are implementing a long-term and methodical transition strategy that will prevent a lapse in experience and job knowledge necessary to effectively operate Citizens' system. . . . The Company will incorporate additional short-term staffing overlaps during 2019 and beyond as appropriate to ensure that new hires have sufficient time to learn the skills needed.

Citizens' Statement No. 4 at 15-16. This trend indicates that more overlaps will be anticipated. Consequently, it is not appropriate to classify the overlap – required for training and consistency of operations – as "one-time," as it will recur in a variety of transitions. The Company's claim should be approved by the Commission.

3. Miscellaneous Distribution Expense (Account No. 588)

The Company's claim for Account No. 588 is $275,814. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1. I&E witness Patel proposes a reduction of $9,218 for a total of $267,781 based on the sub-category of material expense increasing by 44.63% from the HTY to the FPFTY. I&E Statement No. 1-SR at 12-13.

Year-to-date data from September 30, 2019, indicates that the Company is almost precisely on target for this account. The actual 9-month data for Account No. 588 is $201,725. Annualized, plus the 3% inflation adjustment brings this figure to $277,036 for the FPFTY – $1,221 above the Company's claim.

This information indicates that the Company's Miscellaneous Distribution Expense claim should be accepted by the Commission.

4. **Customer Records & Collection Expense (Account No. 903)**

The Company's claim for Account No. 903 is $469,626. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1. I&E witness Patel proposes a reduction of $13,650 for a total of $455,976 based on the sub-category of material expense increasing by 13.15% from the HTY to the FPFTY. I&E Statement No. 1-SR at 14-15.

If the Commission addresses the Advocates' proposed adjustments on an account-by-account basis, the Company accepts I&E's proposed adjustment to this account.

5. **Outside Services (Account No. 923)**

The Company's claim for Account No. 923 is $81,370. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 at 4. Both I&E and OCA proposed adjustments. OCA Statement No. 1 at 7-8; I&E Statement No. 1 at 19-20.

Both witnesses reference the FTY costs incurred over the first six months of 2019 of $27,995 as a basis for their downward adjustments. Conducting the same analysis using the 9-month actual expenses shows the adjustments proposed by OCA and I&E to be overstated. As set forth in Mr. Gorman's Rebuttal Testimony, the actual expenses for this account through September 2019 are closer to the Company's claim when annualized over 12 months. *See* Citizens' Statement No. 1-R at 4. The 9-month YTD expense for Account No. 923 was $47,175. Annualized, with a 3% inflation adjustment, this results in a $64,787 projection for the FPFTY.

As acknowledged by Mr. Patel, the Company's projections removed one-time expenses incurred in 2018. I&E Statement No. 1-R – Rebuttal Testimony of D.C. Patel ("I&E Statement No. 1-R") at 19. The Company's YTD expenses are tracking higher than the historic average (adjusted for the one-time 2018 expenses) calculated by Mr. Patel. Consequently, the Company requests that the Commission approve its expense claim of $81,370. However, if the Commission agrees with the Advocates that a downward adjustment is appropriate for Account No. 923, the Company recommends that the Commission use the annualized and adjusted 9-month YTD figure of $64,787.

6. **Employee Pension & Benefits (Account No. 926)**

Citizens' has proposed to recover the cost of certain employee activities totaling $10,300 for employee recognition expenses and other benefits for employees.

OCA witness Sherwood proposed to disallow $8,039 of these expenses. OCA Statement No. 1 at 9. Ms. Sherwood specifically proposed the disallowance of expenses for certain events (retirement and holiday events), because they "do not serve to enhance service to customers and should not be supported by rates." OCA Statement No. 1 at 8. Ms. Sherwood approved an average of remaining employee appreciation expenses, plus drinking water, for an allowance of $2,261 for the FPFTY. OCA Statement No. 1 at 8.

In the UGI Order, the Commission affirmed the ALJs holding that a utility may "claim employee activity as an expense where the employee activity is for the purpose of employee recognition." UGI Order at 70. In the UGI Order, the Commission pointed to Commission precedent that distinguished between activities involving "employee recognition" and those that did not. Based on this precedent, it is unclear why OCA recommends disallowing employee recognition events.

On Rebuttal, Company CEO Kelchner explained the purpose of the Company events paid for under Account No. 926:

> At every Citizens' employee appreciation event, remarks are made by the Company's senior staff recognizing employee contributions to the Company. An important benefit of these minor costs is to improve morale which reduces turnover. Accordingly, the Company should be permitted to recover expenses for employee recognition expenses including the National Lineman Appreciation Day Breakfast, the Administrative Professionals' Luncheon, the Safety Achievement Recognition Breakfast, retirement parties, and holiday events listed in . . . Exhibit __ (JK-2R).

Citizens' Statement No. 4-R at 7. As indicated by Mr. Kelchner, there are a variety of business benefits to these expenditures as the Company uses these occasions to recognize the achievements and dedication of its staff. *Id.* The Company's approach is consistent with the precedent upheld in the UGI Order. Specifically, the claimed special events are to recognize the employees' hard work and dedication, as well as to boost employee engagement and the morale of the overall workforce. *See id.* They foster a sense of community, which increases communication between employees, enhances problem solving, and improves productivity – all of which benefit customers. Mr. Kelchner's testimony and Commission precedent both demonstrate that the Company's expenses under Account No. 926 are reasonable and prudent costs incurred in order to motivate and recognize employees, which leads them to provide better service to customers. Therefore, these costs are directly related to providing quality service to customers. *See Butler Township*, 81 Pa. Cmwlth. 40 *supra.* This expense claim should be approved.

7. **Rate Case Expense – Normalization Period**

As part of its direct case in this proceeding, the Company proposed a total rate case expense claim of $326,000 and proposed to normalize this amount over three years consistent with the anticipated frequency of base rate proceedings going forward, and with numerous prior Commission proceedings. This resulted in a normalized claim of $108,667. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-3.

Neither I&E nor OCA opposed the Company's total rate case expense amount. However, both parties opposed the Company's proposal to normalize rate case expense over three years (36 months). I&E witness Patel proposed a normalization period of 48 months based on the Company's last three base rate case filings. I&E Statement No. 1 at 7. OCA witness Sherwood proposed 45 months, based on the average time between the "Company's last four rate case filings, including this case." OCA Statement No. 1 at 9.

While historic filing frequency is a factor considered in determining the normalization for rate case normalization, it is not the only factor the Commission considers. *See, e.g., Butler Township* 81 Pa. Cmwlth. 40, 47-48 (affirming that historic practice need not be the exclusive factor relied upon by the Commission). Ratemaking is prospective, and the goal of ratemaking is to reasonably reflect future conditions when new rates are in effect. *See, e.g., Columbia Gas v. Pa. PUC*, 613 A.2d 74, 76 (Pa. Cmwlth. 1992), *aff'd*, 636 A.2d 627 (Pa. 1994). In UGI Order, UGI Electric had not filed a base rate case for 22 years. UGI proposed a three-year normalization period in that case. I&E did not propose the average length between UGI's base rate cases, which would have been over eight years, but instead proposed a five-year normalization period. UGI Order at 58. However, the Commission rejected I&E's approach, stating that UGI had shown its increased capital spending would require the Company to seek relief in a base rate case. The Commission found that "a long period between rate base proceedings is highly unlikely and that the Company's proposed use of a three-year normalization period for rate case expense is appropriate." UGI Order at 60.

In the UGI Order, the Commission stated: "This proceeding is premised on the FPFTY and the recognition that certain expenses may be based on future expectations. Consistent with our determination in the *PPL 2012 Order*, the normalization period for rate case expense is one of those expenses." UGI Order at 59-60.[14]

Similarly, the instant proceeding is based on reasonable future expectations. In Rebuttal, Company witness Gorman acknowledged that the average filing interval for the last three rate cases is 48 months but explained that 48 months is neither the most "typical" filing frequency nor the Company's anticipated time frame before the next base rate filing. Mr. Gorman stated:

> The filing intervals have been 37 months, 75 months and 34 months. While the average is 48 months, the more typical filing interval is about 36 months. The Company is being penalized for being able to forego a rate case for 3.25 additional years (75 months -36 months). In addition, the industry is changing rapidly, and having 36 months between rate cases is much more likely to be the case than 48 months.

Citizens' Statement No. 1-R at 5. Mr. Kelchner and Mr. Gorman explained that the Company's continued expenses related to tree trimming, capital replacements, and other reliability enhancing projects, combined with the Company's limited prospects for load growth, results in a reasonable expectation of a 36-month period between rate cases. Citizens' Statement No. 1-R at 5; Citizens' Statement No. 4-R at 5. Mr. Kelchner further addressed the appropriate normalization period as follows:

> **Q. Are there other reasons justifying a shorter normalization period?**
>
> A. Yes. The shorter period between the 2016 and 2019 rate cases was not a one-time occurrence. While Citizens' has experienced some growth over the past ten years, it is now at or near saturation. As I discuss later in my testimony, most of the Company's recent customer growth comes from new connections to planned developments which at this time have been mostly built out. As a result, Citizens' cannot expect to increase revenue through load growth. On the other hand, Citizens' continues to incur tree trimming costs and capital expenses associated with

[14] *See Pa. PUC, v. PPL Electric Utilities Corporation,* Docket No. R-2012-2290597, *et al*., (Order entered December 28, 2012 (*PPL 2012 Order*) at p. 49. In the *PPL 2012 Order,* PPL Electric sought a two-year normalization of rate case expense. I&E and OCA, based on a rate filing history, proposed a three-year period. *Id.* at 44-45. The Commission approved PPL Electric's two-year normalization of rate case expense. The Commission acknowledged PPL Electric's three-year filing history, but also noted its major capital improvement program to address aging infrastructure. *Id.* at 47-48.

> reliability improvements. Both the Company's most recent filing interval and other objective indicators strongly support a 36-month normalization period.

Citizens' Statement No. 4-R at 5. Finally, Mr. Kelchner pointed out that I&E's proposed normalization period in the 2016 rate case was a significant under-estimation. Had I&E's recommendation in the 2016 case for a 60-month time period been adopted, Citizens' would have significantly under-recovered its rate case expense. Citizens' Statement No. 4-R. I&E's attempts to dismiss the relevance of the filing interval between the 2016 and 2019 rate cases because the 2016 rate case culminated in a black box settlement. *See* I&E Statement No. 1-SR at 7. This argument should be given no weight because all of the prior rate cases upon which I&E bases its recommended normalization period (2016, 2010 and 2007) were also proceedings in which revenue requirement was settled, not litigated. *See* I&E Statement No. 1-SR at 7; *but see* I&E Statement No. 1, Exhibit No. 1, Schedule 1 at 3.

The Company has produced clear testimony that a long period between base rate proceedings is very unlikely to occur going forward, and the Company's most likely projection is that it will need to seek additional rate relief in approximately three years. Accordingly, the Company's three-year proposal reflects a reasonable normalization period and should be accepted.

C. CONCLUSION

For the reasons identified in the previous discussion, the various disallowances to the Company's expenses proposed by the other parties in this proceeding should be rejected, and the Company's total expenses should be accepted and included in the base rate.

VII. FAIR RATE OF RETURN

A. RATE OF RETURN STANDARDS

The United States Supreme Court outlined the principal benchmarks for a fair rate of return in *Bluefield Water Works & Improvement Company v. P.S.C. of West Virginia*, 262 U.S. 679 (1923) (*"Bluefield"*). In this seminal Order, the Court defined a fair rate of return as follows:

> 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.

Bluefield, at 679 (Emphasis added). As referenced by Company Witness Dylan W. D'Ascendis, *Bluefield* established three tenets defining a fair rate of return. Under *Bluefield*, a fair rate of return must be: (1) equal to the return on investments in other business undertakings with the same level of risks (comparable earnings standard); (2) sufficient to assure confidence in the financial soundness of a utility (financial integrity standard); and (3) adequate to permit a public utility to maintain and support its credit, enabling the utility to raise or attract additional capital necessary to provide reliable service (the capital attraction standard). *See* Joint Statement No. 2 – Direct Testimony of Dylan W. D'Ascendis ("Joint Statement No. 2") at 6. The Court later reaffirmed the *Bluefield* standard in *Federal Power Commission v. Hope Natural Gas.,* 320 U.S. 591, 603 (1944) (*"Hope")* and *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

In developing a rate of return for any regulated public utility, the Commission must ensure all public utilities have an opportunity to earn a rate of return sufficient to meet the enumerated criteria. Importantly for the Company, this includes consideration of the specific risks faced by smaller utilities pursuant to the comparable earnings standard. Accordingly, the Commission should approve only a rate of return consistent with the *Bluefield* standards. Mr. D'Ascendis' rate of return is the only proposal in this proceeding that meets these standards.

B. ELECTRIC PROXY GROUP

Mr. D'Ascendis selected a 19-company proxy group based on selection criteria set forth in his Direct Testimony. Joint Statement No. 2, at 11. The proxy group was updated in Mr. D'Ascendis' Rebuttal Testimony to exclude two companies after re-running the selection criteria based on updated data. The remaining 17 company proxy group ("Electric Utility Proxy Group") is set forth on page 4 of Mr. D'Ascendis' Rebuttal Testimony. Joint Statement No. 2-R – Rebuttal Testimony of Dylan W. D'Ascendis ("Joint Statement No. 2-R") at 4.

C. CAPITAL STRUCTURE

Mr. D'Ascendis proposed to use a hypothetical capital structure for Citizens' consistent with the average capital structure ratios in his Electric Utility Proxy Group. *See* Joint Statement No. 2 at 13. As a result, Mr. D'Ascendis recommended a capital structure of 49.33% long-term debt and 50.67% common equity for Citizens'. *See id.* at 13-14. No party disputes the proposed capital structure set forth in Mr. D'Ascendis' Direct Testimony. *See* OCA Statement No. 3 – Direct Testimony of David S. Habr ("OCA Statement No. 3") at 3; *see also* I&E Statement No. 2 – Direct Testimony of Anthony Spadaccio ("I&E Statement No. 2") at 16.

D. COST OF LONG-TERM DEBT

Mr. D'Ascendis proposed to use the Company's actual cost rate of 4.86% for long-term debt. Joint Statement No. 2 at 15. As with the proposed capital structure, no party disputes the proposed long-term debt rate for the Company. *See* OCA Statement No. 3 at 3; I&E Statement No. 2 at 17.

E. COST OF COMMON EQUITY

1. Introduction

The principal disputes concerning the appropriate rate of return for the Company relate to the determination of the Company's cost rate for common equity capital, referenced as the ROE. In reviewing the proposal from the Company and the other parties, the Commission should consider the *Bluefield* standards within the context of the investment marketplace and the investor concerns that will drive or discourage purchases of utility common stocks.

Specifically, the Commission should adopt an ROE that reflects actual market conditions. While the Commission has primarily relied on the Discounted Cash Flow ("DCF") model to set ROE cost rates, the Commission has also observed that DCF-only results may understate the appropriate ROE. UGI Order at 105. Because DCF results may understate ROE, considering results of other models is consistent with the fundamental purpose of the Commission's regulation of public utility ROR where "regulation must act as a substitute for marketplace competition." Joint Statement No. 2-R at 6. Public utilities compete with other firms of comparable risk for investor capital. *See id.* In order to attract the capital necessary to serve the public, public utilities in Pennsylvania rely on the Commission to authorize ROEs that can generate sufficient earnings for investors. *See id.* at 16.

Consistent with the *Bluefield* and *Hope* standards, and as detailed below, Citizens' witness D'Ascendis conducted a thorough analysis of multiple ROE models to develop an ROE based on his proxy group of 9.05%. Mr. D'Ascendis then adjusts the proxy group's ROE upward by 1.00% for the Company's smaller relative size to the proxy group and 0.25% to reflect management performance. As a result of his adjustments to the proxy group's ROE to reflect the unique risk of the Company, Mr. D'Ascendis recommends a 10.30% ROE. *See* Joint Statement No. 2-R, Exhibit __(DWD-1R), Schedule 1R at 2.

Given the critical role of the authorized ROE in attracting capital necessary to meet the Company's public utility obligations, the Commission should be cognizant of the stark disparity between the ROE recommendations from I&E and OCA and actual market conditions. As discussed by Mr. D'Ascendis, the I&E and OCA recommended ROEs for Citizens' of 8.10% and 8.38% "are all below the lowest ROE authorized for any major electric utility followed by Regulatory Research Associates ("RRA"), a division of Standard and Poor's ("S&P") Global Intelligence since at least 1980." Joint Statement No. 2-R at 5. None of the witnesses dispute this fact. Similarly, no witness disputes that the I&E and OCA recommended ROEs for Citizens' are significantly below the 9.55% ROE calculated by the Commission for electric utility DSIC as of November 14, 2019. Tr. 45. Their DCF-only results understate the appropriate ROE for Pennsylvania electric utilities, as the UGI Order noted can occur.

The Commission should also consider that the above-referenced benchmarks only account for the disparity between the OCA and I&E recommended ROEs and the market-reflective ROEs for electric utilities multiple times larger than the Company. For example, the RRA only evaluates rate cases with a proposed rate increase over $5 million or an authorized rate increase over $3 million. Joint Statement No. 2-R at 6. By way of comparison, the Company's requested revenue increase is only approximately $701,000. As observed by Mr. D'Ascendis, "RRA's data would understate ROE's authorized for smaller utilities, like the Companies relative to those companies covered by RRA." *Id.* at 6. Similarly, the proxy group of public utilities used to develop the Commission's DSIC ROE includes companies many times larger than Citizens'. Tr. 55-56 (noting DSIC ROE could be adequate for the Companies after adjusting for size and performance). Accordingly, even the ROEs supported by these marketplace benchmarks like RRA would still understate the appropriate ROE for Citizens', due to its smaller size. Thus, OCA and I&E's positions based on DCF become farther away from the appropriate ROE for Citizens'.

Additionally, despite the contrary positions of the Advocates, the Commission is required to consider utility management effectiveness and efficiency in setting rates. 66 Pa. C.S. § 523. The Company has demonstrated a high level of performance and customer satisfaction supporting approval of the proposed 25 basis performance adjustment to the ROE.

Finally, and consistent with the *Bluefield* standard, the Commission should adjust the Companies ROEs to account for company size, even if the OCA or I&E DCF results are adopted. The Company has provided extensive evidence showing company size to be a risk factor for public utilities. Mr. D'Ascendis' analysis demonstrates that a 470 basis point size adjustment is justified due to Citizens' size difference in comparison to the proxy group. Joint Statement No. 2 at 45; *see also* Tr. 65. The Commission should approve the Company's more modest 100 basis point size adjustment in this proceeding.

All of the above considerations provide the context through which the Commission should evaluate the ROE proposals in this proceeding. Any reasonable evaluation of the relevant market conditions reveals the inadequacy of the ROE proposals advanced by I&E and OCA. To enable Citizens' to attract capital and continue furnishing safe and reliable service to its customers, the Commission should adopt the 10.30% ROE proposed by Mr. D'Ascendis.

2. **Citizens' Return on Common Equity Should Be Adopted.**

a. **<u>Summary of Citizens' ROE proposal</u>**

Company witness Mr. D'Ascendis described his methodology for developing a recommended ROE for Citizens' in his Direct Testimony as follows:

> My recommendation results from applying several cost of common equity models, specifically the [ ] DCF model, the Risk Premium Model ("RPM"), and the Capital Asset Pricing Model ("CAPM"), to the market data of the Electric and Gas Utility Proxy Group whose selection criteria will be discussed below. In addition, I applied the DCF model, RPM, and CAPM to proxy groups of domestic, non-price regulated companies comparable in total risk to the Electric and Gas Utility Proxy Groups

> ("Non-Price Regulated Proxy Groups"). The results derived from each are as follows:
>
> [Table Omitted]
>
> The indicated common equity cost rates were 9.90% and 10.10%, respectively, for the Electric and Gas Utility Proxy Groups, respectively, before any company-specific adjustments. I then adjusted the indicated common equity cost rate upward by 1.00% to reflect the Companies' smaller relative size, as compared to the Electric and Gas Utility Proxy Groups, and by 0.25% to reflect a performance factor adjustment, based on guidance from Pennsylvania Code 66 Pa.C.S. § 523. These adjustments resulted in company-specific indicated common equity cost rates of 11.15% for Citizens' and Wellsboro, and 11.35% for Valley, which are my recommendations.

Joint Statement No. 2 at 4-5. In Rebuttal Testimony, Mr. D'Ascendis updated his original recommended ROE to replicate the same analysis reflecting current market conditions as of September 30, 2019. This update produced the following final ROE recommendation:

Main Brief Table 4

Citizens' Electric Company / Wellsboro Electric Company / Valley Energy, Inc.
Brief Summary of Common Equity Cost Rate

Line No.	Principal Methods	Proxy Group of Seventeen Electric Companies		Proxy Group of Six Natural Gas Distribution Companies	
1.	Discounted Cash Flow Model (DCF)	8.27	%	9.02	%
2.	Risk Premium Model (RPM)	9.57		9.26	
3.	Capital Asset Pricing Model (CAPM)	8.82		9.22	
4.	Market Models Applied to Comparable Risk, Non-Price Regulated Companies	9.43		10.26	
5.	Indicated Common Equity Cost Rate before Adjustment for Business Risks	9.05	%	9.35	%
6.	Size Adjustment	1.00		1.00	
7.	Performance Factor Adjustment	0.25		0.25	
8.	Recommended Common Equity Cost Rate	10.30	%	10.60	%

Joint Statement No. 2-R, Exhibit __(DWD-1R), Schedule 1R at 2. As indicated in the above table, the Rebuttal update reduced the recommended ROE for Citizens' from 11.15% to 10.30%.

As summarized by Mr. D'Ascendis, his ROE reflects the results of his DCF, Risk Premium and CAPM models, plus his application of each model to a proxy group of non-regulated entities. As further discussed below, this approach incorporates multiple models consistent with best practices supported by academic literature and the Commission's policy of relying primarily on the DCF but referencing other models to ensure the reasonableness of the overall ROE recommendation.

b. Company DCF Model

Mr. D'Ascendis uses a single-state constant growth DCF model. The DCF model relies on the theory that the "present value of an expected future stream on net cash flows during the investment holding period can be determined by discounting those cash flows at the cost of capital, or the investors' capitalization rate." Joint Statement No. 2 at 16. The capitalization rate is the anticipated common equity return rate and consists of the dividend yield on market price plus a growth rate. *Id.* at 16-17. The calculation of Mr. D'Ascendis' dividend yield and growth rate are detailed below.

i. Dividend yield

To derive the dividend yield for his DCF model, Mr. D'Ascendis calculated each proxy company's dividends as of September 30, 2019, and divided by the average closing market price for the 60 trading days ending September 30, 2019. *See* Statement No. 2 at 17; *see also* Statement No. 2-R, Exhibit __ (DWD-1R), Schedule 1R at 3, fn. 1 (showing updated dividend yield reflecting data available as of September 30, 2019). Mr. D'Ascendis applied a conservative adjustment to reflect prospective increases to the dividend yield, in accordance with the Gordon Periodic version of the DCF model. Mr. D'Ascendis describes the necessary adjustment in his Direct Testimony as follows:

> Because the companies in the Electric and Gas Utility Proxy Groups increase their quarterly dividends at various times during the year, a reasonable assumption is to reflect one-half the annual dividend growth rate in the dividend yield component, or $D_{1/2}$.. Because the dividend should be representative of the next twelve-month period, this achievement is a conservative approach that does not overstate the dividend yield.

Joint Statement No. 2 at 18. Both the unadjusted dividend yields and the adjusted dividend yields are reflected in columns 1 and 6, respectively, of page 3 to Mr. D'Ascendis' Exhibit __ (DWD-1R), Schedule DWD-1R.

ii. Growth rate

To calculate the growth rate for his DCF, Mr. D'Ascendis utilized the same published earnings growth rates relied upon by investors in the marketplace. Mr. D'Ascendis explained the importance of utilizing earnings growth rates in the below excerpt from his Direct Testimony:

> Investors with more limited resources than institutional investors are likely to rely on widely available financial information services, such as *Value Line*, Reuters, Zacks, and Yahoo! Finance. Investors realize that analysts have significant insight into the dynamics of the industries and individual companies they analyze, as well as companies' abilities to effectively manage the effects of changing laws and regulations, and ever-changing economic and market conditions. For these reasons, I used analysts' five-year forecasts of EPS growth in my DCF analysis.

Id. Subsequently to submitting Direct Testimony, Mr. D'Ascendis eliminated Reuters' growth rates from his calculation because the organization stopped publishing projected earnings growth rates on its website. Joint Statement No. 2-R at 4. Accordingly, as reflected in Mr. D'Ascendis' Exhibit __ (DWD-1R), he developed a growth rate for each proxy group company by averaging the five-year projected growth rates published by Value Line, Zacks, and Yahoo! Finance.

c. Company Risk Premium Model

Mr. D'Ascendis also conducted a risk premium analysis as part of his ROE recommendation. A risk premium analysis seeks to quantify the additional ROE demanded by investors to account for the greater equity investment risk as compared to debt capital. Under a risk premium analysis, "the cost of common equity equals the expected cost rate for long-term capital, plus a risk premium over that cost rate, to compensate common shareholders for the added risk of being unsecured and last-in-line for any claim on the corporation's assets and earnings upon liquidation." Joint Statement No. 2 at 19.

Importantly, Mr. D'Ascendis' risk premium analyses averages the results of two analyses. The first, the Predictive Risk Premium Model ("PRPM") directly estimates the risk premium for equity capital investment based on an evaluation of the actual variance between historical equity risk premiums. *Id.* at 20. The second analysis, the total market approach, relies on known metrics to develop prospective RPM cost rates. *Id.* at 22.

i. <u>PRPM</u>

As referenced above, the inputs to Mr. D'Ascendis' PRPM analysis are historical risk premiums. Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule 1R at 28, fn. 1. Starting with these historical returns, Mr. D'Ascendis develops the PRPM cost rate through the following analysis:

> Using a generalized form of ARCH, known as GARCH, I calculated each Utility Proxy Group company's projected equity risk premium using Eviews© statistical software. When the GARCH model is applied to the historical return data, it produces a predicted GARCH variance series and a GARCH coefficient. Multiplying the predicted monthly variance by the GARCH coefficient and then annualizing it produces the predicted annual equity risk premium. I then added the forecasted 30-year U.S. Treasury bond yield of 3.36% to each company's PRPM-derived equity risk premium to arrive at an indicated cost of common equity.

As set forth in Mr. D'Ascendis' Exhibit No. __ (DWD-1R), applying the PRPM to each Electric Utility Proxy Group produces a risk premium cost rate of 9.69%, which Mr. D'Ascendis averages with the results of his total market approach risk premium for a final risk premium ROE.

ii. <u>Total Market Risk Premium</u>

To conduct his total market approach analysis, Mr. D'Ascendis develops a prospective bond yield and applies it to an average of three equity risk premium rates. The three risk premium rates incorporated into the total market approach are: 1) a beta-adjusted total market equity risk premium; 2) an S&P Utilities Index equity risk premium; and 3) and an equity risk premium based on authorized ROEs for electric distribution utilities. *See* Joint Statement No. 2 at 23, 28-29. Page 29 of Mr. D'Ascendis' Exhibit No. __ (DWD-1R) presents the results of his total market risk premium analysis, showing an ROE of 9.44% for the Electric Utility Proxy Group. This result is then averaged with the 9.69% PRPM ROE for a combined risk premium ROE of 9.57%. *See* Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 27.

d. <u>CAPM</u>

Mr. D'Ascendis also conducts a CAPM ROE analysis. The traditional CAPM "is applied by adding a risk-free rate of return to a market risk premium, which is adjusted proportionately to reflect the systemic risk of the individual security relative to the total market as measured by the beta coefficient." *See* Joint Statement No. 2 at 32. Mr. D'Ascendis uses the traditional CAPM and averages these results with an Empirical CAPM ("ECAPM") analysis, which generally reflects the same analysis, but incorporates a more gently sloping Security Market Line to reflect the results of analysis showing that the steeper slope of the predicted Security Market Line (as used in the traditional CAPM) is not borne out by analysis of the empirical Security Market Line. *See* Joint Statement No. 2 at 32; *see also* Joint Statement No. 2-R at 27.

i. <u>CAPM Risk-Free Rate</u>

For the CAPM risk-free rate, Mr. D'Ascendis used the yield on 30-year U.S. Treasury bonds as set forth on page 42 of Exhibit __ (DWD-1R). Joint Statement No 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 42, fn. 2. As explained in his Direct Testimony, Mr. D'Ascendis selected the 30-year U.S. Treasury bond yields for the risk-free rate because "[t]he yield on long-term U.S. Treasury bonds is almost risk-free and its term is consistent with the long-term cost of capital to public utilities measured by the yield's on Moody's A-rate public utility bonds; the long-term investment horizon inherent in utilities' common stocks; and the long-term life of the jurisdictional rate base to which the allowed fair rate of return (*i.e.*, cost of capital) will be applied."

Joint Statement No. 2 at 33-34. Mr. D'Ascendis' Rebuttal Testimony presents the results of the analysis supporting the risk-free rate of 2.64%.[15]

ii. CAPM Market Risk Premium

To develop the CAPM market risk premium, Mr. D'Ascendis calculated "an average of three historical data-based market risk premiums, two Value Line data-based market risk premiums, and one Bloomberg data-based market risk premium." Joint Statement No. 2 at 34. A detailed description of each of the six data-based market risk premiums is presented in Mr. D'Ascendis' Direct Testimony. Joint Statement No. 2 at 34; *see also* Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 42. Mr. D'Ascendis' Exhibit __ (DWD-1R) shows the derivation of his 10.05% market risk premium based on the updated average of the aforementioned six data-based market risk premiums. As reflected on page 41 of Mr. D'Ascendis' Exhibit __ (DWD-1R), applying the above-referenced risk-free rate and market risk premium to the traditional CAPM and the ECAPM for the Electric Utility Proxy Group results in a CAPM equity cost rate of 8.27% and an ECAPM equity cost rate of 9.38%. Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 41. Mr. D'Ascendis then averages these outputs to arrive at a CAPM/ECAPM equity cost rate of 8.82%.

e. Cost of Equity Models Applied to Comparable Risk, Non-Price Regulated Companies

As a final indicated equity cost rate, Mr. D'Ascendis calculated equity cost rates based on the application of the above-referenced DCF, RPM, and CAPM models to a proxy group of domestic, non-price regulated companies. This methodology provides a valuable indicator of

[15] Mr. D'Ascendis' Direct Testimony set forth his originally proposed risk-free rate 3.36% based on: 1) the expected yields of 30-year U.S. Treasury bonds for the six quarters ending with the third quarter of 2020; and 2) long term projections for the years 2020 -2024 and 2025 – 2029. *See* Joint Statement No. 2 at 33. Mr. D'Ascendis' Rebuttal Testimony updated the risk-free rate to 2.64% based on: 1) the expected yields of 30-year U.S. Treasury bonds for the six quarters ending with the first quarter of 2021; and 2) long term projections for the years 2021 -2025 and 2026 – 2030. See Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 42, fn. 2.

anticipated investor returns for public utilities. As explained by Mr. D'Ascendis, "[b]ecause the purpose of rate regulation is to be a substitute for marketplace competition, non-price regulated firms operating in the competitive marketplace make an excellent proxy *if they are comparable in total risk to the Electric and Gas Utility Proxy Groups* being used to estimate the cost of common equity." Joint Statement No. 2 at 36. In other words, Mr. D'Ascendis' modeling of equity cost rates for non-price regulated companies includes only non-price regulated companies meeting criteria developed to mirror the total risk of the Electric Utility Proxy Group.

To compile a group of domestic, non-price regulated companies comparable in total risk to the companies in the Electric Utility Proxy Group, Mr. D'Ascendis included only companies meeting the following criteria:

(i) They must be covered by Value Line Investment Survey (Standard Edition);

(ii) They must be domestic, non-price regulated companies, i.e., not utilities;

(iii) Their beta coefficients must lie within plus or minus two standard deviations of the average unadjusted beta coefficients of the Utility Proxy Group; and

(iv) The residual standard errors of the *Value Line* regressions which gave rise to the unadjusted beta coefficients must lie within plus or minus two standard deviations of the average residual standard error of the Utility Proxy Group.

Joint Statement No. 2 at 37. In particular, the criteria measuring both beta coefficients and residual standard errors ensure that companies included on the non-price regulated proxy group have similar total risk to the companies in the Electric Utility Proxy Group. Mr. D'Ascendis explains the importance of these two criteria in measuring comparable risks as follows:

> Beta coefficients measure market, or systemic, risk, which is not diversifiable. The residual standard errors of the regressions measure each firm's company-specific, diversifiable risk. Companies that have similar beta coefficients *and* similar residual standard errors resulting from the same regression analyses have similar total investment risk.

Id. Mr. D'Ascendis selection criteria yielded a non-price regulated proxy group of nineteen companies with total investment risk comparable to the Electric Utility Proxy Group. Joint

Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 49. Mr. D'Ascendis then applied the DCF and CAPM analyses in the same manner as the Electric Utility Proxy Group. He also applied the RPM analysis but modified this model slightly to omit utility-specific risk premiums and the PRPM. *Id.* at 38.

As set forth below, Mr. D'Ascendis' application of the DCF, RPM, and CAPM analyses to the non-price regulated proxy group produced the following common equity cost rates:

Main Brief Table 5

Citizens' Electric Company / Wellsboro Electric Company / Valley Energy, Inc.
Summary of Cost of Equity Models Applied to
Proxy Groups of Non-Price Regulated Companies
Comparable in Total Risk to the Proxy Group of Nineteen Electric Companies
and Proxy Group of Seven Natural Gas Distribution Companies

Principal Methods	Proxy Group of Six Non-Price Regulated Companies	Proxy Group of Twenty Non-Price Regulated Companies
Discounted Cash Flow Model (DCF) (1)	8.21 %	10.00 %
Risk Premium Model (RPM) (2)	10.10	10.82
Capital Asset Pricing Model (CAPM) (3)	9.56	10.18
Mean	9.29 %	10.33 %
Median	9.56 %	10.18 %
Average of Mean and Median	9.43 %	10.26 %

Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 46. Per the above discussion, these equity cost rates provide an indication of the returns investors expect from companies exhibiting risk and uncertainties comparable to the public utilities in the Electric Utility Proxy Group. Consistent with the *Bluefield* standard, this information is relevant to the Commission's consideration of an appropriate ROE for the Company.

f. <u>Importance of reflecting multiple methods in Company ROE</u>

By applying the multiple cost of equity models to the Electric Utility Proxy Group and the non-price regulated proxy group, Mr. D'Ascendis develops an unadjusted indicated ROE for the Company of 9.05%. Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 2. Before addressing the appropriate adjustments to determine the recommended ROE for the Company, the importance of Mr. D'Ascendis' reliance on multiple models should be reviewed.

Mr. D'Ascendis discussed the impact of using multiple ROE models in his Rebuttal Testimony. The following excerpt summarizes the rationale and support for his methods:

> As discussed in my direct testimony, the use of multiple models adds reliability to the estimation of the common equity cost rate, with the prudence of using multiple cost of common equity models supported in both the financial literature and regulatory precedent.

Joint Statement No. 2-R at 6. Mr. D'Ascendis proceeds to identify financial literature supporting his application of multiple ROE models to determine a recommended ROE for the Company. The financial literature cited by Mr. D'Ascendis consists of a study of Roger A. Morin in which Dr. Morin references the below findings from Professor Eugene Brigham:

> Three methods typically are used: (1) the Capital Asset Pricing Model (CAPM), (2) the discounted cash flow (DCF) method, and (3) the bond-yield-plus-risk-premium approach. *These methods are not mutually exclusive – no method dominates the others,* and all are subject to error when used in practice. Therefore, when faced with the task of estimating a company's cost of equity, we generally use all three methods and then choose among them on the basis of our confidence in the data used for each in the specific case at hand.

Id. at 7 (emphasis added). The same study also quotes from a similar analysis of Professor Stewart Myers in which he more directly addresses the use of multiple ROE models for regulatory purposes:

> While it is certainly appropriate to use the DCF methodology to estimate the cost of equity, there is no proof that the DCF produces a more accurate estimate of the cost of equity than other methodologies. Sole reliance on the DCF model ignores the capital market evidence and financial theory formalized in the CAPM and other

> risk premium methods. *The DCF model is one of many tools to be employed in conjunction with other methods to estimate the cost of equity.* It is not a superior methodology that supplants other financial theory and market evidence. The broad usage of the DCF methodology in regulatory proceedings in contrast to its virtual disappearance in academic textbooks does not make it superior to other methods. The same is true of the Risk Premium and CAPM methodologies.

Id. at 8 (emphasis added). The referenced financial literature clearly reinforces Mr. D'Ascendis' reliance on multiple ROE models to derive a recommended ROE for Citizens'.

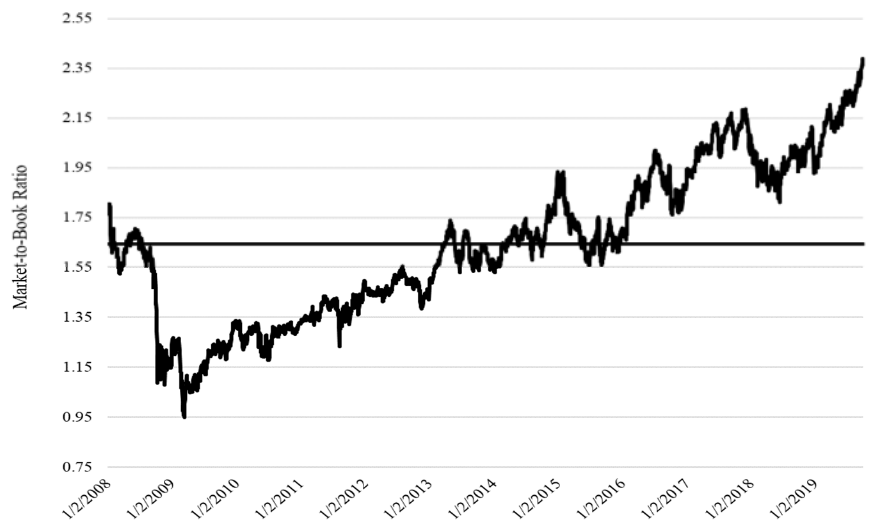
Mr. D'Ascendis also notes that the financial literature supporting use of multiple ROE models is consistent with the Commission's historical review of recommended public utility ROEs. While the Commission has a history of applying the DCF model as the foundation when determining an appropriate ROE for public utility ratemaking, the Commission has also incorporated the results of other models in finalizing the ROE component of an overall authorized ROR for ratemaking purposes. *See id. citing Pa. PUC v. Columbia Water Company*, Docket No. R-20132360798 (Order entered January 23, 2014) ("*Columbia Water*") and *Pa. PUC v. Emporium Water Company*, Docket No. R-2014-2402324 (Order entered January 28, 2015) ("*Emporium*"). Additionally, in the most recent litigated public utility rate determination, the Commission reinforced the importance of using other models in recognizing the potential shortcomings of undue reliance on a single model:

> Initially, we note that UGI has presented a valid argument that sole reliance on one methodology without checking the validity of the results of that methodology with other cost of equity analyses does not always lend itself to responsible ratemaking. As such, where evidence based on other cost of equity methods indicates that the DCF-only results may understate the utility's current cost of equity capital, we will consider those other methods, to some degree, in evaluating the appropriate range of reasonableness for our equity return determination.

UGI Order *at* 104 – 105. Importantly, Mr. D'Ascendis conducted a critical market analysis explaining why reliance solely on the DCF in the current market environment would likely understate the appropriate ROE for the Company. In his Rebuttal Testimony, Mr. D'Ascendis presents the below chart tracking the market-to-book ratio for the combined I&E and OCA electric utility proxy groups compared to the ten-year average:

Main Brief Table 6

<u>M/B Ratios of the Combined Electric Utility Proxy Group Compared with Ten-Year Average</u>



See Joint Statement No. 2-R at 13.

As indicated in Table 6, market-to-book value for the combined proxy group has been significantly higher than the 1.65 ten-year average, particularly since 2018. This trend has significant implications for the reliability of the DCF model. As discussed by Mr. D'Ascendis:

> DCF models assume an M/B ratio of 1.0 and therefore under-or-over-states investors' required return when market value exceeds or is less than book value, respectively. It does so because equity investors evaluate and receive their returns on the market value of a utility's common equity, whereas regulators authorize returns on the book value of common equity. This means that the market-based DCF will produce the total annual dollar return expected by investors, only when market and book values of common equity are equal, a very rare and unlikely situation.

Id. at 11. Importantly, Mr. D'Ascendis' observations of the susceptibility of the DCF model to distortion where market-to-book ratios exceed unity (*i.e.* a 1.0 ratio) are supported both by financial literature and empirical analysis.

In addition to his own summary of the relationship between the DCF model and market-to-book ratios, Mr. D'Ascendis again cites to research from Dr. Morin in which Dr. Morin also asserts that "application of the standard DCF model to utility stocks understates the investor's expected return when the market to-book (M/B) ratio of a given stock exceeds unity." Joint Statement No. 2-R at 10.

Mr. D'Ascendis additionally develops an empirical quantification of the understated return that would result from approval of the I&E and OCA DCF equity cost rates. Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-2R. This analysis indicates that I&E's 8.10% equity cost rate would produce 4.69% growth at market value but would result in just 0.23% growth if applied to book value. *Id.* Similarly, OCA's 8.38% equity cost rate would produce 5.15% growth at market value but would result in just 0.81% growth at book value. *Id.*

Finally, Mr. D'Ascendis further demonstrates the inaccuracy of the DCF model when market-to-book ratios exceed unity by applying the I&E and OCA DCF models to a book value capital structure. This involves de-leveraging the DCF ROE and then applying the de-levered ROE to the book value capital structure. *Id.* at 1. As detailed in Exhibit __ (DWD-1R), Schedule DWD-3R, adjusting the I&E and DCF model to reflect the book capital structure of its proxy group would increase I&E's DCF ROE from 8.10% to 9.19%. The same adjustment would increase OCA's DCF ROE from 8.38% to 9.45%. Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-2R at 3.

g. Management Performance

As addressed later in this Main Brief, the Company has demonstrated effective and efficient management meriting a 25 basis point performance adjustment to the ROE. I&E and OCA have not provided any relevant or persuasive arguments in response to the evidence of management effectiveness furnished by the Company. As a result, the Commission should approve the proposed 25 basis point performance adjustment.

h. Size Adjustment

As further addressed later in this Main Brief, the Company has proposed a 100 basis point size adjustment to account for the additional risks associated with smaller public utilities. The size risk has been recognized in financial literature and further demonstrated by empirical analysis conducted by Company witness Mr. D'Ascendis. Mr. D'Ascendis demonstrated that a 470 basis point adjustment could be justified for Citizens', but he recommends a more modest 100 basis point adjustment. Joint Statement No. 2 at 45. Accordingly, the Commission should approve the proposed 100 basis point performance adjustment.

3. **The Opposing Parties' Unprecedented and Unreasonable Common Equity Recommendations Must Be Rejected.**

In this proceeding, I&E and OCA have advanced ROE recommendations that starkly contrast with the financial and operational reality facing the Company. I&E recommends an ROE of 8.10%, while OCA recommends an ROE of 8.38%. These recommended ROEs are outside the zone of reasonableness and significantly below the lowest ROEs approved for electric utilities anywhere in the country over the past 40 years (as tracked by RRA). *See* Joint Statement No. 2-R at 5.

Not surprisingly, the ROEs recommended by I&E and OCA also depart from ROEs approved by this Commission in fully-litigated rate proceedings for investor-owned public utilities. In October 2018, the Commission approved an ROE of 9.85% for UGI Utilities, Inc. – Electric Division. UGI Order at 119. Additionally, the Commission approved an ROE of 10.40% for PPL Electric Utilities Corporation in 2012 and an ROE of 11.00% for Aqua Pennsylvania, Inc. in 2008. Joint Statement No. 2-R at 5. Although market conditions may change, no empirical evidence supports adoption of ROE's that are 175 and 147 basis points lower than the UGI result, which was decided a mere 18 months before this case.

As indicated by the above background and detailed in the below analysis of the opposing ROE recommendations, the Commission should reject the proposals from I&E and OCA and approve the thoroughly developed and supported ROE recommendation from Mr. D'Ascendis.

a. <u>I&E Arguments</u>

In contrast to Mr. D'Ascendis' detailed analysis addressing the necessity to evaluate the DCF results in conjunction with other models for purposes of this proceeding, I&E maintains an unreasonably narrow focus on relying primarily on the DCF and considering only the CAPM as a check. Generally, I&E's testimony critiques the CAPM and RPM analyses while entirely ignoring similar shortcomings associated with the DCF analysis. I&E's methodology and specific criticisms of Mr. D'Ascendis' recommendations are addressed below.

i. <u>I&E fails to recognize importance of other models.</u>

I&E applies a DCF model and uses the CAPM as a "check" on the DCF results. I&E Statement No. 2 at 20. As discussed by Mr. D'Ascendis, unfortunately, I&E's application of the CAPM suffers from numerous flaws, which renders the "check" useless. Additionally, I&E entirely omits consideration of additional models despite Mr. D'Ascendis providing compelling testimony establishing that market conditions favor reference to other models to correct for inaccuracies embedded in the DCF model.

ii. <u>I&E's CAPM analysis is flawed.</u>

First, I&E identifies the CAPM analysis as subject to manipulation based on the inputs and proceeds to use different inputs than Mr. D'Ascendis. *See* I&E Statement No. 2 at 21-22, 37. I&E's criticism of the CAPM analysis in general as subject to "manipulation" should be given no weight. As noted by Mr. D'Ascendis, I&E's criticism of the CAPM would apply equally to any ROE model as "[a]ll ROE models are only as good as their inputs, and all ROE models can be easily manipulated by changing those inputs." *See* Joint Statement No. 2-R at 38. To illustrate this point, Mr. D'Ascendis compiled the below table reflecting the various data inputs to the DCF that can each alter the results of any individual DCF analysis:

Main Brief Table 7

<u>Various Inputs to DCF Models</u>

Input	**Variations of Inputs**
Cash Flow Stream	Constant-Growth, Blended Growth, Multi-Stage Growth
Dividend Yield	Spot Dividend Yield, average dividend yield
Adjusted Dividend Yield	No adjustment, ½ g adjustment, full g adjustment, projected dividend
Growth Rates	Historical v. Projected v. Sustainable
Growth Measure	EPS, DPS, BVPS
Sources of Growth Rates	Value Line, Zacks, Yahoo, MorningStar, etc.

Joint Statement No. 2 at 39. CAPM should not be disregarded simply because it requires the analyst to make reasonable judgments regarding the model inputs.

In addition to the general critique of the CAPM as subject to manipulation, I&E specifically challenges Mr. D'Ascendis' selection of the 30-year Treasury Bonds as the risk-free rate, his forecast period, and his use of the ECAPM.

Regarding the applicable risk-free rate, I&E claims the 10-year Treasury Note represents the appropriate risk-free rate for a CAPM analysis. I&E bases this assertion on its claim that the 10-year Treasury Note balances short-term volatility risk and long-term inflation risk. *See* I&E Statement No. 2 at 37. I&E also relies on the Commission's decision to adopt its proposal to use the 10-year Treasury Note as the risk-free rate in the 2018 UGI Order. Notwithstanding the prior determination in the UGI rate case, the Company urges the Commission to consider the matching principle explained by Mr. D'Ascendis. Mr. D'Ascendis presents multiple financial analyses from notable scholars confirming that the "risk-free rate used in the CAPM should match the life (or duration) of the underlying investment." *See* Joint Statement No. 2-R at 23. Morningstar, Inc. further explains this matching principle as follows:

> The traditional thinking regarding the time horizon of the chosen Treasury security is that it should match the time horizon of whatever is being valued. When valuing a business that is being treated as a going concern, the appropriate Treasury yield should be that of a long-term Treasury bond. Note that the horizon is a function of the investment, not the investor. If an investor plans to hold stock in a company for only five years, the yield on a five-year Treasury note would not be appropriate since the company will continue to exist beyond those five years.

Id. Mr. D'Ascendis additionally references the below passage from Dr. Morin affirming the same matching principle and directly recommending the use of 30-year Treasury Bonds as the appropriate risk-free rate for CAPM analysis:

> [b]ecause common stock is a long-term investment and because the cash flows to investors in the form of dividends last indefinitely, the yield on very long-term government bonds, namely, the yield on 30-year Treasury bonds, is the best measure of the risk-free rate for use in the CAPM… The expected common stock return is based on long-term cash flows, regardless of an individual's holding time period.

Id. Based on this well-founded matching principle and the useful life of public utility assets ranging from 21-31 years (or more), Mr. D'Ascendis concludes that "the I&E Witnesses' use of a medium-term Treasury bond does not match the life of the assets being valued." *Id.* at 24. I&E

provided no credible academic or financial authority to rebut the multiple studies referenced by Mr. D'Ascendis. Accordingly, the Commission should approve Mr. D'Ascendis' proposed risk-free rate based on the 30-year U.S. Treasury Bonds.

I&E further criticizes Mr. D'Ascendis' forecast period for the risk-free rate. As set forth above, Mr. D'Ascendis' CAPM analysis included a projection of the risk-free rate over the period 2021-2025 and 2026-2030. *See supra* at VII.E.3.ii. I&E claims any projection exceeding five years would include unreliable data. I&E Statement No. 2 at 37. Notably, I&E provides no analysis or citation to any authority to support the assertion that projecting a risk-free rate over a ten-year period would result in unreliable data. To the contrary, Mr. D'Ascendis identifies two significant flaws in the I&E recommendation.

First, he confirms that the Blue Chip Financial Forecasts, the source relied upon by both Mr. D'Ascendis and I&E, projects interest rates out to 2030. Joint Statement No. 2 at 24. Thus, because the DCF model is precipitated on an assumption that the projected growth is constant into perpetuity, I&E contradicts the model by not incorporating the longest projection available. *Id.* Second, Mr. D'Ascendis also observes that investors are generally presumed to act in accordance with the semi-strong form of the Efficient Market Hypothesis, which assumes that "all information (including long-term forecasts of interest rates) are available to the investor, which means the 2026-2030 forecasted interest rate would be considered by investors when making investment decisions and, therefore, should be included in the I&E ROE Witnesses' CAPM analysis." *Id.* at 25. Mr. D'Ascendis has provided ample support for the proposed forecast period, which I&E has failed to credibly rebut. The Commission should therefore approve the Company's proposed forecast period for the risk-free rate.

Finally, I&E fails to include an ECAPM analysis. I&E opposes Mr. D'Ascendis use of the ECAPM claiming that it only exacerbates the subjectivity of the traditional CAPM. I&E's

argument eschews substance in favor of conclusive and thus unreliable assertions. In Surrebuttal Testimony, I&E references unspecified flaws in the ECAPM, alleging "[a]s I explained in my direct testimony, the ECAPM has the same problems as the CAPM." I&E Statement No. 2-SR – Surrebuttal Testimony of Anthony Spadaccio ("I&E Statement No. 2-SR") at 18. However, I&E cites back to pages 38 and 39 of its Direct Testimony, which contains no further articulation of the purported flaws in the CAPM that are not addressed by the ECAPM. *See* I&E Statement No. 2 at 37-38. To the contrary, Mr. D'Ascendis references multiple studies affirming that the ECAPM addresses criticism of the overly steep predicted Security Market Line resulting from the traditional CAPM. For example, Dr. Morin concluded that "[w]ith few exceptions, the empirical studies agree that… low-beta securities earn returns somewhat higher than the CAPM would predict, and high-beta securities earn less than predicted." *See* Joint Statement No. 2-R at 28. The ECAPM directly responds to this concern by relaxing the slope of the predicted Security Market Line to reflect the empirical (i.e. actual) Security Market Line.

iii. I&E Unreasonably Excludes Consideration of the Company's Risk Premium Analyses.

I&E also rejects Mr. D'Ascendis' use of the RPM and PRPM analyses on grounds that both rely on indirect ROE measures and the PRPM is an uncommon methodology requiring purchase of proprietary software at a "substantial fee." I&E Statement No. 2 at 33. These allegations are unfounded. Mr. D'Ascendis confirmed in his Direct Testimony that he adjusted the RPM results "by the beta coefficient to account *for the risk of the Electric and Gas Utility Proxy Groups*." Joint Statement No. 2 at 28 (emphasis added). As Mr. D'Ascendis adjusted for the specific risks of the Electric Utility Proxy Group, the RPM is not based on indirect measure of ROE. Similarly, Mr. D'Ascendis clarified in his Rebuttal Testimony that "[t]he PRPM model used in my RPM analysis measures the risk-return relationship directly using the same company-specific market prices used to derive company-specific beta coefficients." Joint Statement No. 2-R at 39. Mr. D'Ascendis further cites to a *Journal of Regulatory Economics* article by the authors of the model affirming that the PRPM estimates risk *directly* from asset pricing data. *Id.* at 39. Similarly, Mr. D'Ascendis also confirmed in his Direct Testimony that he adjusted the RPM results "by the beta coefficient to account for the risk of the Electric and Gas Utility Proxy Groups." Joint Statement No. 2 at 28. Finally, with regard to the claims that the PRPM is not a commonly used method, Mr. D'Ascendis provided extensive evidence of its use in the industry, including three publications in academic peer-reviewed journals and a recent adoption of the model by the South Carolina Public Service Commission. Joint Statement No. 2-R at 41. Mr. D'Ascendis also addressed I&E's claim that the PRPM is a proprietary model available only through substantial fees by clarifying that he made his workpapers available to all parties in this proceeding and that free versions of software necessary to run the PRPM model are available. *See id.* at 42. While the PRPM analysis has not been commonly adopted by this Commission, Mr. D'Ascendis has provided substantial and unrebutted support for his reliance on the model.

iv. I&E Fails to Incorporate Results of the Company's Analysis of Non-Price Regulated Companies.

I&E also contests Mr. D'Ascendis use of market data from domestic, non-price regulated companies in determining a recommended ROE for the Company. I&E objects to this method principally based on the Commission's observation in the UGI Order that "determining which companies are comparable is entirely subjective." I&E Statement No. 2 at 35. I&E also avers that consideration of non-price regulated companies runs contrary to the *Bluefield* standard. Both arguments should be rejected.

In reviewing Mr. D'Ascendis' reliance on data from non-price regulated companies, the Commission should consider that its decision in the UGI Order was based on the Comparable

Earnings analysis proposed in that proceeding. Notably, the Commission observed in that Order that UGI considered returns on book equity rather than returns on common equity. UGI Order at 105. To the contrary, no party disputes that Mr. D'Ascendis applied the DCF, CAPM, and RPM models to the non-price regulated proxy group. Additionally, as previously observed by Mr. D'Ascendis, there is a measure of subjectivity involved in all ROE models. *See* Joint Statement No. 2-R at 38. Here, Mr. D'Ascendis developed specific selection criteria limiting the non-price regulated proxy group to companies with beta coefficients *and* residual standard errors within plus or minus two standard deviations of the Electric Utility Proxy Group. Joint Statement No. 2 at 37. I&E's criticisms of Mr. D'Ascendis' non-price regulated proxy group would apply with equal force to any ROE model in that the projected risk is never a guarantee of future risk.

Additionally, I&E errs in asserting that consideration of non-price regulated companies violates the *Bluefield* standard. As noted above, the non-price regulated companies meet selection criteria indicating they face similar, albeit not exact, risks as the Electric Utility Proxy Group. I&E's assertion that the companies in the non-price regulated proxy group are "highly profitable or speculative ventures" cannot be reconciled with the selection criteria applied by Mr. D'Ascendis.

I&E failure to consider the multiple ROE models conflicts with Mr. D'Ascendis' testimony demonstrating that the DCF is subject to distortion during periods where market value exceeds book value, which is a situation that currently exists as shown on Table 6. I&E purports to rebut Mr. D'Ascendis' arguments by claiming that any difference between market and book value for electric utilities is reflected in the forecasted growth rates used in the DCF. *See* I&E Statement No. 2-SR at 12. However, I&E's assessment is flatly contradicted by the financial literature cited by Mr. D'Ascendis, which corroborates his observation that "application of the standard DCF model to utility stocks understates the investor's expected return when the market to-book (M/B) ratio of a given stock exceeds unity." Joint Statement No. 2-R at 10.

b. <u>Consideration of DCF-Only Results Still Invalidates I&E's ROE Recommendation.</u>

Although Mr. D'Ascendis provides ample support for his reliance on multiple methods, the Commission should consider that even the DCF-only results support an ROE higher than the recommendations from I&E. The Commission's determination of the ROE for electric utility DSICs indicates that an appropriate ROE should be set at the higher range of DCF results. As discussed by Mr. D'Ascendis in his rejoinder testimony, the Commission does not set the DSIC ROE at the median or mean of its DCF analysis, but rather sets the DSIC ROE at some point within a standard deviation of the results. *See* Tr. 45. Despite arguments from I&E that the DSIC ROE is not relevant to this proceeding, the DSIC ROE is a market indicated cost of common equity developed by the Commission concurrently with this rate case. It applies to utilities that settled their most recent rate cases without a litigated ROE. If ROE was litigated, then the PUC's determination from the rate case is applied. 66 Pa. C.S. § 1357(b)(2). Accordingly, it serves as a meaningful check on the results in this proceeding, although the DSIC results would be conservative as it omits consideration of the specific risks faced by small public utilities like Citizens' and any recognition of a performance adjustment for management effectiveness.

4. **OCA Arguments**

Like I&E, OCA's ROE analysis relies narrowly on the DCF and gives no weight to the results of other models. Interestingly, OCA alleges that it considered other models; however, its 8.38% recommended ROE (or I&E's ROE) remains solely based on the median point of its DCF analysis. As noted above, OCA's ROE would be the lowest ROE approved for an electric utility in the country. *See* Joint Statement No. 2-R at 5. While the below discussion will address specific faults with OCA's analysis, the Commission should consider the drastic departure from market realities sufficient reason to summarily reject OCA's recommended ROE.

a. OCA fails to recognize importance of other models.

Although Mr. D'Ascendis provided evidence demonstrating that current market conditions render the DCF subject to distortion, OCA continues to recommend an 8.38% ROE for the Company based solely on a combination of a constant growth DCF and the Federal Energy Regulatory Commission ("FERC") two-step DCF analysis. Joint Statement No. 2-R at 46. In addition to the combined DCF/two-step DCF model, OCA conducts a two-stage DCF analysis, a CAPM analysis, and a CAPM/Risk Premium analysis, but places no weight on these analyses. Joint Statement No. 2-R at 46. Therefore, OCA's recommended ROE is based solely on the DCF. OCA Statement No. 3 at 25.

b. OCA's Non-Constant DCF Results Have No Merit.

The constant growth DCF model applied by OCA substantially duplicates Mr. D'Ascendis' DCF model. The OCA errs by also considering non-constant DCF results. Specifically, the OCA's alternative non-constant FERC two-step DCF and the two-stage DCF are predicated on false premises and should be rejected as invalid ROE models. As described by Mr. D'Ascendis, both the FERC two-step DCF and the two-stage DCF alternative growth rates are intended to reflect the dual premises: "(1) that growth is limited by the long-term growth in gross domestic product ("GDP") and (2) utility companies are not in the 'steady state' stage in the company/industry life cycle." Joint Statement No. 2-R at 49. However, neither premise holds true.

Mr. D'Ascendis provided an analysis illustrating the fallacy of referencing GDP as a limit on long-term growth, showing that even the highest growth rate industry (Educational Services, Healthcare, and Social Assistance) would need 3,467 years of compound annual growth to comprise 100% of GDP. Joint Statement No. 2-R at 50. In addition, Mr. D'Ascendis further cited to financial literature evidencing that electric utilities are mature (i.e. steady state) firms. *Id.* at 51-52. In other words, both premises cited above do not apply in this context.

In response, OCA further argues that use of the non-constant FERC two-step DCF and two-stage DCF are unrelated to the underlying firm's growth stage and applied to serve as a check on unsustainable analyst growth rates used in the constant growth DCF model. OCA Statement No. 3-SR – Surrebuttal Testimony of David S. Habr ("OCA Statement No. 3-SR") at 7. However, OCA's reasoning is circular as OCA recognizes that the non-constant DCF models are generally reserved for growth-stage firms rather than mature steady stage firms like electric utilities. *Id.* at 7. OCA provides no basis for applying these models to steady stage firms other than an unsubstantiated allegation that the otherwise applicable 5-year forecasts are "unsustainable." *Id.* at 7.

c. <u>OCA's CAPM Analysis is Flawed.</u>

As stated above, OCA also performs a CAPM analysis as a check on its DCF results, which results in a range of 6.11% to 11.38% for his electric proxy group. OCA Statement No. 3 at 24. However, Mr. D'Ascendis identified numerous flaws invalidating OCA's CAPM analysis. In principle, and as discussed in detail in Mr. D'Ascendis' Rebuttal Testimony, OCA's CAPM analysis: 1) fails to utilize a risk-free rate based on a forecast period, despite common knowledge that investors are aware of and rely on interest rate forecasts; 2) relies on four flawed market risk premium calculations; and 3) similar to I&E, fails to incorporate an ECAPM analysis. Joint Statement No. 2-R at 55-63. As indicated by Mr. D'Ascendis, correcting OCA's CAPM to incorporate a projected risk-free rate and corrected market risk premiums would result in an adjusted range of 6.06% to 12.14% for his electric proxy group.

d. <u>OCA's CAPM/Risk Premium Analysis Is Not a Generally Accepted Model.</u>

OCA compounds the ineffectiveness of its CAPM analysis by applying a purported "risk premium" analysis that simply replaces the risk-free rate in the CAPM with a six-month average utility bond yield. Joint Statement No. 2-R at 64. As discussed in Mr. D'Ascendis' Rebuttal Testimony, this model is "a substantial departure from the CAPM's theoretical basis, simply because it assumes no risk-free asset." *Id.* at 65. While OCA argues that its risk premium analysis preserves a risk-free asset in the market risk premium calculation, it concedes that the "free-standing" risk free asset component of the CAPM is eliminated. OCA Statement No. 3-SR at 9. As OCA provides neither financial literature nor other support for this departure from the widely accepted CAPM or risk premium analyses, the Commission should dismiss OCA's unsupported risk premium analysis.

As referenced above, OCA conducted multiple analyses, but developed its recommended ROE of 8.38% based solely on the results of its constant growth and FERC two-step DCF models. While OCA claims to have considered various other models, it used the results of its two-stage DCF model, CAPM model, and CAPM/Risk Premium model OCA only to set the upper and lower limits for its electric proxy group. *Id.* at 5. Accordingly, OCA omits consideration of multiple ROE models in the same manner as I&E. In response to Mr. D'Ascendis' presentation of evidence establishing the susceptibility of DCF models to distortion during periods where market-to-book ratios exceed unity, OCA offers parallel arguments to those advanced by I&E, each of which fails to overcome the empirical evidence advanced by Mr. D'Ascendis in favor of using other models to counter unreliable DCF results.

e. <u>Consideration of DCF-Only Results Still Invalidates OCA's ROE Recommendation.</u>

Finally, as detailed above in response to I&E's ROE analysis, OCA's ROE recommendation remains unsupported even if considered solely on the basis of its DCF results, as both the Commission's practice in setting the DSIC ROEs and the policy initiatives necessitating significant capital expenditures for reliability improvements would favor awarding an ROE closer to the high end of the DCF results, subject to further adjustments.

F. MANAGEMENT PERFORMANCE

Citizens' has demonstrated effective management of operations and costs which warrants a performance adjustment. OCA and I&E are incorrect in their assertions that Citizens' successes in providing effective management of operations and costs merely achieve what the Public Utility Code requires all utilities to do—*i.e.*, provide adequate, efficient, safe, and reasonable service.[16] *See* OCA Statement No. 3 at 31; *see also* I&E Statement No. 2 at 43.

Section 523 of the Public Utility Code, 66 Pa. C.S. § 523, requires the Commission to consider management effectiveness in setting rates and states, in relevant part:

> (a) Considerations. — The commission *shall consider*, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.

66 Pa. C.S. § 523. (Emphasis added). In order to be rewarded with a rate of return premium, the utility must provide specific evidence to support the adjustment. *Pa. PUC v. Columbia Water Co.*, 2013 Pa. PUC LEXIS 763, *82.

Citizens' has listed a number of performance metrics that constitute specific evidence in support of a performance adjustment. The performance metrics demonstrate Citizens' effective management of costs and operations and, therefore, warrant a performance adjustment.

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[16] Section 1501 of the Public Utility Code, 66 Pa. C.S. § 1501 provides, in relevant part: "Every public utility shall furnish and maintain adequate, efficient, safe, and reasonable service and facilities."

1. Citizens' Effective Management of Operations and Costs Warrants a Performance Adjustment.

In managing operations and costs, Citizens has gone beyond what it is required to do by improving the quality of public utility service for customers in multiple respects. As Company Chief Executive Officer John Kelchner described in his direct testimony, Citizens' has accomplished the following: (1) low number of customer complaints; (2) favorable customer feedback; (3) high responsiveness to customer support calls and in energizing new service locations; (4) excellent reliability metrics; (5) no reportable injuries; (6) technological improvements in customer service by offering Smarthub use to customers and providing line crews with tablets; (7) increased pole attachment billing; (8) recognition as a "Tree Line USA" utility[17]; (9) replacement of forty percent of all the streetlights in its service area with LED lights; and (10) continued significant capital investment of approximately $1.4 million per annum. Citizens' Statement No. 4 at 9-12.

In order to highlight the gravity of the accomplishments Citizens' has made, a few of these achievements will be explained in more detail. With respect to Citizens' low number of customer complaints, for the years of 2016 to 2018, Citizens' received 13 informal complaints but no formal complaints. *Id.* at 9. Further, each informal complaint was either resolved within nineteen days or dismissed by the Commission. *See id. at* Exhibit__(JK-1). Citizens' high responsiveness in customer support calls is reflected in Exhibit__(JK-3) attached to Mr. Kelchner's Direct Testimony, which shows that, on average, Citizens' responds to 97% of customer phone calls within thirty seconds. *See id. at* Exhibit__(JK-3). The Company has also sustained excellent reliability metrics in 2018 by meeting, and in some cases, out-performing, all applicable

[17] The Tree Line USA utility designation recognizes utilities that have made commitments to proper tree pruning techniques. Proper tree pruning increases efficiency in vegetation management which is important to power line maintenance.

Commission reliability objectives. *Id.* at 10. Through Citizens' completion of an electronic attachment mapping and audit project the Company was able to realize a 9.2% increase in pole attachment billing from 2018 to 2019. *Id.* at 11. The revenues from pole attachment billing aided Citizens in offsetting the increased distribution system expenses and reducing the revenue requirement to be recovered from ratepayers. Further, Citizens has continued to invest approximately $1.4 million per annum in system replacements and improvements which ultimately help the Company to continue providing excellent and reliable service to its customers. *Id.* at 12. Notably, Citizens' implemented these system improvements through effective management of base rate revenues, without employing a DSIC. *Id.*

All the above discussed performance metrics show Citizens' commitment to improve its operations to increase reliability, increase attention to customer needs and customer satisfaction, and increase the overall effectiveness of the Company's service. These accomplishments achieve more than just mere compliance with Commission requirements and policies and demonstrate Citizens' commitment to providing reliable and quality service to its customers above and beyond what is required by the Public Utility Code. Based on Citizens' effective cost and operations management, a performance adjustment is warranted.

2. I&E and OCAs Rejection of Any Allowance for Management Effectiveness Should Be Rejected.

Witnesses Habr and Spadaccio, in their direct testimonies on behalf of OCA and I&E, respectively, contend that Citizens' has not earned a performance adjustment because the Company is merely taking actions it is required to take pursuant to the Public Utility Code. *See* OCA Statement No. 3 at 31; I&E Statement No. 2 at 43. As discussed above, however, Section 523 of the Public Utility Code requires the Commission to consider evidence concerning a utility's efficiency, effectiveness, and adequacy of service in determining whether a utility has earned a performance adjustment. 66 Pa. C.S. § 523(a); *Pa. PUC v. Columbia Water Co.*, 2013 Pa. PUC LEXIS 763 at *82-83. The Public Utility Code, in very general terms, requires utilities to "furnish and maintain adequate, efficient, safe, and reasonable service and facilities." 66 Pa. C.S. § 1501. In support of Citizens' efficiency, effectiveness, and adequacy of service, the Company has listed numerous performance metrics and provided evidence in support thereof. The Commission did not require Citizens' to develop and implement innovative and progressive solutions such as optimizing the customer service experience through Smarthub and maximizing the Company's ability to provide efficient service by supplying each lineman with tablets. Citizens' pursued these service enhancements on its own initiative. The Advocates have failed to address whether Citizens' has provided evidence of effective and efficient management consistent with Section 523(a) of the Public Utility Code and have instead offered only general opposition to the principle of a performance adjustment. If the contentions of OCA and I&E are accepted, there would never be in instance in which the Commission could grant a performance adjustment to a utility.

Certainly, the Commission has stated that utilities who meet the bare requirements of the Public Utility Code have not proven that their performance warrants a performance adjustment. *See Pa. PUC v. Columbia Water Co.*, 2013 Pa. PUC LEXIS 763 at *84 ("In this case, the evidence provided by Columbia shows compliance with Commission requirements and policies, *i.e.* reasonable and adequate service, but it does not even support a rate adjustment in the amount requested. Columbia provided testimony regarding its compliance with state and federal drinking water standards. The evidence regarding Columbia's adequacy of service and water quality is not sufficient to warrant a rate of return premium of 0.25%."). Here, however, Citizens has provided evidence of performing above and beyond the its compliance obligations under the Public Utility Code in greatly increasing the efficiency, reliability, and quality of service through the many listed performance metrics.

G. SIZE ADJUSTMENT

In considering the appropriate ROE for Citizens', the Commission must include a size adjustment to account for the greater risk faced by smaller public utilities in comparison to the Electric Utility Proxy Group. By any measure, Citizens' is smaller public utility compared to the companies in the Electric Utility Proxy Group and most of the other electric utilities regulated by the Commission. While application of a size adjustment may not be necessary or appropriate in every utility base rate proceeding, the Company has provided evidence demonstrating that a size adjustment is necessary to reflect the difference in scale and size between Citizens' and the companies in the Electric Utility Proxy Group. I&E and OCA oppose the size adjustment based on allegations that utilities are immune from size risk, but these assertions are unpersuasive considering the body of evidence to the contrary. Accordingly, the Commission should approve the 100 basis point size adjustment proposed by Mr. D'Ascendis.

1. **The Proposed Size Adjustment is Necessary to Ensure Citizens' ROE Meets the *Bluefield* Standard.**

The Company's proposed size adjustment is a corollary to the *Bluefield* standard determining that public utilities are entitled to earn a rate of return on property placed into public service commensurate with other business undertakings "which are attended by corresponding risks and uncertainties." *Bluefield* at 79. As detailed below, company size is a risk factor. Accordingly, an ROE developed using proxy groups differing substantially in size from the public utility requesting a rate increase will understate the appropriate ROE unless the result is adjusted to account for size risk.

Notably, the Commission has previously recognized the validity of a size adjustment. In a 2007 Order, the Commission awarded a size adjustment to PPL Gas Corp. *Pa. PUC v. PPL Gas Corp.*, 2007 Pa. LEXIS 779, *105. Additionally, while the Commission denied the size adjustment proposed by UGI Electric in 2018, the Commission preserved the validity of the size effect and found only that UGI failed to present sufficient evidence to warrant an adjustment in that proceeding. UGI Order at 100. To the contrary, and as addressed below, the Company has provided compelling evidence supporting its proposed size adjustment.

2. The Evidentiary Record Supports the Proposed Size Adjustment.

Mr. D'Ascendis discussed the inverse relationship between company size and risk in his Direct Testimony, as set forth below:

> The Companies' smaller size relative to the Electric and Gas Utility Proxy Groups indicates greater relative business risk for the Companies because, all else being equal, size has a material bearing on risk.
>
> Size affects business risk because smaller companies generally are less able to cope with significant events that affect sales, revenues and earnings. For example, smaller companies face more risk exposure to business cycles and economic conditions, both nationally and locally. Additionally, the loss of revenues from a few larger customers would have a greater effect on a small company than on a bigger company with a larger, more diverse, customer base.

Joint Statement No. 2 at 42. Per Mr. D'Ascendis' explanation, failure to reflect the increased risk faced by smaller public utilities such as Citizens' would understate the ROE demanded by investors. Citizens' witness Mr. Kelchner further details the realities of small company risk in the following excerpt from his Direct Testimony:

> As explained in Mr. D'Ascendis' testimony, small utilities face increased financial and business risks. A significant risk we face is the reduction of electric load due to business closures or other factors outside of our control that adversely impact our kWh sales (such as weather, net metering, customer on-site generation, etc.). Citizens' capital investment and operating expenses that are necessary to maintain service and reliability remain the same whether we lose customers or distribute less kWh; however, our operating income is decreased. Small utilities also experience greater revenue swings and variation based on weather patterns. Finally, at times, the costs of complying with regulatory requirements can have greater impact on Citizens' than it would larger EDCs.

Citizens' Statement No. 4 at 6. As summarized by Mr. Kelchner, smaller companies experience greater financial and business risks because they lack the scale that larger companies rely on to absorb the impacts of unanticipated business or operational developments. *See id.*

The reality that investors demand greater returns to account for size risk is further evidenced through review of the relevant financial literature. In his Direct Testimony, Mr. D'Ascendis references a Duff & Phelps 2019 Valuation Handbook Guide to Cost of Capital - Market Results through 2018 ("D&P - 2019"), which discusses the nature of the small-size phenomenon in detail as follows:

> The size effect is based on the empirical observation that companies of smaller size are associated with greater risk and, therefore, have greater cost of capital [sic]. The "size" of a company is one of the most important risk elements to consider when developing cost of equity capital estimates for use in valuing a business simply because size has been shown to be a *predictor* of equity returns. In other words, there is a significant (negative) relationship between size and historical equity returns - as size *decreases*, returns tend to *increase*, and vice versa. (emphasis in original)

Joint Statement No. 2 at 42. Mr. D'Ascendis additionally cites to the "The Capital Asset Pricing Model: Theory and Evidence," in which Fama and French observe that:

> . . . the higher average returns on small stocks and high book-to-market stocks reflect unidentified state variables that produce undiversifiable risks (covariances) in returns not captured in the market return and are priced separately from market betas.

Id. Finally, Mr. D'Ascendis references noted scholar Eugene Brigham's research identifying the "small-firm effect" as a hindrance to small firm operations:

> A number of researchers have observed that portfolios of small-firms (sic) have earned consistently higher average returns than those of large-firm stocks; this is called the "small-firm effect." On the surface, it would seem to be advantageous to the small firms to provide average returns in a stock market that are higher than those of larger firms. In reality, it is bad news for the small firm; *what the small-firm effect means is that the capital market demands higher returns on stocks of small firms than on otherwise similar stocks of the large firms.* (emphasis added)

Id. at 43. Mr. D'Ascendis' review of financial literature establishes the inverse relationship between Company size and risk. The question relevant to whether a size adjustment is necessary to appropriately reflect Citizens' risk factors turns to whether Citizens' is considerably smaller than the companies in the Electric Utility Proxy Group.

To determine whether a size adjustment should be incorporated, Mr. D'Ascendis conducted a market capitalization analysis to quantify the relative size risk. Joint Statement No. 2 at 44. Mr. D'Ascendis' study observed that, as of March 29, 2019, Citizens' had a market capitalization of $26.840 million compared with an average company market capitalization of $16,675.447 million for the Electric Utility Proxy Group. *Id* at 45. This amounts to a size difference of 621.3x.[18] *Id.*

In order to quantify the appropriate size adjustment, Mr. D'Ascendis relied on "size premiums for portfolios of New York Stock Exchange, American Stock Exchange, and NASDAQ listed companies ranked by deciles for the 1926 to 2018 period." Joint Statement No. 2 at 45. The Electric Utility Proxy Group $16.7 billion market capitalization ranked in the 2nd decile, while Citizens' $26.8 million market capitalization ranked in the 10th decile, resulting in a size premium spread of 4.70%. Joint Statement No.2 at 45. Following review of the proxy groups compiled by I&E and OCA, Mr. D'Ascendis refined this market capitalization analysis to include the average market capitalizations of the I&E and OCA proxy groups and finds similar results. *See* Joint Statement No. 2-R at 32; *see also id.*, Exhibit No.__ (DWD-1R), Schedule DWD-5R. Accordingly, although his analysis supports a 470 basis point adjustment, Mr. D'Ascendis recommends a conservative size adjustment of 1.00% or 100 basis points to the Company's ROE. Joint Statement No. 2 at 45.

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[18] *Id.* Notably, Mr. D'Ascendis also pointed to Citizens' rate base as an indicator of size, observing that even the combined $45 million rate base of Citizens', Valley, and Wellsboro are multiple time smaller than the $1.6 billion rate base of the average electric utility granted an ROE of approximately 9.60%. *See* Tr. 44.

3. The Advocates Arguments in Opposition to the Size Adjustment are Unsupported.

I&E does not contest the general applicability of size risk but allege that the studies referenced by the Company are irrelevant because they are not specific to the utility industry. While the Company does not concede that only financial authorities specific to public utilities are relevant to its ROE determination, Mr. D'Ascendis rebutted the I&E claims with reference to a utility-specific study and his own utility specific analysis demonstrating that size risk impacts public utilities. Joint Statement No. 2-R at 32-36. OCA also contests the proposed size adjustment but bases its opposition on a misunderstanding of Mr. D'Ascendis' size premium and irrelevant condemnations of small utility operations. As OCA and I&E have not credibly responded to Mr. D'Ascendis' proffered utility-specific evidence, their arguments should be dismissed.

In opposing the Company's proposed size adjustment, I&E places exclusive weight on a single study by Dr. Annie Wong concluding that there is "no need to adjust for the firm size in utility rate regulation." *See* I&E Statement No. 2 at 42. In response, Mr. D'Ascendis notes that Dr. Wong's study erroneously equates "a change in size to beta coefficients, which accounts for only a small percentage of diversifiable company-specific risk." Joint Statement No. 2-R at 33. By analyzing only the risk captured in beta, Dr. Wong understates the total impact of size risk. Joint Statement No. 2-R at 33.

In addition to critiquing Dr. Wong's methods, Mr. D'Ascendis cited to a more recent article by Thomas M. Zepp which also criticized Dr. Wong's study and observed "[t]wo other studies discussed here support a conclusion that smaller water utility stocks are more risky than larger ones. To the extent that water utilities are representative of all utilities, there is support for smaller utilities being more risky than larger ones." Joint Statement No. 2-R at 34. While I&E attempts to invalidate Dr. Zepp's observations by critiquing his methods, the indisputable fact remains that

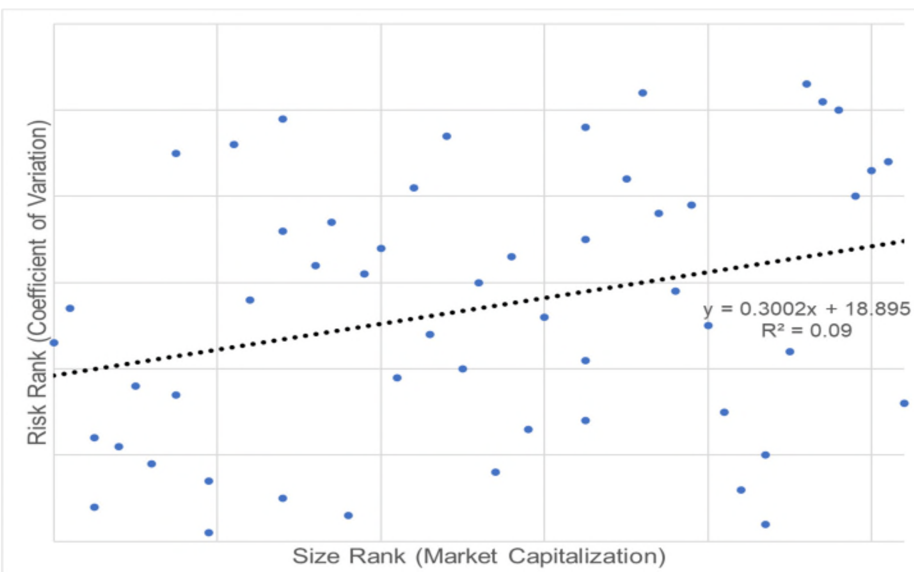
Dr. Zepp presented an authoritative analysis disputing Dr. Wong's findings, and was not rebutted in the financial literature by Dr. Wong or her advocates. Particularly in light of Mr. D'Ascendis' pointed critique of Dr. Wong's study and the abundance of financial literature supporting the size effect, Dr. Wong's findings that the size effect impacts every industry except utilities should be met with skepticism.

To definitively test Dr. Wong's finding, Mr. D'Ascendis conducted a study to whether size effect is applicable to utilities. Mr. D'Ascendis' methodology and the results are presented below:

> My study included the universe of electric, gas, and water companies included in *Value Line Standard Edition.* From each of the utilities' *Value Line Ratings & Reports*, I calculated the 10-year coefficient of variation ("CoV") of net profit (a measure of risk) and current market capitalization (a measure of size) for each company. After ranking the companies by size (largest to smallest) and risk (least risky to most risky), I made a scatter plot of the data, as shown on Chart 3, below:

Main Brief Table 8

<u>Relationship between Size and Risk for the *Value Line* Universe of Utility Companies</u>



Joint Statement No. 2-R at 35. In assessing the results, Mr. D'Ascendis concluded that the study shows an R-Squared of 0.09, meaning that approximately 9% of the change in risk is explained by size. Mr. D'Ascendis further clarified that a 0.09 R-Squared would not generally be considered to have strong explanatory power, but in this case, it exceeds the average R-Squared of each of the I&E and OCA proxy group companies' beta coefficients, which is a common measure of market risk. *See* Joint Statement No. 2-R at 36.

OCA's opposition to the size adjustment also lacks merit. OCA contests Mr. D'Ascendis' calculation of the applicable size premium, arguing that Mr. D'Ascendis should asses the Duff & Phelps size premium decile based on the proxy group's Ordinary Least Squares ("OLS") beta rather than company market capitalization. OCA Statement No. 2 at 29. Importantly, OCA offers no explanation to support its contention that OLS beta is more relevant that market capitalization to assess size risk. Further, even accepting OCA's premise, the size premium calculated by Mr. D'Ascendis represents the *spread* between the Company decile size premium and average proxy group decile size premium. *See* Joint Statement No. 2 at 45. As demonstrated by the Duff & Phelps size premiums chart provided in OCA's testimony, the spread between decile 10 and decile 1 remains consistent with Mr. D'Ascendis' proposed size adjustment of 100 basis points. *See* OCA Statement No. 3 at 29.

Finally, OCA also generally contends that public utility customers should not be required to pay higher costs via a size adjustment for "inefficient utility operations." *See* OCA Statement No. 3 at 30. This argument runs contrary to the *Bluefield* standard and should be given no weight. OCA's characterization of the Company's operations as "inefficient" makes no effort to quantify the customer benefits of being served by a smaller public utility such as Citizens' and should be disregarded.

For the reasons stated above, the I&E and OCA arguments in opposition to the Company's proposed size adjustment should be denied.

H. CONCLUSION AS TO RATE OF RETURN

As detailed above, the Company is entitled to the opportunity to earn a fair and reasonable return consistent with *Bluefield*. Investors expect to earn increased returns on common equity sufficient to justify the risks of equity investment in smaller companies. The Commission must consider the market signals that would result from a decision approving the unprecedented cost of common equity proposals advanced by I&E and OCA and instead support the goals of accelerating replacement of aging infrastructure and continued provision of safe and adequate public utility service. To that end, the Commission should adopt the Company's proposed cost of common equity of 10.30%, which results in an overall rate of return of 7.62% after adjusting for the Company's unopposed capital structure and debt cost rate. *See* Joint Statement No. 2-R, Exhibit __(DWD-1R), Schedule DWD-1R at 1.

VIII. TAXES

A. TAX CUTS & JOBS ACT

On December 31, 2017, Federal Income Tax rates for corporations dropped from 34% to 21% due to the passage of the TCJA. The PUC opened an investigation to determine the actions, if any, that it would take to address the TCJA. *Tax Cuts and Jobs Act of 2017, Secretarial Letter*, Docket No. M-2018-2641242 (February 12, 2018). Ultimately, after communication with Commission staff and approval by the Commission, Citizens' implemented a voluntary surcharge ("TCJA Voluntary Surcharge") that served as a surcredit to flow back benefits to customers. Joint Statement No. 3 – Direct Testimony of Melissa Sullivan ("Joint Statement No. 3") at 13. Citizens' chose to decrease its distribution rates to reflect the surcredit rather than implementing a surcharge line item on its bills. On November 8, 2018, the Commission approved a petition by Citizens' and Wellsboro to maintain the regular reconciliation process for the TCJA Voluntary Surcharge until the Companies submit rate cases. Joint Statement No. 3 at 13. Subsequently, Citizens' submitted a reconciliation statement in May 2019, but proposed to keep the distribution rates at the current levels pending resolution of this rate case.

Upon filing rate cases, Citizens' proposed to maintain the current distribution rates reflecting the TCJA Voluntary Surcharges during the pendency of this base rate case, after which a final reconciliation for the TCJA Voluntary Surcharge will be calculated. Citizens' requested to provide a final reconciliation of the TCJA Voluntary Surcharges within 120 days after new rates take effect. Joint Statement No. 3 at 13.

In Direct Testimony, OCA witness Morgan responded to the Company's proposal. Mr. Morgan argued that providing a final reconciliation of the TCJA Surcharges within 120 days after new rates take effect could subject customers to multiple rate changes and recommended that Citizens' provide the final reconciliation of the TCJA Surcharges at a sooner point before final rates go into effect. OCA Statement No. 2 at 10.

On Rebuttal Testimony, C&T Chief Financial Officer Melissa Sullivan responded to Mr. Morgan's recommendation as follows:

> Citizens' and Wellsboro will not have the 2019 tax data to perform the reconciliation until March or April of 2020. Citizens' and Wellsboro will attempt to accelerate the filing of the final reconciliation of the TCJA Voluntary Surcharges; however, if they do not have accurate 2019 tax data, this may not be possible.

Joint Statement No. 3-R – Rebuttal Testimony of Melissa Sullivan ("Joint Statement No. 3-R") at 2. Based on the availability of final 2019 tax data, Citizens' maintains its position and requests Commission approval to provide a final reconciliation of the TCJA Voluntary Surcharge within 120 days after new rates take effect.

B. EXCESS ACCUMULATED DEFERRED INCOME TAXES

As explained in Section IV.E., *supra*, EDIT directly addresses the benefit the Company received by taking extra depreciation expense for tax purposes while the Federal tax rate was 34%

and now reflecting straight line depreciation assumptions in its revenue requirement in prior cases. Citizens' Statement No. 1 at 14. As explained above, the Company is flowing back to customers the benefit of the tax reduction by amortizing the EDIT balance over the estimated remaining book life of the assets – ten years. *Id.* The EDIT balance included in rate base declines each year during this ten-year period. The annual EDIT accretion (Schedule C1-6, line 40) is carried forward to reduce Income tax expense (Schedule C1-4, line 28). *Id.*

In Direct Testimony, OCA witness Morgan did not oppose the flowback of the EDIT generally but disagreed with the Company that 2018 was the appropriate commencement date of the flowback, arguing that rates were not changed in 2018 to reflect the flowback of the EDIT. OCA Statement No. 2 at 9.

In Rebuttal Testimony, Mr. Gorman refuted Mr. Morgan's argument, as follows:

> **Q. Do you agree with the commencing EDIT accretion when new rates are effective?**
>
> A. No. Mr. Morgan's asserts "rates were not changed to reflect the flowback of the EDIT." This is not correct, rates were changed in 2018 to reflect the Tax Cut and Jobs Act, which gave rise to the EDIT. This proposed adjustment should be rejected by the Commission.

Citizens' Statement No. 1-R at 13.

For the foregoing reason, the Commission should deny OCA's proposed adjustment and accept the Company's EDIT claim for 2018.

IX. RATE STRUCTURE

A. ALLOCATED CLASS COST OF SERVICE STUDY

1. Citizens' Cost of Service Study Is Reasonable and Should Be Adopted.

The purpose of an ACOS is to assign the total distribution revenue requirement of a utility to the rate classes in its Tariff, on a cost-causation basis. Citizens' Statement No. 1 at 14. As stated by Company witness Gorman:

> In performing the ACOS, all of the utility's costs of providing service are analyzed, in order to assign or allocate the costs among the rate classes, so that the utility can establish rates that ensure, subject to assumptions such as delivery volumes and customer counts, that it recovers its costs in full from each class.

Id. at 15-16. In developing the ACOS, Mr. Gorman followed the traditional three-step process: (1) functionalization of rate base and costs; (2) classification of functionalized costs as demand-related, commodity-related, or customer-related; and (3) class allocation of the functionalized, classified costs among the rate classes. *Id.* at 17.

Citizens' ACOS includes the following functions: (1) primary distribution (including substations as well as conductors operating primarily at voltages of > 600V and related assets); (2) secondary distribution (facilities designed to move power from primary distribution system to customers' premises; includes services); and (3) billing (includes meters as well as assets and activities related to enabling the distribution of electricity to customers and billing and collecting revenue). *Id.* at 17-18.

Mr. Gorman classified assets and costs into three categories: (1) customer-related costs; (2) commodity-related costs; and (3) demand (or capacity) related costs. *Id.* at 18. Mr. Gorman then assigned or allocated assets and costs, as set forth on Exhibit__(HSG-1), Schedules D through D6 attached to his Direct Testimony. *Id.*

Citizens' ACOS was relied upon by I&E witness Cline in evaluating the Company's proposed revenue allocation. OCA witness Mierzwa did not oppose the ACOS generally but expressed concerns about the classification of Secondary portions of distribution plant (accounts 364, 365, 366) and Transformers (account 368).[19] Citizens' Statement No. 1-R at 14.

[19] Mr. Mierzwa also opposes the reflection in the cost study of the completion of a large solar installation at Bucknell, which is addressed herein, *supra*, at Section V.

2. **Citizens' classification of secondary distribution plant as part demand related and part customer-related is appropriate and should be approved.**

As stated above, I&E did not oppose any element of Citizens' ACOS. OCA witness Mierzwa found Citizens' primary plant classification as demand-related generally acceptable. He also accepted Citizens' classification of 100% of services and meters as customer-related, viewing there to be a "clear one-to-one relationship between the number of services and meters and the number of customers." OCA Statement No. 4 at 8.

However, Mr. Mierzwa disagreed with the classification of a "significant portion of secondary distribution plant upstream of meters and services" as customer-related. OCA Statement No. 4 at 8. Despite OCA's opposition, the Company's approach to classification of secondary distribution plant is well-grounded in Commission precedent. As stated by Mr. Gorman in his Rebuttal Testimony:

> It has been well-established that the costs of Secondary distribution plant are partly driven by the number of customers; the same is also true for Transformers, which are even closer to the customer than Secondary plant.

Citizens' Statement No. 1-R at 14. Fundamental utility accounting practices recognize that upstream distribution plant *(e.g.,* transformers, conductors, poles, and towers) all contain customer costs**.** The minimum system method is an appropriate means of making this classification and the Commission, in the UGI Order, recently found that the minimum system method is "consistent with the NARUC Manual and more accurately reflects cost-causation principles than the ACOSS methodology proposed by the OCA." UGI Order at 160. Moreover, using a demand allocation factor alone assumes that transformer and conductor capacity is the same for all classes; it is not. In summary, absent the use of the minimum system, the distribution costs are incorrectly allocated to each class.

Importantly, OCA's recommended approach was rejected by the Commission in both PPL's 2012 rate case and more recently in UGI Electric's 2018 rate case. *See, e.g., PPL 2012 Order,* p. 113 (noting that OCA's arguments were the same as those rejected in prior PPL proceedings); *see also* UGI Order at 157. In the UGI Order, the Commission stated:

> Additionally, the OCA argues that the "minimum system" method misallocates primary distribution conductors such that UGI extends its primary distribution system by the same number of feet to connect a large customer as it does a small customer. The OCA contends that this failure to account for the significant differences in the upstream distribution facilities associated with serving larger customers results in unfair treatment of the residential class and is inconsistent with the theory of cost causation. . . .
>
> We have reviewed the OCA's position and Exceptions on this issue and are not persuaded by the arguments it presented in support of its recommended alternative ACOSS methodology. As UGI and the OSBA pointed out, the OCA has presented its alternative ACOSS methodology in prior Commission proceedings and we have rejected it, including in our 2012 PPL Order.

UGI Order at 159-160. Citizens' classification of upstream distribution plant as both customer- and demand-related, and using a minimum system study is reasonable, consistent with Commission precedent, and should be accepted.

B. REVENUE ALLOCATION

1. Company Position

Upon development of the ACOS, the rate of return for each class is compared to a system average rate of return to determine if each rate class is currently either under-paying or over-paying its allocated cost of service. This information is used to determine how the proposed rate increase should be allocated among the rate classes. In developing the Company's proposed revenue allocation, the Company had the following objectives:

1. To move each class closer to its cost of service, as computed in the ACOS; and
2. To mitigate extreme rate impacts on rate classes and on customer subgroups.

Citizens' Statement No. 1 at 29-30. Consistent with these goals, Mr. Gorman evaluated the revenue requirement for each class. Citizens' Statement No. 1 at 30; *see also* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule E-1. The Company's proposed revenue allocation is set forth in Schedule B6-4. *Id.* at Schedule B6-4.

2. **Other Parties' Positions**

I&E, OCA, and OSBA each proposed modifications to the Company's proposed revenue allocation, as follows:

- **I&E.** I&E witness Cline proposed that no class should receive a decrease. Mr. Cline proposed to re-allocate the Company's proposed decrease for GLP-3 to OL and to GLP-1. I&E Statement No. 3 at 30.
- **OCA.** OCA witness Mierzwa proposed that no class should receive a decrease. Mr. Mierzwa proposed to re-allocate the Company's proposed decrease to GLP-3 among other classes. OCA Statement No. 4 at 21.
- **OSBA.** OSBA witness Kalcic proposed that no class should receive a decrease. Mr. Kalcic proposed to re-allocate the decrease to GLP-3 that the Company proposed among other classes. In deriving OSBA's proposed revenue allocation, Mr. Kalcic used an alternative measure of movement toward cost of service based on the dollar subsidy that classes pay or receive. OSBA Statement No. 1 – Direct Testimony of Brian Kalcic ("OSBA Statement No. 1") at 5. Mr. Kalcic claimed this was a more appropriate measurement than the relative rate of return guideline used by the Company. OSBA Statement No. 1 at 6.

3. **Citizens' Revenue Allocation Is Reasonable and Consistent with Controlling Precedent.**

The Company maintains that a rate decrease for rate class GLP-3 is reasonable and appropriate to bring all classes closer to cost of service. It has long been established in

Pennsylvania that cost-causation is the "polestar" of utility ratemaking. *Lloyd v. Pa. PUC,* 904 A.2d 1010, 1015 (Pa. Cmwlth. 2006).

In UGI Order, OCA opposed a decrease to non-residential class GS-4, arguing that there should be no decrease for any class while rates are increasing. UGI Order at 163. However, the ALJs "determined that UGI's proposed revenue requirement allocation among the various rate classes achieves significant progress in moving rate classes toward the system average of relative rate of return." The Commission adopted the ALJs' recommendation and approved UGI's revenue allocation, including the decrease for GS-4.

Similarly, the Commission should approve Citizens' proposal in this instance. As stated by Mr. Gorman, "the Company supports moving its classes closer to cost of service, including through rate reductions where appropriate." Citizens' Statement No. 1-R at 8. In his Surrebuttal Testimony, Mr. Gorman explained the Company's continued position that the ACOS should control revenue allocation, including if a decrease is warranted for a class:

> The Company continues to reject the position that no class should receive a decrease and continues to support decreases for classes consistent with the ACOS results…the Company's position on revenue allocation applies with equal force, in the event of a scaleback…if the ACOS indicates a class is significantly over-earning at present rates, that class should receive a decrease in revenue.

Citizens' Statement No. 1-SR – Surrebuttal Testimony of Howard S. Gorman ("Citizens' Statement No. 1-SR") at 2.

The Company also disagrees with OSBA's measurement of movement toward cost of service only in absolute dollar amounts. Mr. Gorman stated:

> This is not necessarily an appropriate measure because it does not account for the size of the overall increase – a larger overall increase can cause a class to pay or receive a larger subsidy in dollar terms, even as its rate of return moves closer to the average. In my experience, while Mr. Kalcic's measure can be useful, it is more appropriate to look at relative rates of return to evaluate whether a proposed revenue allocation moves classes closer to cost of service.

Citizens' Statement No. 1-R at 15-16.

This conclusion is consistent with the measurement used in UGI Order, where UGI's revenue allocation was affirmed for "moving rate classes toward the system average rate of return." Additionally, Mr. Gorman noted that besides a "small difference in the MBL class," the Company's revenue allocation proposal met Mr. Kalcic's test. *Id.* at 16.

C. RATE DESIGN

1. Summary of Proposed Rate Design

Citizens' proposed rates for each rate class are set forth in Schedules B6-3 and B7 (in table format). Citizens' Statement No. 1, Exhibit__(HSG-1), Schedules B6-3 and B7. In most respects, Citizens' rate design is consistent with prior rate designs approved by the Commission. However, to ensure the Company reasonably recovers its fixed costs, Citizens' proposes to begin including a small portion of demand costs (equal to the minimum demand for residential customers pursuant to the ACOS) through its residential monthly customer charges. Specifically, the Company proposes to include $2.06 of demand costs in a $15.00 customer charge for Residential Customers and $6.04 of demand costs in a $24.00 customer charge for Residential Heating Customers.

This proposed rate design reflects several developments since Citizens' last rate case in 2016. First, Citizens' has been functioning for some time with its entire system operating with advanced metering infrastructure. Now that the Company has the metering technology to measure demand across its entire customer base, the Company is positioned to begin moving toward rates that reflect real demand-related costs, either as a demand element of its rate design or, as proposed here, in the fixed monthly charge *based on demand levels that the vast majority of the accounts experience each month*. Second, in 2018, the General Assembly passed Act 58, providing clear legislative authority to approve alternative ratemaking methodologies. 66 Pa. C.S. § 1330. Third, in 2019, the Commission established a Final Policy Statement on alternative ratemaking, where it identified a set of factors the Commission will consider in determining just and reasonable distribution rates that promote meet certain policy objectives, including to "ensure adequate revenue to maintain the safe and reliable operation of fixed utility distribution systems." *See Fixed Utility Distribution Rates Policy Statement, Final Policy Statement Order*, Docket No. M-2015-2518883 (Order entered July 18, 2019).

In light of these factors, Citizens' proposes to include the minimum per-customer demand-related costs in the fixed monthly charges for its Residential customers – Classes RS (Residential) and SH (Space Heating). In conjunction, the Company intends to explore programs that will link rates to how well customers manage their peak demand and their usage, while protecting low-income and low-usage customers.

2. The Company's Proposed Customer Charges Are Reasonable and Should Be Approved.

As set forth below, multiple factors support Citizens' rate design proposal. First, the Company's proposal moves towards cost of service-based rates and facilitates reasonable recovery of fixed minimum demand costs while honoring gradualism and protecting customers. Second, the Company's proposal aligns with the Commission's enumerated policy factors established in its Final Policy Statement. 52 Pa. Code § 69.3302.

For Residential Customers, Citizens' proposes to increase the monthly charge from $11.24 to $15.00, with the balance of the revenue target to be recovered from the volumetric kWh charge. The proposed monthly charge includes two components:

- **Customer-related costs**. These are costs, based on the ACOS, that have historically been included in the fixed monthly charge. This totals to $12.94 of the $15.00 customer charge and is set forth in Schedule E1-C, line 21.

- **Demand-related costs.** The demand-related costs total to $2.06 of the $15.00 and represent a portion of Residential demand costs. Specifically, $2.06 represents the cost of 0.38 kW-month per user, based on the $5.40 per kW-month demand costs for the Residential Class set forth in the ACOS (Schedule E1-B).

Citizens' Statement. No. 1 at 32.

As explained on pages 37-38 of Mr. Gorman's Direct Testimony, Mr. Gorman determined the portion of demand-related costs to include in the fixed monthly charge by considering the percentage of customers that reached specific demand levels. Citizens' Statement No. 1 at 37-38. In conducting this analysis, Mr. Gorman found that 96.8% of Residential monthly customer bills reflected demand of 0.38 kW or higher in 2018. *Id.* Additionally, more than 99% of Residential customers experienced demand of 0.38 kW or more at least once in 2018. *Id.* Thus, the Company's proposal to allocate the cost for 0.38 kW-demand ($2.06 per month) to the Residential customer charge shifts only the minimum demand costs to the fixed charge. *See id.*

For Space Heating Customers, the structure is similar. The Company proposes to increase the monthly fixed charge from $18.57 to $24.00, structured as follows:

- **Customer-related costs:** $17.96, representing the costs that have historically been included in the fixed monthly charge.
- **Demand-related costs:** $6.04, representing the cost of 0.95 kW-month, based on the $6.37 per kW-month cost from the ACOS.

Citizens' Statement. No. 1 at 38.

On a bill basis, 81% of Space Heating customers experienced 1.0 kW of demand every month. *Id.* However, over 95% of Space Heating customers reached demand of 1.0 kW at least once in 2018. *Id.* Therefore, the Company's proposal to allocate the cost for 1.0 kW-demand

($6.04 per month) to the Space Heating customer charge shifts only the minimum demand costs to the fixed charge. *See id.* at 37-38.

a. <u>The Company's proposal moves towards cost of service-based rates while honoring gradualism, rate simplicity and customer protection.</u>

Mr. Gorman explained two competing policy objectives that the Company's proposal balances effectively. According to *Lloyd*, rate design should reflect cost of service; however, other factors such as gradualism and simplicity can be factors. Moving the residential rate design towards cost of service would require addition of a demand billing element. Citizens' believes that incorporating minimum demand costs into the monthly customer charge will be easier for residential customers to understand. Citizens' Statement No. 1 at 37. To recognize cost of service in the proposal, Citizens' chose a demand level annually met by 99% of the residential accounts in the service territory. *Id.* at 37-38. This also reflects a gradual approach to making this transition.

The Company's proposal balances many ratemaking goals – cost of service, simplicity, and gradualism. It will also enhance revenue stability for Citizens'. The monthly customer charges are just, reasonable, and appropriate. By including only the portion of demand charges constituting the minimum demand for customers, the Company reasonably aligns customer rates with costs.

b. <u>The Company's proposal aligns with the Commission's enumerated policy factors.</u>

The Commission's Final Policy Statement Order establishes 14 specific factors the Commission may consider in reviewing proposed alternative ratemaking mechanisms. These factors are set forth in the chart below with Mr. Gorman's analysis of how the Company's proposed rate design addresses each of these 14 issues.

Main Brief Table 9

#	Issue Concerning Proposed Ratemaking Mechanism & Rate Design	Analysis
1	Alignment of revenues with cost causation principles as to both fixed and variable costs.	**More closely aligns rates with costs**, which largely reflect peak demand.
2	Impact on fixed utility's capacity utilization.	**Does not materially impact this factor (presently)**. However, it may serve as a step toward future designs promoting efficient resource utilization by customers.
3	Level of demand associated with the customer's anticipated consumption levels.	**Does not materially impact this factor (presently)**. However, it may serve as a step toward future rate designs reflecting customers' actual demand levels even more closely.
4	Limits on or elimination of interclass and intraclass cost shifting.	Begins to reduce intraclass cost-shifting by **aligning rates with costs more closely**.
5	Limits on or elimination of disincentives for the promotion of efficiency programs.	The Company's proposal promotes revenue stability for the Company and provides some insulation for reduction in usage, which **reduces Company disincentives to promote efficiency efforts**.
6	Impact on customer incentives to employ efficiency measures and distributed energy resources.	The Company's proposal is the **first step in educating customers about the factors that drive costs**, and then developing rate structures that reflect those costs (i.e., demand-based rates).
7	Impact on low-income customers and support customer assistance programs.	**Does not materially impact this factor.**
8	Impact on customer rate stability principles.	The utility's costs throughout the year are largely fixed, and the Company's proposal would **promote customer rate stability throughout the year**.
9	Impact on utility revenue	**Does not materially impact this factor**.
10	Impact on the frequency of rate case filing and regulatory lag.	The Company's proposal promotes revenue stability and thus **may reduce the frequency of rate cases**.
11	Interaction with other revenue sources, such as Section 1307 automatic adjustment surcharges.	**Does not materially impact this factor**.

12	Inclusion of appropriate consumer protections.	The Company's proposal is based on cost causation principles, which **protects customers from unreasonable rates**.
13	Understandability to consumers.	The Company's proposal does **not introduce a new surcharge or other rate mechanism** but serves as a first step to developing rates that fully reflect demand-based costs, which will likely **require customer education**.
14	Support of improvements in utility reliability.	By aligning rates with costs, the Company's proposal **supports the Company's ongoing efforts to invest in reliability projects**.

See Citizens' Statement No. 1 at 34-37. As seen in the above analysis, and further detailed in Mr. Gorman's Direct Testimony, the Company's proposal to include a small part of demand costs in the fixed monthly fee is reasonable, aligns closely with cost-causation principles, and supports Commission policies provided in the Final Policy Statement Order.

3. I&E and OCA Arguments Against Inclusion of a Demand-Related Component in the Company's Proposed Residential Customer Charge Are Flawed and Contrary to Act 58.

I&E and OCA both opposed the Company's proposal to include a portion of demand costs in the monthly fixed charge. Both I&E witness Cline and OCA witness Mierzwa proposed that the Residential Class monthly fixed charge be set at the level of customer-related costs determined in the ACOS.

I&E opposed this proposal based on claims that a utility's investment in demand infrastructure are not fixed costs because there remains some possibility that future capital investment could be avoided if customers reduce consumption and peak demands. I&E Statement No. 3 at 34-35. As a corollary argument, I&E claims that higher fixed charges do not signal to customers to either to avoid usage at the peak or to conserve energy at all times. *Id.* at 35. Based on these arguments, I&E recommends that monthly fixed charge generally be set at the level of customer-related costs determined in the ACOS, consistent with the Commission's present policy on fixed monthly charges.

OCA presented similar arguments to I&E's, alleging that the costs of the Company's distribution system varies with demand, that volumetric energy charges offer meaningful price signals to customers, and that volumetric charges are more consistent with energy conservation policies. *See* OCA Statement No. 4 at 26. Interestingly, OCA also observes that volumetric charges will "help minimize electric distribution system costs over the long term." *See id.*

OCA and I&E ignore the fact that the Company's proposal to allocate a small portion of demand costs to the customer charge preserves the price signals associated with volumetric rates while appropriately allowing the Company to assess fixed charges for what amounts to the *minimum demand usage* for the impacted customers. The OCA and I&E arguments might have some merit if the Company was proposing to shift a majority of demand costs to the customer charge. However, the Company's proposes to shift only the minimum demand costs to the customer charge to reflect the reality that this portion of demand cost is fixed. As stated by Mr. Gorman, this proposed change more closely aligns Company revenue and customer rates:

> [C]osts are incurred based on peak demand not on usage. In my view, it is appropriate to include some portion of demand-related costs in the monthly charge, in order to align the utility's revenue and costs more closely, and to help stabilize the utility's revenue and customers' costs.

Citizens' Statement No. 1 at 33. As Mr. Gorman explained, "including $2.06 in the fixed monthly charge [for Residential Customers], equal to the monthly cost of 0.38 kW of demand, is a reasonable balance between aligning more closely with costs on the one hand, and the principle of gradualism on the other hand." Citizens' Statement No. 1 at 38. The same rationale applies to the proposal to allocating $6.04 of demand costs to the fixed monthly charge for Space Heating customers. *Id.* Both of these proposed changes further the goals of Act 58 by aligning the fixed nature of minimum demand costs with fixed rates. *See* 52 Pa. Code § 63.3302(1). This is consistent with cost-causation principles, retains price signals, and respects the principle of gradualism.

For the foregoing reasons, the adjustments of I&E and OCA should be denied, and the Company's proposal should be approved by the Commission.

D. SCALE BACK

1. Citizens' Scale Back Proposal

If the Commission approves a revenue requirement for Citizens' that is less than Citizens' full requested increase, Citizens' recommends that rates for each class be scaled back rates based on the cost of service study approved by the Commission in a proportional manner. Citizens' Statement No. 1-SR at 2. In Surrebuttal Testimony, Mr. Gorman stated, "[T]he Company's position on revenue allocation applies with equal force, in the event of a scaleback." *Id.* This includes a proportional scale back of both increases and decreases. Citizens' Statement No. 1-SR at 2.

2. Scale Back Modifications Proposed by I&E, OCA, and OSBA

I&E, OCA, and OSBA each proposed modifications to the Company's scale back proposal, as follows:

- **I&E.** I&E requests a proportionate scale back based on the Commission's final approved cost of service study, with the exception that only those customer charges, usage rates, and rate classes that received a proposed increase should be scaled back. I&E Statement No. 3 at 42.
- **OCA.** OCA proposed a proportionate scale back limited to the increase for each rate class. OCA Statement No. 4 at 21.

- **OSBA.** OSBA witness Kalcic recommended that scale backs be done proportionately to Mr. Kalcic's recommended increases in Schedule BK-3(C), with the exception of Rate Class MBL, which he recommended be excluded from any scaleback. OSBA Statement No. 1 at 9.

3. The Company's Scale Back Proposal Is Consistent with Cost of Service Principles and Should Be Approved.

The Company's recommendation of a proportionate scale back of rates is consistent with the cost-causation principles articulated herein and in Mr. Gorman's Direct Testimony. As explained above, the purpose of an ACOS is to assign the total distribution revenue requirement of a utility to the rate classes in its Tariff, on a cost-causation basis. Citizens' has proposed to move each class closer to its actual cost to serve. To preserve this movement, the Company believes a proportionate scaleback, including to rate decreases, is appropriate. As stated by Mr. Gorman, "The Company does not accept the proposal that no class should receive a decrease, because the ACOS indicated the GLP-3 class is significantly over-earning at present rates." Citizens' Statement No. 1-SR at 2. The Company requests that any scale back of rates should be proportionate based on the allocated cost of service study methodology accepted by the Commission, updated to reflect the revenue requirement authorized by the Commission.

X. MISCELLANEOUS ISSUES

A. REPORTING REQUIREMENTS

In Direct Testimony, I&E witness Cline accepts the Company's plant in service projections for the FTY and FPFTY, but adds a request for the Company to submit updates to Schedule C3 by April 1, 2020 (for the year ended December 31, 2019) and by April 1, 2021 (for the year ended December 31, 2020). Citizens' Statement No. 4-R at 7; *see also* I&E Statement No. 3 at 12.

The Company respectfully opposes the imposition of additional requirements not required by statute or regulation. The Company submits numerous filings to the Commission each year, including the Annual Reports required by the Commission's Regulations. *See* 52 Pa. Code § 57.47. These Annual Reports include detailed plant, expense, and sales data that the Commission and I&E can review. In addition, Commission regulations require quarterly updates while the filing is pending. 52 Pa. Code § 53.56. Thus, year-end balances will be provided through other means. The Company urges the Commission to mitigate the regulatory burden on small utilities by denying I&E's request.

The Commission has not adopted rules or regulations comprehensively addressing the requirements for public utilities utilizing the FPFTY. As stated by Mr. Kelchner, "[t]he Company should not be required to comply with additional filing requirements unless those requirements are part of the regulations applicable to all EDCs. I&E and other interested parties will have the opportunities to review this information when the Company files a subsequent base rate case." Citizens' Statement No. 4-R at 8. *See, e.g., Pa. PUC v. Pennsylvania-American Water Co*., Docket No. R-00932670 et al., 1994 Pa. PUC LEXIS 120 at *158 (Final Order entered July 26, 1994) (adopting the ALJ's conclusion that the issues raised by OCA were outside the scope of rate case and would be better addressed in a statewide rulemaking proceeding). Presumably, the ongoing FPFTY stakeholder process will result in a clear set of reporting standards to which the Company (and all EDCs) will be subject. Meanwhile, the Company already has continual reporting requirements in a highly regulated context. Until the Commission makes a broad determination on reporting requirements applicable to all EDCs, the Company should not be required to provide the reports recommended by Mr. Cline.

XI. CONCLUSION

WHEREFORE, Citizens' Electric Company of Lewisburg, PA, respectfully requests that the Pennsylvania Public Utility Commission approve the rate increase and other proposals set forth in Tariff-Electric Pa. PUC No. 14.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By ______________________________

Pamela C. Polacek (PA I.D. No. 78276)
Adeolu A. Bakare (PA I.D. No. 208541)
Matthew L. Garber (PA I.D. No. 322855)
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Phone: (717) 232-8000
Fax: (717) 260-1744
ppolacek@mcneeslaw.com
abakare@mcneeslaw.com
mgarber@mcneeslaw.com

Counsel to Citizens' Electric Company of Lewisburg, PA

Dated: January 8, 2020

Appendix A
Rate Case Tables

TABLE I
Citizens' Electric Company of Lewisburg
INCOME SUMMARY
R-2019-3008212

	Pro Forma Present Rates (1)	Company Adjustments (1)	Pro Forma Present Rates (Revised) (1)	ALJ Adjustments	ALJ Pro Forma Present Rates	ALJ Revenue Increase	Total Allowable Revenues
	$	$	$	$	$	$	$
Operating Revenue	4,860,408	0	4,860,408	0	4,860,408	700,746	5,561,154
Expenses:							
O & M Expense	2,803,733	0	2,803,733	0	2,803,733	0	2,803,733
Depreciation	1,029,328	0	1,029,328	0	1,029,328	0	1,029,328
Taxes, Other	356,823	0	356,823	0	356,823	0	356,823
Income Taxes:							
State	49,319	0	49,319	33	49,352	70,005	119,357
Federal	111,471	0	111,471	62	111,533	132,456	243,989
Total Expenses	4,350,673	0	4,350,673	95	4,350,768	202,461	4,553,229
Net Inc. Available for Return	509,734	0	509,734	(95)	509,639	468,887	978,527
Rate Base	12,847,545	0	12,847,545	0	12,847,545		12,847,545
Rate of Return	3.97%		3.97%				7.61644800%
Source:	C1 (R)						

(1) Company Main Brief

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TABLE I(A)
Citizens' Electric Company of Lewisburg
RATE OF RETURN
R-2019-3008212

	Structure	Cost	After-Tax Weighted Cost	Effective Tax Rate Complement	Pre-Tax Weighted Cost Rate
Total Cost of Debt			2.39743800%		
Long-term Debt	49.33%	4.86%	2.39743800%		2.40%
Short-term Debt	0.00%	0.00%	0.00000000%		
Preferred Stock	0.00%	0.00%	0.00000000%	0.711079	0.00%
Common Equity	50.67%	10.30%	5.21901000%	0.711079	7.34%
	100.00%		7.61644800%		9.74%
Pre-Tax Interest Coverage	4.06				
After-Tax Interest Coverage	3.18				
Source:	C1-2 (R)	C1-2 (R)			

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TABLE I(B)
Citizens' Electric Company of Lewisburg
REVENUE FACTOR
R-2019-3008212

100%	1.00000000
Less:	
Uncollectible Accounts Factor (*)	0.00000000
PUC, OCA, OSBA Assessment Factors (*)	0.00000000
Gross Receipts Tax	0.05900000
Other Tax Factors	0.00000000
	0.94100000
State Income Tax Rate (*)	0.09990000
Effective State Income Tax Rate	0.09400590
Factor After Local and State Taxes	0.84699410
Federal Income Tax Rate (*)	0.21000000
Effective Federal Income Tax Rate	0.17786876
Revenue Factor (100% - Effective Tax Rates)	0.66912534
	1.49448831
(*) Company Main Brief	
Source:	C1-3 (R)

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TABLE II
Citizens' Electric Company of Lewisburg
SUMMARY OF ADJUSTMENTS
R-2019-3008212

Adjustments		Rate Base	Revenues	Expenses	Depreciation	Taxes-Other	State Income Tax	Federal Income Tax
		$	$	$	$	$	$	$
RATE BASE:								
CWC:								
Int. & Div. (Table IV)	(IV!B38)							
Taxes (Table V)	(V!P34)							
O & M (Table VI)	(VI!B42)							
REVENUES:								
			0				0	0
EXPENSES:								
				0			0	0
				0			0	0
				0			0	0
				0			0	0
				0			0	0
				0			0	0
				0			0	0
				0			0	0
				0			0	0
				0			0	0
				0			0	0
				0			0	0
TAXES:								
Interest Synchronization (Table III)							33	62
TOTALS		0	0	0	0	0	33	62

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TABLE III
Citizens' Electric Company of Lewisburg
INTEREST SYNCHRONIZATION
R-2019-3008212

	Amount $
Company Rate Base Claim	12,847,545
ALJ Rate Base Adjustments	0
ALJ Rate Base	12,847,545
Weighted Cost of Debt	2.39743800%
ALJ Interest Expense	308,012
Company Claim (1)	308,341
Total ALJ Adjustment	329
Company Adjustment	0
Net ALJ Interest Adjustment	329
State Income Tax Rate	9.99%
State Income Tax Adjustment	33
Net ALJ Interest Adjustment	329
State Income Tax Adjustment	33
Net ALJ Adjustment for F.I.T.	296
Federal Income Tax Rate	21.00%
Federal Income Tax Adjustment	62

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Source: C1-4 (R)

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TABLE IV
Citizens' Electric Company of Lewisburg
CASH WORKING CAPITAL - Interest and Dividends
R-2019-3008212

Accrued Interest	Long-Term Debt	Short-Term Debt	Preferred Stock Dividends	
Company Rate Base Claim	$12,847,545	$12,847,545	Company Rate Base Claim	$12,847,545
ALJ Rate Base Adjustments	$0	$0	ALJ Rate Base Adjustments	$0
ALJ Rate Base	$12,847,545	$12,847,545	ALJ Rate Base	$12,847,545
Weighted Cost of Debt	2.39743800%	0.00%	Weighted Cost Pref. Stock	0.00000000%
ALJ Annual Interest Exp.	$308,012	$0	ALJ Preferred Dividends	$0
Average Revenue Lag Days	0.0	0.0	Average Revenue Lag Days	0.0
Average Expense Lag Days	45.0	0.0	Average Expense Lag Days	0.0
Net Lag Days	-45.0	0.0	Net Lag Days	0.0
Working Capital Adjustment				
ALJ Daily Interest Exp.	$844	$0	ALJ Daily Dividends	$0
Net Lag Days	-45.0	0.0	Net Lag Days	0.0
ALJ Working Capital	($37,980)	$0		$0
Company Claim (1)	$0	$0	Company Claim (1)	$0
ALJ Adjustment	($37,980)	$0		$0
Total Interest & Dividend Adj.	($37,980)			

(1) Company Main Brief.

{*A7294292:1}

TABLE V
Citizens' Electric Company of Lewisburg
CASH WORKING CAPITAL -TAXES
R-2019-3008212

Description	Company Proforma Tax Expense Present Rates	ALJ Adjustments	ALJ Pro forma Tax Expense Present Rates	ALJ Allowance	ALJ Adjusted Taxes at Present Rates	Daily Expense	Net Lead/ Lag Days	Accrued Tax Adjustment
PUC Assessment	$44,186	$0	$44,186	$0	$44,186	$121.06	0.00	$0
Public Utility Realty	$23,066	$0	$23,066		$23,066	$63.19	0.00	$0
Capital Stock Tax	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
State Income Tax	$49,319	$33	$49,352	$70,005	$119,357	$327.01	0.00	$0
Federal Income Tax	$111,471	$62	$111,533	$132,456	$243,989	$668.46	0.00	$0
	$228,042	$95	$228,137	$202,461	$430,598			

Source: C1-3 (R)

ALJ Allowance	0
Company Claim (1)	0
ALJ Adjustment	0

(1) Company Main Brief

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TABLE VI
Citizens' Electric Company of Lewisburg
CASH WORKING CAPITAL -- O & M EXPENSE
R-2019-3008212

Description	Company Pro forma F.T.Y. Expense	ALJ	ALJ Pro forma Expenses	Lag Days	Lag Dollars
O&M	$2,803,733	$0	$2,803,733	45.00	$126,167,988
Less: Uncollectibles	($20,600)	$0	($20,600)	45.00	($927,000)
Group Insurance	$0	$0	$0	45.00	$0
Insurance, Other	$0	$0	$0	45.00	$0
Labor	$0	$0	$0	45.00	$0
Leased Equip./Rent	$0	$0	$0	45.00	$0
Leased Vehicles	$0	$0	$0	45.00	$0
Miscellaneous	$0	$0	$0	45.00	$0
Natural Gas	$0	$0	$0	45.00	$0
Power	$0	$0	$0	45.00	$0
Purchased Water	$0	$0	$0	45.00	$0
Telephone	$0	$0	$0	45.00	$0
Waste Disposal	$0	$0	$0	45.00	$0
Post Retirement Benefits	$0	$0	$0	45.00	$0
Pensions	$0	$0	$0	45.00	$0
	$2,783,133	$0	$2,783,133	45.00	$125,240,988

ALJ Average Revenue Lag	0.0	
Less: ALJ Avg. Expense Lag	45.0	
Net Difference	-45.0	Days
ALJ Pro forma O & M Expense per Day	$7,625	
ALJ CWC for O & M	($343,125)	
Less: Company Claim (1)	($342,721)	C1-6 (R)
ALJ Adjustment	($404)	

(1) Company Main Brief

{*A7294292:1}

APPENDIX B

PROPOSED FINDINGS OF FACT

RESOLVED ISSUES

1. The Company initially proposed to add a Construction Work in Progress ("CWIP") amount of $70,492 to its FPFTY rate base total. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C2.

2. Because Citizens' CWIP projections were based on historic figures rather than specific identified projects projected to be under construction at the conclusion of the FPFTY, Citizens' accepted the removal of CWIP from rate base. Citizens' Statement No. 1-R at 13.

3. Citizens' acceptance of the removal of CWIP from rate base is conditioned on the premise that plant projected to be in service by the end of the FPFTY is included in rate base, consistent with Commission precedent; If "average" rate base figures for the FPFTY are used, as argued by OCA, the Company believes retaining its CWIP claim is appropriate. Citizens' Statement No. 1-R at 13.

4. Citizens' makes a variety of charitable contributions to different community organizations each year in support of the local community. *See* I&E Statement No. 1, I&E Exhibit No. 1, Schedule 8.

5. Citizens' charges these charitable expenditures to Account 426.1. Citizens' Statement No. 1-R at 5.

6. Citizens' clarified in Rebuttal Testimony that Account 426.1 was not included in Citizens' revenue requirement. Citizens' Statement No. 1-R at 5.

7. I&E withdrew its proposed adjustments connected to this account. I&E Statement No. 1-SR at 22.

8. The Company proposed to add $178,276 to rate base for materials and supplies. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-6.

9. I&E witness Cline and OCA witness Morgan proposed to use an average of the most recent 13 months of actual inventories, as shown on I&E Exhibit No. 3, Schedule 3 and OCA Schedule LKM-3. I&E Statement No. 3 at 8; OCA Statement No. 2 at 3.

10. The Company accepted the Advocates' 13-month methodology and reduced its claim by $4,209 to $174,067. Citizens' Statement No. 1-R at 6, 13.

11. The Company proposed to deduct $106,386 from rate base for customer deposits. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-6.

12. Instead of basing the customer deposits amount on the Company's end-of-year HTY balance, OCA proposed to use a 13-month average balance resulting in a $209

adjustment to the Company's claim for customer deposits. OCA Statement No. 2, Schedule LKM-4.

13. The Company accepted OCA's 13-month methodology and reduced its customer deposits adjustment by $209 to $106,177. Citizens' Statement No. 1-R at 13.

14. Citizens' revenue projections include sales reductions due to the anticipated completion of 600 kW of CHP generation at one customer location; a large solar photovoltaic ("Solar PV") generation at Bucknell University; and the loss of 32 meters at East Lewisburg due to the transfer of those customers to PPL. Citizens' Statement No. 4 at 7.

15. While increased sales are projected from an expansion underway at Evangelical Community Hospital, overall sales are projected to decline from 177,519,531 kWh in the 2016 rate case settlement to 167,748,001 in 2020. Citizens' Statement No. 4 at 7.

16. OCA argued that, due to outages or maintenance requirements, Citizens' would need to supply power to the CHP customer at times and recommended that Citizens' provide a revised reduction. OCA Statement No. 4 at 30.

17. Citizens' clarified that total energy production from the CHP unit is anticipated to exceed the customer's historic usage and because the account is entitled to Net Metering, even if the customer takes service from Citizens' for scheduled maintenance or other outages, that usage would be netted against the excess output from the CHP unit. Citizens' Statement No. 4-R at 11.

18. On cross-examination, Mr. Mierzwa accepted the Company's response and withdrew his proposed adjustment. Tr. 314.

RATE BASE

19. The Company's claim for original cost utility plant in service of $26,687,785 is based on projected plant in service at the end of the FPFTY. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedules C1-6, C2, C3, E-1A.

20. OCA witnesses oppose the Company's calculation of plant in service at the end of the FPFTY, instead proposing an average calculation of rate base throughout the FPFTY. OCA Statement No. 2 at 4.

21. OCA proposes to average the plant in service balance on December 31, 2019 ($25,502,273) with the plant in service balance at the end of the FPFTY on December 31, 2020 ($26,687,785). *See* OCA Statement No. 2, Schedule LKM-1.

22. The Company's claimed plant in service, based on plant projected to be in service at the end of the FPFTY, is consistent with both the Commission's holding in the UGI Order and long-standing Commission precedent, which has uniformly approved the calculation of plant in service at a point in time, i.e. the end of the relevant test year.

See, e.g., Pa. PUC, et al. v. PPL Electric Utilities Corporation, Docket Nos. R-2012-2290597, et al., at 12.

23. OCA's proposal would eliminate half of benefits of using the FPFTY by only allowing $592,756 in plant additions in 2020, where Citizens' has planned for $1,185,512 of plant additions for the FPFTY. *See* OCA Statement No. 2, Schedule LKM-1.

24. OCA proposed an adjustment to accumulated depreciation based on its arguments that original cost utility plant in service should be based on an average of the beginning-of-year and end-of-year FPFTY plant balances. OCA Statement No. 2 at 4.

25. OCA's FPFTY average balance calculation of $26,095,029 resulted in a $378,420 reduction in accumulated depreciation amount, for a total accumulated depreciation of $13,158,754. OCA Statement No. 2, Schedule LKM-1.

26. The Company agreed to a small Materials and Supplies adjustment proposed by OCA and I&E, reducing its claimed increase from $178,276 to $174,067. Citizens' Statement No. 1-R at 6.

27. The Company proposed a reduction to rate base for Accrued Pension / OPEB liability; this reduction reflects the excess of amounts charged to expense over amounts paid. Citizens' Statement No. 1 at 14.

28. Neither OCA nor I&E proposed any adjustments to the Company's Accrued Pension/OPEB claim. OCA Statement No. 1, Schedule SLS-3; I&E Statement No. 3 at 6.

29. Regarding Cash Working Capital ("CWC"), the Company claimed an increase of $342,049 to rate base. Citizens' Statement No. 1, Exhibit__(HSG-1) Schedule C1-6.

30. I&E and OCA do not oppose the 1/8 method for CWC proposed by the Company. Citizens' Statement No. 1-R at 4-5.

31. I&E and OCA each propose to reduce the CWC claim to reflect the respective party's proposed O&M expense adjustments. I&E Statement No. 1 at 23; OCA Statement No. 1 at 9.

32. While the Company opposes several O&M expense adjustments proposed by I&E and OCA, the Company agrees that CWC should be recalculated if the Commission orders any changes to the Company's claimed O&M expenses. *See* Citizens' Statement No. 1-R at 5, 12.

33. OCA proposed a $209 adjustment to Customer Deposits, which the Company accepted. *See* OCA Statement No. 2 at 6; *see also* Citizens' Statement No. 1-R, at 13.

34. ADIT addresses the difference between actual tax liability for accumulated depreciation paid by Citizens' and the amount of tax expense for accumulated depreciation paid by ratepayers in the revenue requirement. Citizens' Statement No. 1 at 13-14.

35. EDIT, on the other hand, directly addresses the benefit the Company received by taking depreciation expense for tax purposes while the Federal corporate tax rate was 34% and the revaluation of EDIT as of December 31, 2017, when the corporate tax rate changed from 34% to 21%. Citizens' Statement No. 1 at 13-14.

36. No party challenged the Company's calculation of ADIT; however, OCA proposed adjustments to the Company's calculation of EDIT.

37. The Company's final claimed rate base of $12,847,545 is reasonable and, therefore, should be approved.

REVENUE

38. Citizens' anticipated system usage is projected to decline from 178,005,729 kWh in 2018 to 167,748,001 kWh in 2020; under present rates, this will reduce distribution revenues from $5,003,249 in 2018 to $4,860,408 in 2020. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1.

39. Citizens' testimony explained a variety of factors that are causing the sales decline, including a pending interconnection application for a solar project at Bucknell University scheduled for completion by December 31, 2020. See Citizens' Statement No. 4 at 7.

40. Bucknell has not withdrawn the interconnection application submitted to Citizens'. Tr. 142-43.

41. There is no indication that the delayed vote from the Planning Commission will extend the in-service date for Bucknell's solar project beyond December 2020. Citizens' Statement No. 4-R at 9.

42. Bucknell voluntarily withdrew its project from the municipal planning process (not from Citizens' interconnection application process) to allow East Buffalo Township to pass a zoning ordinance addressing solar projects. Tr. 139.

43. The East Buffalo Township Planning Commission approved a zoning ordinance on December 11, 2019, and recommended that the Township Board of Supervisors approve the proposed ordinance. The Township Board of Supervises is expected to vote on the zoning ordinance January 2020. Tr. 141, 152.

44. The Company removed only forecasted revenue losses associated with the solar array's expected energy production… accordingly, the Company will continue to earn revenue from Bucknell, but this revenue is already reflected in the Company's proposed FPFTY revenues. Citizens' Statement No. 4-R at 10.

45. Under net metering regulations in the Company's Tariff and Commission regulations, Citizens' must virtually aggregate usage for all Bucknell meters located within two miles of the solar array. See Citizens' Tariff Rider B and 52 Pa. Code §§ 75.13-14.

46. The transfer of 32 East Lewisburg customers from Citizens' to PPL was approved on August 8, 2019. *See* Order, *Joint Application of PPL Electric Utilities Corporation and Citizens' Electric Company of Lewisburg, PA*, Docket No. A-2019-3008827 (Order entered Aug. 8, 2019).

47. In light of historic trends, available year-to-date data, and the Union County Planning Commission Annual Report, Citizens' estimations of customer counts are reasonable. Citizens' Statement No. 4-R at 12-13; Tr. 162.

48. Annualized FTY Uncollectible Accounts expense (Account No. 904) is projected to reach $33,492, compared to the $20,600 projection. See Citizens' Statement No. 1-R at 5.

EXPENSES

49. The Company developed its FPFTY claim by adding a 3% wage, salary, and benefit inflation adjustment and other known adjustments to the O&M accounts in its FTY budget. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1.

50. In estimating costs for the FPFTY, the Company's management has years of experienced evaluating year-to-year changes in labor, benefits, materials, and outside contractor costs. Tr. 135, 148-149.

51. Annualizing the Company's actual 9-month expenses and adding 3% for general inflations results in a projection for FPFTY O&M costs that is "*almost the same* as the costs that were claimed in the Company's FPFTY" in its filing. Citizens' Statement No. 1-R at 3.

52. As seen in Main Brief Table 2, total 2019 O&M costs are, when annualized, projected to be $2,678,748. Citizens' Statement No. 1-R at 4.

53. After adding the 3% inflation factor, and removing the expense for amortization of 2016 Rate Case Expense, this results in an annualized projection for the FPFTY of $2,695,345, $279 greater than the Company's FPFTY claim of $2,695,066. Citizens' Statement No. 1-R at 4.

54. The Company has effectively managed its resources and conservatively projected its expenses, consistent with its managerial discretion and the needs of a smaller public utility to nimbly reallocate resources as issues arise. Citizens' Statement No. 1-R at 4; Citizens' Statement No. 4-R at 3-4.

55. Actual historic O&M expenses show a greater than 3% increase *every year* from 2012 to 2018 (the last year full expense data is available). Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 at 2.

56. Mr. Kelchner also testified on rejoinder that the Company anticipated increases to health insurance costs, employee salaries, and vendor costs – specifically referencing a

notice from the Company's sole source of meter reading hardware and software support that prices would be increasing by 4-6%. Tr. 144-156.

57. The 3% inflation adjustment is supported both by the Company's historical experience, specific indicators of cost increases for the FPFTY, and the Company's development of its 2020 budget. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 at 2; Tr. 143-145.

58. Account No. 593 includes expenses for Citizens' right of way inspections, tree trimming and other vegetation management for customer service reliability; a primary reason that Citizens' costs in this account have increased relates to maintenance and repairs due to tree damage from the Emerald Ash Borer. Citizens' Statement No. 4 at 13.

59. There is a significant increase in the Company's vegetation management (tree-trimming costs between 2016-2018 (the years averaged) and the FPFTY claim due to additional resources that will be required to meet Citizens' regulatory obligations. Citizens' Statement No. 4-R at 6.

RATE OF RETURN

60. Because DCF results may understate ROE, considering results of other models is consistent with the fundamental purpose of the Commission's regulation of public utility ROR where "regulation must act as a substitute for marketplace competition." Joint Statement No. 2-R at 6.

61. Citizens' witness D'Ascendis conducted a thorough analysis of multiple ROE models to develop an ROE based on his proxy group of 9.05%. *See* Joint Statement No. 2-R, Exhibit __(DWD-1R), Schedule 1R at 2.

62. Mr. D'Ascendis then adjusts the proxy group's ROE upward by 1.00% for the Company's smaller relative size to the proxy group and 0.25% to reflect management performance. *See* Joint Statement No. 2-R, Exhibit __(DWD-1R), Schedule 1R at 2.

63. As a result of his adjustments to the proxy group's ROE to reflect the unique risk of the Company, Mr. D'Ascendis recommends a 10.30% ROE. *See* Joint Statement No. 2-R, Exhibit __(DWD-1R), Schedule 1R at 2.

64. The I&E and OCA recommended ROEs for Citizens' of 8.10% and 8.38% "are all below the lowest ROE authorized for any major electric utility followed by Regulatory Research Associates ("RRA"), a division of Standard and Poor's ("S&P") Global Intelligence since at least 1980." Joint Statement No. 2-R at 5.

65. Mr. D'Ascendis' observations of the susceptibility of the DCF model to distortion where market-to-book ratios exceed unity (*i.e.* a 1.0 ratio) are supported both by financial literature and empirical analysis. Joint Statement No. 2-R at 10.

66. Application of the standard DCF model to utility stocks understates the investor's expected return when the market to-book (M/B) ratio of a given stock exceeds unity. Joint Statement No. 2-R at 10.

67. Market-to-book value for the combined proxy group has been significantly higher than the 1.65 ten-year average, particularly since 2018. See Joint Statement No. 2-R at 13.

68. Mr. D'Ascendis developed an empirical quantification of the understated return that would result from approval of the I&E or OCA DCF equity cost rates. Joint Statement No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-2R.

69. The Commission approved an ROE of 10.40% for PPL Electric Utilities Corporation in 2012, an ROE of 11.00% for Aqua Pennsylvania, Inc. in 2008 and an ROE of 9.85% for UGI in 2018. Joint Statement No. 2-R at 5.

70. Although market conditions may change, no empirical evidence supports adoption of ROE's that are 175 and 147 basis points lower than the UGI result, which was decided a mere 18 months before this case. Joint Statement No. 2-R at 5.

71. I&E's criticism of the CAPM analysis in general as subject to "manipulation" should be given no weight; as noted by Mr. D'Ascendis, I&E's criticism of the CAPM would apply equally to any ROE model as "[a]ll ROE models are only as good as their inputs, and all ROE models can be easily manipulated by changing those inputs." *See* Joint Statement No. 2-R at 38.

72. Mr. D'Ascendis presents multiple financial analyses from notable scholars confirming that the "risk-free rate used in the CAPM should match the life (or duration) of the underlying investment." *See* Joint Statement No. 2-R at 23.

73. The I&E Witnesses' use of a medium-term Treasury bond does not match the life of the assets being valued. Joint Statement No. 2-R at 24.

74. I&E provides no analysis or citation to any authority to support the assertion that projecting a risk-free rate over a ten-year period would result in unreliable data. I&E Statement No. 2 at 37.

75. Mr. D'Ascendis has provided ample support for the proposed forecast period, which I&E has failed to credibly rebut. Joint Statement No. 2 at 24.

76. Mr. D'Ascendis references multiple studies affirming that the ECAPM addresses criticism of the overly steep predicted Security Market Line resulting from the traditional CAPM. *See* Joint Statement No. 2-R at 28.

77. The PRPM model used in Mr. D'Ascendis' RPM analysis measures the risk-return relationship directly using the same company-specific market prices used to derive company-specific beta coefficients. Joint Statement No. 2-R at 39.

78. Mr. D'Ascendis provided extensive evidence of the PRPM's use in the industry, including three publications in academic peer-reviewed journals and a recent adoption

of the model by the South Carolina Public Service Commission. Joint Statement No. 2-R at 41.

79. Mr. D'Ascendis also addressed I&E's claim that the PRPM is a proprietary model available only through substantial fees by clarifying that he made his workpapers available to all parties in this proceeding and that free versions of software necessary to run the PRPM model are available. *See* Joint Statement No. 2-R at 42.

80. Mr. D'Ascendis developed specific selection criteria limiting the non-price regulated proxy group to companies with beta coefficients *and* residual standard errors within plus or minus two standard deviations of the Electric Utility Proxy Group. Joint Statement No. 2 at 37.

81. The Commission does not set the DSIC ROE at the median or mean of its DCF analysis, but rather sets the DSIC ROE at some point within a standard deviation of the results. *See* Tr. 45.

82. The Commission's determination of the ROE for electric utility DSICs indicates that an appropriate ROE should be set at the higher range of DCF results. *See* Tr. 45.

83. In addition to the combined DCF/two-step DCF model, OCA conducts a two-stage DCF analysis, a CAPM analysis, and a CAPM/Risk Premium analysis, but places no weight on these analyses. Joint Statement No. 2-R at 46.

84. Both the FERC two-step DCF and the two-stage DCF alternative growth rates are intended to reflect the dual premises: (1) that growth is limited by the long-term growth in gross domestic product ("GDP") and (2) utility companies are not in the 'steady state' stage in the company/industry life cycle; however, neither premise holds true. Joint Statement No. 2-R at 49.

85. OCA's CAPM analysis: 1) fails to utilize a risk-free rate based on a forecast period, despite common knowledge that investors are aware of and rely on interest rate forecasts; 2) relies on four flawed market risk premium calculations; and 3) similar to I&E, fails to incorporate an ECAPM analysis. Joint Statement No. 2-R at 55-63.

86. OCA applies a purported "risk premium" analysis that simply replaces the risk-free rate in the CAPM with a six-month average utility bond yield - this model is a substantial departure from the CAPM's theoretical basis, simply because it assumes no risk-free asset. Joint Statement No. 2-R at 64.

87. OCA argues that its risk premium analysis preserves a risk-free asset in the market risk premium calculation, but concedes that the "free-standing" risk free asset component of the CAPM is eliminated. OCA Statement No. 3-SR at 9.

88. OCA provides neither financial literature nor other support for this departure from the widely accepted CAPM or risk premium analyses. OCA Statement No. 3-SR at 9.

89. Citizens' has accomplished the following: (1) low number of customer complaints; (2) favorable customer feedback; (3) high responsiveness to customer support calls and in energizing new service locations; (4) excellent reliability metrics; (5) no reportable injuries; (6) technological improvements in customer service by offering Smarthub use to customers and providing line crews with tablets; (7) increased pole attachment billing; (8) recognition as a "Tree Line USA" utility; (9) replacement of forty percent of all the streetlights in its service area with LED lights; and (10) continued significant capital investment of approximately $1.4 million per annum. Citizens' Statement No. 4 at 9-12.

90. These accomplishments achieve more than just mere compliance with Commission requirements and policies and demonstrate Citizens' commitment to providing reliable and quality service to its customers above and beyond what is required by the Public Utility Code. *See* Citizens' Statement No. 4 at 9-12.

91. The Companies' smaller size relative to the Electric and Gas Utility Proxy Groups indicates greater relative business risk for the Companies because, all else being equal, size has a material bearing on risk. Joint Statement No. 2 at 42; Citizens' Statement No. 4 at 6.

92. Mr. D'Ascendis' review of financial literature establishes the inverse relationship between Company size and risk. Joint Statement No. 2 at 42-43.

93. The question relevant to whether a size adjustment is necessary to appropriately reflect Citizens' risk factors turns to whether Citizens' is considerably smaller than the companies in the Electric Utility Proxy Group. Joint Statement No. 2 at 42-43.

94. To determine whether a size adjustment should be incorporated, Mr. D'Ascendis conducted a market capitalization analysis to quantify the relative size risk. Joint Statement No. 2 at 44.

95. Mr. D'Ascendis' market capitalization study observed that, as of March 29, 2019, Citizens' had a market capitalization of $26.840 million compared with an average company market capitalization of $16,675.447 million for the Electric Utility Proxy Group; this amounts to a size difference of 621.3x. Joint Statement No. 2 at 45.

96. In order to quantify the appropriate size adjustment, Mr. D'Ascendis relied on "size premiums for portfolios of New York Stock Exchange, American Stock Exchange, and NASDAQ listed companies ranked by deciles for the 1926 to 2018 period." Joint Statement No. 2 at 45.

97. The Electric Utility Proxy Group $16.7 billion market capitalization ranked in the 2nd decile, while Citizens' $26.8 million market capitalization ranked in the 10th decile, resulting in a size premium spread of 4.70%. Joint Statement No.2 at 45.

98. Although his analysis supports a 470 basis point adjustment, Mr. D'Ascendis recommends a conservative size adjustment of 1.00% or 100 basis points to the Company's ROE. Joint Statement No. 2 at 45.

99. In opposing the Company's proposed size adjustment, I&E places exclusive weight on a single study by Dr. Annie Wong concluding that there is "no need to adjust for the firm size in utility rate regulation." *See* I&E Statement No. 2 at 42.

100. Mr. D'Ascendis finds that Dr. Wong's study erroneously equates "a change in size to beta coefficients, which accounts for only a small percentage of diversifiable company-specific risk." Joint Statement No. 2-R at 33.

101. By analyzing only the risk captured in beta, Dr. Wong understates the total impact of size risk. Joint Statement No. 2-R at 33.

102. Mr. D'Ascendis cited to a more recent article by Thomas M. Zepp which also criticized Dr. Wong's study and observed "[t]wo other studies discussed here support a conclusion that smaller water utility stocks are more risky than larger ones. To the extent that water utilities are representative of all utilities, there is support for smaller utilities being more risky than larger ones." Joint Statement No. 2-R at 34.

103. Dr. Zepp presented an authoritative analysis disputing Dr. Wong's findings, and was not rebutted in the financial literature by Dr. Wong or her advocates. Joint Statement No. 2-R at 34.

104. To definitively test Dr. Wong's finding, Mr. D'Ascendis conducted a study to determine whether size effect is applicable to utilities. Joint Statement No. 2-R at 35.

105. In assessing the results, Mr. D'Ascendis concluded that the study shows an R-Squared of 0.09, meaning that approximately 9% of the change in risk is explained by size. Joint Statement No. 2-R at 35.

106. A 0.09 R-Squared would not generally be considered to have strong explanatory power, but in this case, it exceeds the average R-Squared of each of the I&E and OCA proxy group companies' beta coefficients, which is a common measure of market risk. *See* Joint Statement No. 2-R at 36.

TAXES

107. On November 8, 2018, the Commission approved a petition by Citizens' and Wellsboro to maintain the regular reconciliation process for the TCJA Voluntary Surcharge until the Companies submit rate cases. Joint Statement No. 4 at 13. Upon filing rate cases, Citizens' proposed to maintain the current distribution rates reflecting the TCJA Voluntary Surcharges during the pendency of this base rate case, after which a final reconciliation for the TCJA Voluntary Surcharge will be calculated; Citizens' requested to provide a final reconciliation of the TCJA Voluntary Surcharges within 120 days after new rates take effect. Joint Statement No. 4 at 13.

108. Citizens' and Wellsboro will not have the 2019 tax data to perform the reconciliation until March or April of 2020. Citizens' and Wellsboro will attempt to accelerate the filing of the final reconciliation of the TCJA Voluntary Surcharges; however, if they

do not have accurate 2019 tax data, this may not be possible. Joint Statement No. 3-R at 2.

109. Citizens' rates were changed in 2018 to reflect the Tax Cut and Jobs Act, which gave rise to the EDIT. Citizens' Statement No. 1-R at 13.

RATE STRUCTURE

110. In developing the ACOS, Mr. Gorman followed the traditional three-step process: (1) functionalization of rate base and costs; (2) classification of functionalized costs as demand-related, commodity-related, or customer-related; and (3) class allocation of the functionalized, classified costs among the rate classes. Citizens' Statement No. 1 at 14.

111. The Commission, in the UGI Order, recently found that the minimum system method is "consistent with the NARUC Manual and more accurately reflects cost-causation principles than the ACOSS methodology proposed by the OCA." UGI Order at 160.

112. Citizens' classification of upstream distribution plant as both customer- and demand-related, and using a minimum system study is consistent with Commission precedent. Citizens' Statement No. 1 at 14; UGI Order at 160.

REVENUE ALLOCATION

113. The Company continues to reject the position that no class should receive a decrease and continues to support decreases for classes consistent with the ACOS results…the Company's position on revenue allocation applies with equal force, in the event of a scaleback…if the ACOS indicates a class is significantly over-earning at present rates, that class should receive a decrease in revenue. Citizens' Statement No. 1-SR at 2.

RATE DESIGN

114. The Company's proposal to allocate the cost for 0.38 kW-demand ($2.06 per month) to the Residential customer charge shifts only the minimum demand costs to the fixed charge. Citizens' Statement. No. 1 at 37-38.

115. The Company's proposal to allocate the cost for 1.0 kW-demand ($6.04 per month) to the Space Heating customer charge shifts only the minimum demand costs to the fixed charge. Citizens' Statement. No. 1 at 37-38.

116. Citizens' believes that incorporating minimum demand costs into the monthly customer charge will be easier for residential customers to understand than implementing a separate demand charge. Citizens' Statement No. 1 at 37.

117. By including only the portion of demand charges constituting the minimum demand for customers, the Company reasonably aligns customer rates with costs. Citizens' Statement. No. 1 at 37-38.

118. The Company's proposal to include a small part of demand costs in the fixed monthly fee is reasonable, aligns closely with cost-causation principles, and supports

Commission policies provided in the Final Policy Statement Order. *See* Citizens' Statement No. 1 at 34-37.

APPENDIX C

PROPOSED CONCLUSIONS OF LAW

BURDEN OF PROOF

1. Utilities have the burden of proving that each element of the rate increase request is just and reasonable. *Univ. of Pa. v. Pa. PUC*, 485 A.2d 1217, 1226 (Pa. Cmwlth. 1984).

2. Public utilities are not, however, required to affirmatively defend claims that have gone unchallenged. *See Allegheny Ctr. Assoc.'s v. Pa. PUC,* 570 A.2d 149, 153 (Pa. Cmwlth. 1990).

3. The ultimate burden of proof does not shift from the utility seeking a rate increase; however, where a party proposes an adjustment to the utility's rate making claim, that party must present evidence or analysis that demonstrates the reasonableness of its proposed adjustment. *See e.g., Pa. PUC v. Phila. Elec. Co.,* Docket No. R-891364, *et al.*, 1990 Pa. PUC LEXIS 155 (Order dated May 16, 1990); *see also Pa. PUC v. Breezewood Tel. Co.*, Docket No. R-901666, 1991 Pa. PUC LEXIS 45, at *10 (Order dated Jan 31, 1991).

4. A party that raises an issue that is not included in a public utility's general rate case filing bears the burden of proof. *See, e.g., Pa. PUC. v. Metro. Edison Co., et al.,* Docket Nos. R-00061366, *et al.*, 2007 Pa. PUC LEXIS 5, at *111-12 (Order entered Jan.11, 2007).

RATE BASE

5. The Company's claimed plant in service, based on plant projected to be in service at the end of the FPFTY, is consistent with both the Commission's holding in the UGI Order and long-standing Commission precedent, which has uniformly approved the calculation of plant in service at a point in time, *i.e.* the end of the relevant test year. *See, e.g., Pa. PUC, et al. v. PPL Electric Utilities Corporation*, Docket Nos. R-2012-2290597, et al., at 12; *Pa. PUC v. UGI Utilities, Inc. – Electric Division* (*"UGI Utilities"*), Docket No. R-2017-2640058 (Order Entered October 25, 2018) ("UGI Order") at 23-26.

6. The language of Act 11 fully supports use of end of test year balances. 66 Pa. C.S. § 315(e).

7. The Legislature (1) expressly indicated that the FPFTY may include plant projected to be in service *during* the FPFTY; and (2) specifically noted that Section 1315, which codified the "used and useful" standard, provides no bar to including in rate base all plant added during the FPFTY. 66 Pa. C.S. § 315(e).

EXPENSES

8. The Company's proposed expenses are reasonably necessary to provide service to its customers and to earn a fair rate of return on the investment and plant used and useful in providing service. *Butler Township Water Co. v. Pa. PUC,* 81 Pa. Cmwlth. 40, 43-44, 473 A.2d 219, 221 (1984) *("Butler Township"). See also T.W. Phillips Gas and Oil Co. v. Pa. PUC,* 81 Pa. Cmwlth. 205, 474 A.2d 355 (1984).

9. The expense adjustments proposed by OCA and I&E would understate the revenue requirement necessary to provide the Company with an opportunity to earn a fair rate of return on the investment and plant used and useful in providing service. *Butler Township Water Co. v. Pa. PUC,* 81 Pa. Cmwlth. 40, 43-44, 473 A.2d 219, 221 (1984) *("Butler Township"). See also T.W. Phillips Gas and Oil Co. v. Pa. PUC,* 81 Pa. Cmwlth. 205, 474 A.2d 355 (1984).

10. The Company's has exercised managerial discretion to prudently manage its HTY and FTY expenses. *See Pa. PUC v. Philadelphia Suburban Water Company*, 1991 Pa. PUC LEXIS 206, *9-10 (Pa. PUC October 18, 1991).

11. The expense adjustments proposed by OCA and I&E place undue reliance on outcomes or results-oriented review of managerial decisions, which would find imprudence merely because an intended result was not achieved. *Pa. PUC v. Duquesne Light Co.*, 63 Pa. PUC 337, 351 (1987).

12. The Company's proposal to apply a 3% inflation adjustment to various O&M expenses based on historical expenses, historical inflation, and 2020 budgeting proposals is consistent with Commission precedent authorizing the use of inflation factors in projecting costs. *See, e.g.*, Opinion and Order, *Pa. PUC v. Pennsylvania-American Water Co.*, Docket No. R-00038304 (Order entered Jan. 29, 2004) at 35; Opinion and Order, *Pa. PUC v. Pennsylvania-American Water Co., et al,* Docket No. R-880916 (Order entered Oct. 21, 1988) at 54.

13. The Company's proposal to apply a 3% inflation adjustment to various O&M expenses based on historical expenses, historical inflation, and 2020 budgeting proposals is consistent with Act 11. 66 Pa. C.S. § 315(e).

14. The Company's historic filing frequency is a factor considered in determining the normalization for rate case normalization, but is not the only factor the Commission considers. *See, e.g., Butler Township* 81 Pa. Cmwlth. 40, 47-48 (affirming that historic practice need not be the exclusive factor relied upon by the Commission).

15. Ratemaking is prospective, and the goal of ratemaking is to reasonably reflect future conditions when new rates are in effect. *See, e.g., Columbia Gas v. Pa. PUC,* 613 A.2d 74, 76 (Pa. Cmwlth. 1992), *aff'd,* 636 A.2d 627 (Pa. 1994).

RATE OF RETURN

16. A fair rate of return must be: (1) equal to the return on investments in other business undertakings with the same level of risks (comparable earnings standard); (2) sufficient to assure confidence in the financial soundness of a utility (financial integrity standard); and (3) adequate to permit a public utility to maintain and support its credit, enabling the utility to raise or attract additional capital necessary to provide reliable service (the capital attraction standard). *Bluefield Water Works & Improvement Company v. P.S.C. of West Virginia*, 262 U.S. 679 (1923) (*"Bluefield"*); *Federal Power Commission v. Hope Natural Gas.,* 320 U.S. 591, 603 (1944) (*"Hope");* and *Duquesne Light Co. v. Barasch,* 488 U.S. 299 (1989).

17. The Commission will rely on multiple return on equity models where evidence indicates the results from the DCF model would understate a utility cost of common equity. UGI Order at 104-105.

18. The Commission is required to consider utility management effectiveness and efficiency in setting rates. 66 Pa. C.S. § 523.

19. Utilities who only meet the bare requirements of the Public Utility Code have not, however, proven that their performance warrants a performance adjustment. *See Columbia Water Co.*, 2013 Pa. PUC LEXIS 763 at *84.

20. The Companies have provided specific evidence to support a rate of return premium for management effectiveness pursuant to Section 523 of the Public Utility Code. 66 Pa. C.S. § 523; *see also Pa. PUC v. Columbia Water Co.*, 2013 Pa. PUC LEXIS 763, *82.

21. The Company's proposed size adjustment is a corollary to the *Bluefield* standard determining that public utilities are entitled to earn a rate of return on property placed into public service commensurate with other business undertakings "which are attended by corresponding risks and uncertainties." *Bluefield* at 79.

REVENUE ALLOCATION

22. Where revenue allocation is concerned, it has long been established in Pennsylvania that cost-causation is the "polestar" of utility ratemaking. *Lloyd v. Pa. PUC,* 904 A.2d 1010, 1015 (Pa. Cmwlth. 2006).

RATE DESIGN

23. The Act of July 1, 1978, P.L. 598, as amended, added by Act of June 28, 2018, P.L. 58, 66 Pa. C.S. § 1330 ("Act 58") authorizes the Commission to approve alternative ratemaking methodologies. 66 Pa.C.S. § 1330.

24. The Company's proposal to shift a portion of demand costs, equivalent to minimum demand, to fixed charges is consistent with Act 58 and meets numerous policy objections set forth in the Commission's Final Policy Statement on Alternative

Ratemaking. 66 Pa.C.S. § 1330; *see also Fixed Utility Distribution Rates Policy Statement*, *Final Policy Statement Order*, Docket No. M-2015-2518883 (Order entered July 18, 2019).

<u>APPENDIX D</u>

PROPOSED ORDERING PARAGRAPHS

1. That Citizens' Electric Company of Lewisburg, PA is authorized to file tariffs, tariff supplements and/or tariff revisions, on at least one day’s notice, and pursuant to the provisions of 52 Pa. Code §§ 53.1, et seq., and 53.101, designed to produce an annual distribution rate revenue increase of approximately $701,000, to become effective for service rendered on and after May 1, 2020.

2. That Citizens' Electric Company of Lewisburg, PA shall file detailed calculations with its tariff filing, which shall demonstrate to the Commission’s satisfaction that the filed tariff adjustments comply with the provisions of this final Opinion and Order.

3. That Citizens' Electric Company of Lewisburg, PA shall allocate the authorized increase in operating distribution revenue to each customer class, and rate schedule within each customer class, in the manner prescribed in this Opinion and Order.

4. That Citizens' Electric Company of Lewisburg, PA is directed to submit a reconciliation of the TCJA Voluntary Surcharge within 120 days of May 1, 2020.

5. That, upon acceptance and approval by the Commission of the tariff supplements filed by Citizens' Electric Company of Lewisburg, PA, consistent with its Final Order, the investigation at Docket R-2019-3008212 be marked closed.

6. That Citizens' Electric Company of Lewisburg, PA shall comply with all directives, conclusions, and recommendations contained in the body of this Opinion and Order, which are not the subject of an individual directive in these ordering paragraphs, as fully as if they were the subject of a specific ordering paragraph.

7. That the complaint filed by the Office of Consumer Advocate in this proceeding at Docket Number C-2019-3011849 be dismissed and marked closed.