BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

MAIN BRIEF OF WELLSBORO ELECTRIC COMPANY

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I. INTRODUCTION

On July 1, 2019, Wellsboro Electric Company ("Wellsboro" or "Company") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") Supplement No. 125 to Tariff Electric-Pa. PUC No. 8 ("Original Supplement No. 125"), proposing an annual increase in revenues of $1,419,610. In support of this filing, Wellsboro submitted a Statement of Reasons, the supporting information required by 52 Pa. Code § 53.52(a), (b), and (c), and various other information.

On July 31, 2019, Wellsboro filed a revised Supplement No. 125 ("Supplement No. 125") modifying the proposed revenue increase to approximately $999,999 for compliance purposes and therefore seeks a revenue increase lower than that supported by the Company's analysis.[1] The Company's analysis continued to support the $1,419,610 increase in revenue. Wellsboro Statement No. 1 – Direct Testimony of Howard S. Gorman ("Wellsboro Statement No. 1"), Exhibit__(HSG-1), Schedule C1 (W)

In its Rebuttal Testimony, Wellsboro subsequently revised its proposed revenue increase to approximately $999,999, reflecting rate of return and rate base adjustments to the as-filed request. Wellsboro Statement No. 1-R – Rebuttal Testimony of Howard S. Gorman ("Wellsboro Statement No. 1-R"), Exhibit__(HSG-1R), Schedule C1 (R)[2] The Rebuttal position also shows the Company can support a higher revenue increase of approximately $1.1 million, but the

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[1] Wellsboro initially requested an increase of $1.419 million but later changed its request to $999,999. Wellsboro Statement No. 1-R at 2. While Wellsboro's rate case supported an increase of $1.419 million, the requested revenue increase was reduced to $999,999 to maintain Wellsboro's ability to use simplified rate case procedures under 52 Pa. Code § 53.52. *See* Section X.B., *infra*; *see also* Wellsboro Exhibit No. 1, Exhibit__(HSG-1), Schedule C5-1 (W).

[2] In its Rebuttal Testimony, Wellsboro provided an updated Schedule C1 showing adjustments to present and proposed revenue, rate base and rate of return. *See* Wellsboro Statement No. 1-R, (Exhibit__HSG-1R), Schedule C1 (R). At this time, all other schedules remain unchanged from the July 31, 2019 filing.

Company requests that the Commission approve the proposal to increase base rate revenues by approximately $999,999.

A. WELLSBORO ELECTRIC COMPANY

Wellsboro is a small investor-owned Electric Distribution Company ("EDC") providing service in the Borough of Wellsboro, Pennsylvania, and surrounding areas in Tioga County. Wellsboro is wholly-owned by C&T Enterprises, Inc. ("C&T"). C&T is a holding and management services company that currently also owns Citizens' Electric Company of Lewisburg, PA ("Citizens'") and Valley Energy, Inc. ("Valley").

Wellsboro's service territory is predominantly rural and is surrounded by the service territory of Pennsylvania Electric Company ("Penelec") and Tri-County Rural Electric Cooperative. As of December 31, 2018, Wellsboro served 6,337 customers, of which 5,116 were residential, 1,216 were commercial and industrial, 2 were lighting, and 4 were exchange utility. *See* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule B5 (W).

Through the instant proceeding, Wellsboro requests from the Commission approval of an increase in annual distribution revenues. Wellsboro 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, Wellsboro 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 an overall distribution rate increase of $1,419,610 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. On July 31, 2019, the Company filed replacement base rate schedules and tariff sheets reflecting an increase in distribution revenues of $999,999 in order to comply with 52 Pa. Code § 53.53 regarding base rate cases requesting increases in excess of $1 million.[3]

Under current rates, Wellsboro earned a rate of return on its distribution business in 2018 of only 5.73%, a low return that will not support the long-term health of the Company. *See* Wellsboro Statement No. 1-R, Exhibit__(HSG-1), Schedule C1 (R). By 2020, the Company's FPFTY, Wellsboro's return is projected to decline substantially to 2.56%, a level far too low under the *Hope* and *Bluefield* standards.[4] *See id.* If the full request is granted, the Company will be able to earn a return of approximately 7.14%. *See id.* Wellsboro believes that this is still an inadequate return for its regulated distribution service, but it is all that can be accommodated following the Commission's rejection of the requested waiver. This is especially true for Wellsboro's investors because smaller utilities are generally viewed as carrying more risk due to their susceptibility to larger revenue fluctuations due to weather-related usage variations, loss of customers, and other factors.

Since its last distribution rate increase, Wellsboro has continued to provide safe and reliable service to customers while at the same time the costs of operating the distribution system have continued to grow. Wellsboro has been systematically completing two voltage conversions,

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[3] Concurrent with this rate case filing, Wellsboro filed a Joint Petition for Waiver with Valley ("Joint Petition for Waiver") seeking a waiver from informational requirements for general rate increase requests in excess of $1 million as set forth in 52 Pa. Code § 53.53 of the Commission's regulations. Both OCA, I&E, and OSBA filed a Joint Motion to Reject Wellsboro's rate filing and a Joint Answer to the Petition for Waiver collectively opposing the Company's request to proceed with its fully requested rate increase upon a waiver of the filing requirements for general rate case increase requests in excess of $1 million. *See Motion of the Joint Statutory Advocates to Reject the Base Rate Filing of Wellsboro Electric Company*, Docket No. R-2019-3008208 *et al.,* (July 22, 2019) ("Joint Motion to Reject"); *see also Joint Answer of the Bureau of Investigation and Enforcement, Office of Consumer Advocate, and Office of Small Business Advocate in Opposition to Petition,* Docket No. P-201903011478 *et al.,* (July 22, 2019) ("Joint Answer to Petition for Waiver"). The Commission subsequently issued a Secretarial Letter advising that Wellsboro must either reduce the general rate increase to under $1 million or provide the information required for general rate increase in excess of $1 million. *Secretarial Letter,* Docket R-2019-3008208 *et al.,* (July 24, 2019). Finally, the Commission entered an Order in the above-captioned docket rejecting the Petition for Waiver on August 8, 2019.

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

replacing its aging distribution infrastructure, including reconductoring and installing three-phase tie-points on select lines, increasing pole replacements towards a target of 200-230 per year, installing switches and vacuum reclosers to automate the isolation of faults to reduce customer outages, completing the installation of Advanced Metering Infrastructure ("AMI") metering and performing other reliability-enhancing improvements. The Company also completed a Geographic Information Systems mapping project in 2018. Referenced as the Asset Verification Project, this effort increased the accuracy of the Company's asset inventory and improved the Company's mapping and outage reporting capabilities along with pole attachment inventory which helped the Company collect additional revenue.

Additionally, approximately $850,000 is planned to be invested in the substation and transmission work associated with the Mid-Atlantic Interstate Transmission ("MAIT") 115Kv transmission line upgrade that will lead to more reliable electric supply to Wellsboro. This project involves the installation of a 115 kV circuit breaker, a 115 kV switch, and a ground switch or relay; high side switch maintenance; a metering installation (revenue quality); a transformer tap change from 34.5 kV to 115 kV and associated testing; and a connection to MAIT with an associated structure.

Since the end of 2016, the Company will have invested over $6 million in its utility plant in service by the end of the FPFTY. *See* Wellsboro Statement No. 1 Exhibit__(HSG-1), Schedule C3 (W). In a rural territory such as this, capital improvements and vegetation management are ongoing and important activities to ensure service reliability. Operations and Maintenance ("O&M") costs are approximately $565,000 higher for the FPFTY when compared to the 2016 rate case. *See* Wellsboro Statement No. 1 Exhibit__(HSG-1), Schedule C5-1 (W). These increases are driven by several key factors. Notably, Wellsboro's tree-trimming contractor costs have increased by over $126,000 due to contractor cost increases over the past three years, the Emerald

Ash Borer removal, and enhanced tree growth due to wet growing seasons over the past two years. Vegetation management activities are particularly critical in a rural territory like Wellsboro's, which has many miles of off-road rights-of-way carrying poles and wires. The Company is also proactively addressing succession planning for its small workforce. These increased expenses reflect some overlap in positions when appropriate to transition administrative and executive duties. The expenses also reflect the hiring of a VP, Engineering & Operations/COO, a position which had been vacant. The Company is expecting 8 of the 17 positions to retire in the next 3-10 years which will require a hiring overlap to reduce knowledge loss and there will be training required to keep personnel current with industry practices and applications that will be used to safely and efficiently run the business.

Above all, the proposed distribution rates will promote the continued provision of safe and reliable service by ensuring that Wellsboro will earn a fair and reasonable return on the resources invested in the distribution system. Wellsboro 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 Wellsboro's 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 Wellsboro filed Supplement No. 125 with the Commission. The Office of Consumer Advocate ("OCA") filed a Formal Complaint against Wellsboro's rate increase on August 5, 2019. On July 22, 2019, the Office of Small Business Advocate ("OSBA") submitted a Notice of Appearance in this proceeding. The Bureau of Investigation and Enforcement ("I&E") filed a Notice of Appearance on July 19, 2019. Pursuant to 52 Pa. Code § 5.61(d), Wellsboro elected not to file an answer to OCA's Complaint.

Concurrent with this rate case filing, Wellsboro filed a Joint Petition for Waiver with Valley ("Joint Petition for Waiver") seeking a waiver from informational requirements for general rate increase requests in excess of $1 million as set forth in 52 Pa. Code § 53.53 of the Commission's regulations. Valley withdrew from the Joint Petition for Waiver on July 29, 2018. While awaiting a Commission determination, Wellsboro filed replacement base rate schedules and tariff sheets reflecting an increase in distribution revenues of $999,999 on July 31, 2019. On August 8, 2019, by Secretarial Letter, the Commission denied the Joint Petition for Waiver and acknowledged Wellsboro's updated revenue request.

At its Public Meeting of August 29, 2019, the Commission suspended Wellsboro's proposed tariff supplement by operation of law until March 30, 2020, and instituted an investigation into this proceeding. On September 9, 2019, Wellsboro filed a tariff supplement voluntarily extending the suspension period through April 29, 2019. On October 2, 2019, Wellsboro 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 Citizens' and Valley at Docket Nos. R-2019-3008212 and R-2019-3008209, respectively. Prior to the Prehearing Conference, on August 2, 2019, Wellsboro provided the parties with its Direct Testimony. In accordance with the procedural schedule established at the Prehearing Conference, Wellsboro received Direct Testimony from OCA, I&E, and OSBA on October 15, 2019. On November 14, 2019, Wellsboro submitted Rebuttal Testimony and received Rebuttal Testimony from OCA and OSBA on that same date. Wellsboro 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 Farnsworth 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 other witnesses was entered into the record by stipulation 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. Wellsboro files this Main Brief to address all remaining disputed issues. As set forth more fully in this Main Brief, Wellsboro's proposed rate base, revenue, expenses, rate of return, and rate design are just and reasonable and should be accepted 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 entered May 16, 1990); *See also Pa. PUC v. Breezewood Tel. Co.,* Docket No. R-901666, 1991 Pa. PUC LEXIS 45, at *10 (Order entered Jan 31, 1991) ("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, the utility would oppose).

II. SUMMARY OF ARGUMENT

Wellsboro requests an approximately $999,999 overall revenue increase in this proceeding. Since late 2016, the Company has made significant system investments and will have invested over $6 million in its utility plant in service by the end of the FPFTY.

As a small utility, Wellsboro continues to excel in providing exceptional service to its customers. The Company has been systematically replacing its aging distribution infrastructure, including reconductoring and installing three-phase tie-points on select lines, increasing pole replacements towards a target of 200-230 per year, installing switches and vacuum reclosers to automate the isolation of faults to reduce customer outages, completing the installation of AMI metering and performing other reliability-enhancing improvements. Additionally, Wellsboro is in the process of investing $850,000 in substation and transmission work associated with the MAIT transmission line upgrade to increase reliability of Wellsboro's electric supply. 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.

Wellsboro 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 its 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; (4) excellent reliability metrics; (5) very low reportable injuries; (6) technological improvements in customer service by offering Smarthub use to customers and completing an Asset Verification Project, which improves outage reporting capabilities (used by approximately one-fifth of Wellsboro's customers); (7) a replacement program to replace all streetlights in its service area with LED lights; (8) tablets are being implemented for field personnel to use for maps and inspections; and (9) continued significant capital investment of approximately $1.25 million annually since the last rate case. The bottom line in determining management effectiveness is quality of service and reasonable rates. As explained further in this Main Brief, Wellsboro 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 Wellsboro 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. 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 initially challenged Wellsboro's present rate revenue claims, arguing that Wellsboro understates its FPFTY customer count. I&E later withdrew its objection to Wellsboro's calculations, leaving only a dispute over Forfeited discounts. 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. Wellsboro FTY (2019) year-to-date data, provided up through September 30, 2019 in Rebuttal Testimony, shows that the Company is carefully managing its costs. The Company's expenses are tracking below projections, in part due to certain one-time events causing a reduction in expenses during 2019. However, on Rebuttal, the Company proposed an across-the-board expense adjustment based on annualized year-to-date figures and a 3% inflation adjustment to capture increases in wages, salary, benefits, and other O&M expenses. The Company's updated expense projections are reasonable and conservative, particularly as the Company's revenue request of approximately $999,999 is already below the $1.1 million revenue requirement supported by the Company's filing. 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 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. 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, Wellsboro 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 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 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 Wellsboro and the opposing parties largely disappears, demonstrating that the Company should be awarded all or nearly all of its requested rate relief. Therefore, Wellsboro respectfully requests that the ALJs and the Commission deny the adjustments of the opposing parties and approve Wellsboro proposed rate increase.

III. ISSUES RESOLVED AMONG ALL PARTIES[5]

A. RATE BASE – CONSTRUCTION WORK IN PROGRESS

The Company initially proposed to add a Construction Work in Progress ("CWIP") amount of $59,971 to its FPFTY rate base total. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C2 (W). This amount was based on the balance sheets for the historic test year ("HTY"), FTY,

[5] The rate case tables attached as Appendix A reflect any revisions Wellsboro accepted in its Rebuttal Testimony.

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 5-6.

Because the Company's CWIP projections were based on historic figures rather than specific identified projects projected to be under construction at conclusion the FPFTY, Wellsboro accepted the removal of CWIP from rate base. Wellsboro Statement No. 1-R – Rebuttal Testimony of Howard S. Gorman ("Wellsboro Statement No. 1-R") at 13. However, Wellsboro's 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. RATE BASE – MATERIALS & SUPPLIES

In its revised filing, the Company proposed to add $245,607 to rate base for materials and supplies. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W). 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 Statement No. 2, Schedule LKM-3. I&E Statement No. 3 at 7-8; OCA Statement No. 2 at 6.

On Rebuttal, the Company accepted the Advocates' 13-month methodology. Wellsboro Statement No. 1-R at 6, 13. According to I&E witness Cline, this methodology reduces the Company's claim by $35,389 to $210,218. I&E Statement No. 3 at 7. OCA calculated a reduction of $37,074 to $208,533, a different calculation than I&E. *See* OCA Statement No. 2, Schedule LKM-4. The Company deducted OCA's recommended amount of $37,074 from rate base, which was accepted by I&E. I&E Statement No. 3-R at 4.

C. RATE BASE – CUSTOMER DEPOSITS

In its filing, the Company proposed to deduct $82,025 from rate base for customer deposits. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W). 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 6-7. OCA proposed a $5,810 adjustment to the Company's claim for customer deposits. OCA Statement No. 2, Schedule LKM-5.

On Rebuttal, the Company accepted OCA and I&E's 13-month methodology and reduced its customer deposits adjustment by $5,810 to $76,215. Wellsboro Statement No. 1-R at 13.

D. REGULATORY COMMISSION EXPENSE (ACCOUNT 928)

FPFTY Regulatory Commission expense includes PUC General Assessment fees and 2016 amortized base rate case expense. I&E Exhibit No. 1, Schedule 6 at 1. The Company originally claimed $107,341 for this account. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W).

In response, I&E witness Patel proposed a reduction of $68,710, representing normalized rate case expense the Company included from the 2016 rate case included in the Company's FPFTY expense claim. I&E Statement No. 1 – Direct Testimony of D.C. Patel ("I&E Statement No. 1") at 17. This adjustment resulted in a proposed allowance of $38,631 in the FPFTY. On Rebuttal, Company witness Gorman accepted the adjustment by removing the 2016 rate case expense. Wellsboro Statement No. 1-R at 4; *see also* I&E Statement No. 1-R – Rebuttal Testimony of D.C. Patel ("I&E Statement No. 1-R") at 24.

E. PRESENT RATE REVENUE

Wellsboro's revenue projections include flat sales due to customer losses and limited prospects for load growth. Wellsboro Statement No. 4 – Direct Testimony of Craig Eccher ("Wellsboro Statement No. 4") at 7. Overall sales are projected to go from 106,161,461 kWh in the 2018 to 107,825,923 kWh for both 2019 and 2020. Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R). Additionally, the Company projects a flat customer count of 6,337 for the FTY and FPFTY, in line with the Company's customer count in the HTY. *Id.*, Schedule C5 (W).

Initially, I&E rejected Wellsboro's projection of a flat customer count from the HTY and proposed an increase to FPFTY present rate revenue from $5,132,321 to $5,168,495, an increase of $36,174. I&E Statement No. 3, Exhibit No. 4, Schedule 7. This projection was based on I&E witness Cline's projection of an increase of 18 customers in the FTY and 18 more customers in the FPFTY.

On Rebuttal, Wellsboro witnesses further explained why Mr. Cline's present rate revenue adjustment was inaccurate. Company witness Farnsworth testified to the Company's customer count as of October 2019, which showed no growth from December 2018. Wellsboro Statement No. 6-R – Rebuttal Testimony of Barney Farnsworth ("Wellsboro Statement No. 6-R"). Mr. Farnsworth also referred to a new interconnection application for a large customer proposing to install a 1.5 MW AC solar array. *Id.*

On Surrebuttal, Mr. Cline withdrew his recommendation to increase present rate revenue by $36,174. I&E Statement No. 3-R at 10.

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. Wellsboro Statement No. 1 at 2; Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R). In keeping with Commission regulations, Wellsboro has provided detailed data for the HTY ending December 31, 2018. Wellsboro Statement No. 1 at 9-10.

Wellsboro's final claimed rate base of $14,614,186 reflects all adjustments adopted by the Company in this proceeding. Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R). 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. Wellsboro 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 $29,325,470 is based on projected plant in service at the end of the FPFTY. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedules C1-6 (W), C2 (W), C3 (W), E-1A (W). OCA witness Morgan alleges that the Company's plant in service and accumulated depreciation calculations for the FPFTY do not appropriately reflect plant retirements. OCA Statement No. 2 at 4. OCA witnesses also 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.

1. Adjustments for Plant Retirements

OCA witness Morgan observes that the Company's calculation of Plant in Service did not reflect plant retirements. OCA Statement No. 2 at 4. Mr. Morgan added that any adjustment to Plant in Service for retirements would require a parallel adjustment to accumulated depreciation.

Id. In total, this proposal results in a $1,070,430 adjustment to Plant in Service and a $1,111,730 adjustment to accumulated depreciation. *Id.* at 5.

These parallel adjustments do not result in a material impact on the Company's rate base claim. The Company recommends approval of its Plant in Service and Accumulated Depreciation calculations without modification.

2. 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 Pa. PUC v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Order Entered October 25, 2018) ("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 ($27,455,940 per OCA's adjustment for retirements) with the plant in service balance at the end of the FPFTY on December 31, 2020 ($28,255,040 per OCA's adjustment for retirements). *See* OCA Statement No. 2, Schedule LKM-2. The result is a $399,550 downward adjustment to Wellsboro's claim for plant in service.[6]

[6] 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. *See* Wellsboro Statement No. 1-R at 12-13. 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. *Id.*

OCA's primary argument is that Wellsboro's 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 on the assumption that customers will be paying for plant that is not yet in service. Specifically, OCA witness Sherwood argues that Wellsboro 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 accepted 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 the Act of February 14, 2012, Pub. L. 72, No. 11 ("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. <u>The Use of End of Test Year Plant Balances Is Consistent with the Policy Underlying Act 11.</u>

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 Distribution System Improvement Charge ("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 half of Wellsboro's planned $1,599,100 in plant additions to count toward the Company's original plant in service. *See* OCA Statement No. 2, Schedule LKM-2.

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* Wellsboro Statement No. 1-R at 12-13.

This approach is inconsistent with the purpose and policy underlying Act 11. OCA has provided no sound 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* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W). 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 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's decision is currently under legal challenge by OCA. OCA Statement No. 2 at 2. Regardless of the status 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 includes an accumulated depreciation of $15,178,447 for the FPFTY. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W). As described by Wellsboro witness Gorman, accumulated depreciation is calculated by adding annual depreciation expense at each year-end and subtracting retirements to the previous year-end balance. Wellsboro Statement No. 1 at 16.

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 include removal of plant retirements and be based on an average of the beginning-of-year and end-of-year FPFTY plant balances. OCA Statement No. 2 at 4; Schedule LKM-2. OCA's FPFTY average balance calculation of $27,855,490 resulted in a $265,988 reduction in accumulated depreciation amount from OCA's initial adjustment for retirements, for total accumulated depreciation of $13,800,728. OCA Statement No. 2, Schedule LKM-2.

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 of plant in service. As stated above, the Company contends that original cost of plant in service should be calculated based on the FPFTY year-end balance, consistent with the Commission's holding in the UGI Order.[7]

D. ADDITIONS TO RATE BASE

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

1. Materials & Supplies

As stated above, the Company agreed to a Materials and Supplies adjustment proposed by OCA and I&E, reducing its claimed increase from $245,607 to $208,533. Wellsboro Statement No. 1-R at 6; *see also* I&E Statement No. 3 at 7; OCA Statement No. 2, Schedule LKM-4; and I&E Statement No. 3-R at 4.

2. Accrued Pension/OPEB Liability

In its filing, the Company proposed a reduction to rate base for Accrued Pension / OPEB liability. *See* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W). This reduction reflects the excess of amounts charged to expense over amounts paid (negative balance). *Id.*

[7] OCA's "averaging" adjustment to Accumulated Depreciation must be rejected for both original plant in service and accumulated depreciation. 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.

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 $388,475 to rate base. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W). The Company derived the CWC by using the widely-accepted formula of 1/8 of non-fuel cash operating costs. Wellsboro Statement No. 1 at 18.

I&E and OCA do not oppose the 1/8 method proposed by the Company. 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 28; 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* Wellsboro Statement No.1-R at 6, 11. 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. *See* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W).

1. Customer Deposits

As stated above, OCA proposed a $5,810 adjustment to Customer Deposits, which the Company accepted. *See* OCA Statement No. 2 at 7; *see also* Wellsboro Statement No. 1-R at 13.

2. ADIT and EDIT

ADIT addresses the difference between actual tax liability for accumulated depreciation paid by Wellsboro and the amount of tax expense for accumulated depreciation paid by ratepayers in the revenue requirement. Wellsboro Statement No. 1 at 17. 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 $40,701 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 Wellsboro's actual tax Federal tax expense (i.e., based on double declining balance method), times the current Federal income tax rate. Wellsboro Statement No. 1 at 17; *see also* Wellsboro Statement No. 1, Schedule C1-6 (W), 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. Wellsboro Statement No. 1 at 17. The EDIT is computed on Schedule C1-6 (W), lines 34-39 and carried up to Schedule C1-6 (W), 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 (W), line 40) is carried forward to reduce Income tax expense (Schedule C1-4 (W), 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 AS TO RATE BASE

For the reasons fully explained above, the Company's final claimed rate base of $14,614,186 is reasonable and, therefore, should be accepted.

V. REVENUES

Wellsboro's anticipated system usage is projected to remain relatively flat, at 106,161,461 kWh in 2018 and 107,825,923 kWh in 2020. Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R). Under present rates, this will reduce distribution revenues from $5,305,912 in 2018 to $5,247,047 in 2020. *Id*. Wellsboro's testimony explained a variety of factors that are impeding growth. *See* Wellsboro Statement No. 4 at 6-7.

In Direct Testimony, I&E initially challenged Wellsboro's revenue calculations pertaining to customer counts and projected revenue for Forfeited Discounts. As stated in Section III, *supra*, I&E withdrew its objection to Wellsboro's calculations pertaining to customer counts. The other issue – Forfeited Discounts – remains contested and is addressed below.

A. FORFEITED DISCOUNTS

For 2020, the Company claimed $35,443 in revenue Forfeited Discounts (late payment charges). Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule B6 (W).

In response, I&E witness Cline proposed an adjustment to the Company's claim. Mr. Cline noted that Wellsboro's revenue claim for Forfeited Discounts was the same under both present and proposed rates. I&E Statement No. 3 at 18. Mr. Cline proposed that the Company's claim for Forfeited Discounts be increased by $1,734 to $37,177 for the FPFTY. I&E Statement No. 3 at 19. Specifically, Mr. Cline recommended that the final Forfeited Discounts amount reflect the same percentage of the Company's projected revenue with final-approved rates as it does for projected revenue under present rates. I&E Statement No. 3 at 20; I&E Statement No. 3-R at 11.

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 in approximately the same amount. Wellsboro 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. Wellsboro Statement No. 1-R at 7. Because Uncollectible Accounts expense may increase at a similar or greater rate than revenue from Forfeited Discounts, I&E's adjustment should be rejected.

In the alternative, if the Commission approves I&E's revenue adjustment for Forfeited Discounts, the Company requests that the Commission 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 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 undue reliance on outcomes or results-oriented review of managerial decisions, which would find imprudence merely because an intended result was not achieved. *See 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 are reflected in the Company's initial filing. *See* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedules B1 (W) - C5 (W). 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 Wellsboro 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 accepted.

A. COMPANY PROPOSAL

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

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:

- Operations & Maintenance ("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.

Wellsboro Statement No. 1 at 11. Schedule C1-1 (W) shows historical O&M costs on a detailed basis but reflects the as-filed projected changes for the FTY and the FPFTY.[8] Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1-1 (W).

On Rebuttal, the Company modified its total expense claims to align with updated projections based on year-to-date ("YTD") data for the FTY through September 30, 2019. *See* Section VI.A.2, *infra*. The aggregate updated expense claim is provided in Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R).

The Company's O&M expenses for the HTY totaled $8,393,703. *See* Wellsboro Statement No. 1, Exhibit__(HSG-1R), Schedule C1 (R). Subtracting purchased electricity, the distribution-only O&M total was $2,673,265. *Id.* The Company's total distribution-only O&M expense claim for the FPFTY is $2,874,643. *Id.* Total distribution-only expenses for the HTY (including

[8] As noted above, only Schedule C1 was updated to reflect the adjustments accepted by the Company's Rebuttal Testimony. *See* Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R).

depreciation and taxes other than income) was $4,174,508. *Id.* Total distribution-only expenses for the FPFTY (including depreciation and taxes other than income) at present rates is projected to be $4,671,367. *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. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W), at 3-4 (showing adjustments to the FTY revenues). 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 on a total expense basis. For example, Wellsboro witness Farnsworth testified about movement from Account 590 (Maintenance Supervision & Engineering) and Account 588 (Miscellaneous Distribution Expense) due to an employee spending more time than anticipated on work that is booked to Account 588. Wellsboro Statement No. 6-R at 8-9. While there is necessarily movement between accounts throughout the year, the Company strives to operate within the budgeted total expenses.

In estimating costs for the FPFTY, the Company's management relied on its years of experience evaluating year-to-year changes in labor, benefits, materials, and outside contractor costs. *See* Wellsboro Statement No. 6-R at 4; Tr. 176-77. 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 Revised 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).

As seen on Main Brief Table 1 below, the Company is tracking below its planned expenditures for 2019 as reflected in the FTY in the initial filing. *See* Wellsboro Statement No. 1-R at 4.

Main Brief Table 1

Account	2019 Actual 9 months	Annualized	FPFTY	Claim	Difference
580	63,103	84,137	86,662	106,704	(20,042)
583	29,231	38,975	40,144	39,061	1,083
585	2,993	3,990	4,110	3,525	585
586	51,452	68,603	70,661	28,558	42,103
587	7,876	10,502	10,817	8,672	2,145
588	169,106	225,474	232,239	219,007	13,232
589	15,997	21,329	21,969	28,119	(6,150)
590	47,530	63,373	65,275	80,232	(14,957)
591	165	220	227	0	227
592	8,417	11,222	11,559	13,898	(2,339)
593	422,595	563,460	580,364	669,615	(89,252)
594	18,076	24,101	24,824	35,032	(10,208)
595	14,762	19,683	20,273	17,028	3,245
596	147	196	202	216	(14)
597	46,148	61,531	63,377	47,852	15,525
902	4,586	6,115	6,299	11,470	(5,171)
903	462,230	616,307	634,796	542,467	92,329
904	15,000	20,000	20,600	20,600	(0)
908	3,651	4,867	5,013	19,197	(14,184)
920	332,763	443,683	456,994	582,942	(125,948)
921	46,869	62,492	64,367	140,595	(76,228)
923	84,532	112,710	116,091	101,764	14,327
924	44,637	59,516	61,301	59,225	2,076
928	78,161	104,215	107,341	107,341	(0)
930	62,287	83,050	85,541	102,842	(17,301)
931	1,196	1,594	1,642	2,575	(933)
932	51,409	68,546	70,602	90,199	(19,597)
	2,084,919	2,779,892	2,863,289	3,078,736	(215,447)
2016 Rate Case			(68,710)		(68,710)
			2,794,579	3,078,736	(284,157)

Based on most recent YTD data (through September 30), total 2019 O&M costs are, when annualized, projected to be $2,779,892. After adding the 3% inflation factor, and removing the expense for amortization of 2016 Rate Case Expense, this results in an annualized projection of $2,794,579. This is $284,157 less than the Company's FPFTY claim of $3,078,736. As described in Section X, *infra*, accepting the reduced FPFTY expenses projection still results in the Company's full adjusted claim of $999,999 being conservative and below needed revenues.

While Wellsboro proposes to reasonably adjust its O&M expense based on actual FTY data, 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." Wellsboro Statement No. 1-R at 11. Similarly, I&E made selective adjustments. Wellsboro Statement No. 1-R at 3. Mr. Farnsworth explained his disagreement with the approach taken by OCA and I&E as follows:

> The expense adjustments from the OCA and I&E witnesses generally focus on individual accounts, and they ignore the Company's success in managing overall costs very close to its budgeted costs. For example, if the Company's actual expense for one category, such as miscellaneous distribution expense, runs below budgeted costs in the Future Test Year ("FTY"), then OCA and/or I&E would recommend a downward adjustment to the FPFTY. But on the other hand, if actual expenses for another expense, such as outside services, run above budgeted costs for the FTY, this overage would not likely be considered in conjunction with the shortfall for miscellaneous distribution expense.

Wellsboro Statement No. 6-R at 4. Mr. Farnsworth explained how this granular approach raises unique challenges for Wellsboro:

> For a smaller utility like Wellsboro, this approach presents real challenges because the Company shifts resources and priorities during the year as operational needs develop. Expense amounts can move between General Ledger accounts based on the specific work to be performed. This is unlike my experiences working at larger utilities where employees were dedicated to specific functions. The approach of the OCA and I&E actually penalizes the Company for being responsive and for applying resources where most needed.

Id. As seen by the YTD data provided by the Company, and the testimony of Mr. Gorman and Mr. Farnsworth, the Company has conservatively managed its resources, consistent with its managerial discretion and the needs of smaller public utility to nimbly reallocate resources as issues arise. Based on the Company's YTD data, the Company has adjusted its operating expense claim from $3,078,736 to $2,874,643 and its total expense claim (including depreciation expense and taxes other than income) from $4,935,200 to $4,730,367. *See* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1 (W); *cf.* Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R). As explained in Section X, *infra*, this still results in a total revenue requirement exceeding the Company's $999,999 requested increase. Consequently, the Commission should deny I&E's and OCA's expense adjustments and approve the Company's full expense claim as stated in its Rebuttal Testimony.

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 8. 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 9.

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 Wellsboro's 2020 budget. While fluctuations may occur on an account-by-account basis, developing FPFTY O&M 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 both past experience and confirmed by the Company's 2020 budget.</u>

Wellsboro witness Gorman explained in his Rebuttal Testimony that growth in costs cannot be "known with certainty, but can be reasonably estimated." Wellsboro 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 compiling the rate filing, the Company reviewed both inflation data and historical expense increases.

The Company used the PPI as a guideline in forming its 3% inflation projection. OCA Statement No. 2 at 8. This percentage selected by the Company is reasonable and, as detailed below, comports with Wellsboro's historic trends.

Historical O&M data indicates that the Company's selection of a 3% escalator is appropriate. As seen in Schedule C1-1 (W), actual historic O&M expenses show an increase of over 18% from 2015 to 2018 (the last year full expense data is available) and 24% from 2012 to 2018. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W). As explained by Wellsboro witness Eccher in Direct Testimony:

> Mr. Gorman's Exhibit __ (HSG-1), Schedule C1-1 (Rev1) provides an illustration of how our actual expenses increased from calendar year 2015 through calendar year 2018. In that time period, our Operating & Maintenance Expenses increased by $262,806, from $749,987 in 2015 to $1,012,793 in 2018. Similarly, our Administrative & General Expenses increased by $52,048, from $991,061 in 2015 to $1,043,109 in 2018. Our Customer Account and Collection Expenses also rose by $103,324 from 2015 to 2018.

Wellsboro Statement No. 4 at 5. It is clear that, historically, 3% is a reasonable and conservative projection of the Company's increase in O&M costs.

Mr. Farnworth in Rebuttal Testimony also specifically affirmed the reasonableness of the 3% escalator in the FPFTY:

> **Q. Does Wellsboro expect its overall expenses to remain the same in 2020?**
>
> A. 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.

Wellsboro Statement No. 6-R at 5. 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. Farnsworth also testified on rejoinder that the Company anticipated increases to salaries, benefits, and vendor costs – specifically referencing a notice from the Company's primary source of materials that prices would be increasing by 2-5%. Tr. 179-182. On Rejoinder, Mr. Farnsworth stated as follows:

> Q. When did you become aware of this document [from Hubbell Utility Solutions]?
>
> A. Just recently we had a vendor in that provides our material and purchases from Hubbell. And conversations we had with him at that point, if he had any further information at that point if we're going to be seeing any kind of increases. He told us, yes, there was.
>
> Q. Does the document provide a rate increase?
>
> A. Yes, it does.
>
> Q. What is that range?
>
> A. Two to five percent.
>
> Q. And what are the products that Hubbell provides the Company?
>
> A. Anywhere from wire to construction material… pole construction, transformer connections, any of that stuff. It's not the transformers themselves, but all the other material required to put them together.

Tr. 181. Mr. Farnsworth also referenced a price increase notice from another vendor. Tr. 182.

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

Q. Did the company request . . . inflation in its 2020 budget?

A. Yes, we did.

Tr. 179. 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 (W) shows the escalation of wages and materials that was assumed in the FPFTY. Wellsboro Statement No. 1, Exhibit__(HSG-1), C1-1 (W), at 3-4. Knowing that expenses fluctuate on an account-by-account basis, Wellsboro's 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 Wellsboro. 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 Wellsboro's case, the 2020 projections will be used to form the rates that must meet the Company's expenses in 2020, 2021, and each year until Wellsboro files its next rate case. To insist that the Company use 2019 data in its projections for 2020 denies Wellsboro the benefits of a *fully projected* future test year. OCA's arguments should be rejected, and the Company's inflation adjustment should be accepted 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 9. 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 at 3. 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 Wellsboro 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 supports the Company's revised FPFTY O&M expense claim. While the Advocates have proposed a variety of adjustments to individual accounts, they have not disputed the fact that Wellsboro's revised expense claim was derived from 9-month YTD 2019 data, as described herein, *supra*. For these reasons, it is appropriate to approve Wellsboro's revised 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 Expense (Account 593)

In its Direct Testimony, Wellsboro included a claim for Maintenance of Overhead Lines of $669,615 for the FPFTY. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W).

Account 593 includes expenses for Wellsboro's right of way inspections, tree trimming, and other vegetation management. Vegetation management is directly connected with customer service reliability. A primary reason that Wellsboro's costs in this account have increased relates to maintenance and repairs due to tree damage from the Emerald Ash Borer. Wellsboro Statement No. 6 at 7-8. The Emerald Ash Borer causes impacted trees to become more of a significant risk to distribution lines. As stated by Wellsboro witness Farnsworth, "enhanced tree growth and the Emerald Ash Borer threats . . . continue to escalate Wellsboro's tree-trimming costs. Tree contractor costs are expected to increase in 2020 compared with 2019 costs." Wellsboro Statement No. 6-R at 7. Mr. Farnsworth explained:

> Wellsboro's annual tree-trimming contractor costs have increased by over $100,000 due to contractor cost increases over the past three years, the Emerald Ash Borer removal, and enhanced tree growth due to wet growing seasons over the past two years. Vegetation management activities are particularly critical in a rural territory like Wellsboro's, which has many miles of off-road rights-of-way carrying poles and wires.

Wellsboro Statement No. 6 at 8. As explained by Mr. Farnsworth on Rejoinder, danger tree removal is important to maintaining reliability of the Company's distribution system. Tr. 176-177. There have been increases in outages attributed to danger trees. Tr. 176.

Wellsboro 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 the Commission's Bureau of Technical Utility Services ("TUS"). Wellsboro Statement No. 6-R at 7; Tr. 177. As stated by Mr. Farnsworth, "The inspection and management program is necessary to efficiently identify and target vulnerable facilities for maintenance, including tree-trimming. This expense is not decreasing; in fact, it may grow beyond what we projected for 2020." Wellsboro Statement 6-R at 7. Wellsboro 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 Wellsboro's contracts. Wellsboro Statement No. 6 at 8. In Rebuttal Testimony, Mr. Farnsworth stated that the Company's 2020 vegetation management budget "will be $60,000 higher than our 2019 trimming budget." Wellsboro Statement No. 6-R at 8.

I&E proposed a reduction of $20,535 to recommend a claim of $649,081 based on averaging the last three years' labor costs for maintenance lines – storm expense (Sub-account 593.51). I&E Statement No. 1-SR at 27. On Rebuttal, Wellsboro witness Farnsworth accepted I&E's proposed adjustment for a claim of $649,081, noting that the Company's FTY budget included $20,600 of duplicative costs. Wellsboro Statement No. 6-R at 6.

However, while Mr. Farnsworth accepted I&E's Direct Testimony adjustment, I&E proposed a further adjustment reducing the Company's claim to $580,364. *See* I&E Statement No. 1-SR at 28. I&E mistakenly concluded that Wellsboro was revising its claim to $580,364. *Id.* This position should be rejected as Mr. Farnsworth's Rebuttal testimony did not reduce the claim to $580,364. Wellsboro Statement No. 6-R at 7-8. To the contrary, Mr. Farnsworth clearly explained that annualizing the 9-month data would not reflect actual year-end costs for Account 593 due to tree-trimming costs to be incurred in the 4th quarter. *Id.* On Rejoinder, Mr. Farnsworth further explained that $65,000 of additional funds that had been budgeted for 2019 were expected to be spent at the end of the year, which would increase the FTY projection above the annualized amount. Tr. 176; Wellsboro Statement No. 6-R at 7. Mr. Farnsworth additionally clarified that the YTD FTY expense for Account No. 593 reflected a non-recurring employee absence that reduced overhead costs that would have been recorded to Account 593. *See* Wellsboro Statement No. 6-R at 5; *see also* Wellsboro Statement No. 5-R at 3. Finally, Mr. Farnsworth testified that the Company received bids from contractors for 2020 tree-trimming work on December 5, 2019 showing increased costs from 2019. Tr. 186-87.

The Company requests acceptance of this expense claim to fulfill its duty to provide safe and reasonably reliable service to its customers. 66 Pa. C.S. § 1501. The Company is required to 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. I&E's adjustment would understate future tree-trimming costs based on non-recurring events in the FTY. Accordingly, I&E's adjustment should be rejected, and Company's original claim should be accepted.

OCA initially recommended reducing the Company's claim by $137,354 to $523,261. OCA Statement No. 1 at 8. However, in Surrebuttal Testimony, OCA witness Sherwood updated her recommendation to $563,460 based on the annualized YTD number as of September 30, 2019 (without an inflation adjustment). OCA Statement No. 1-SR (Revised) at 9. For the same reasons detailed in the above response to I&E's adjustment, OCA's adjustment should be denied.

2. Operations Supervision & Maintenance Expense (Account 580)

The Company's initial claim for Account 580 was $106,704. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W). I&E witness Patel proposed a reduction of $27,724 for a total allowance of $86,662. I&E Statement No. 1 at 13. I&E bases this argument on the annualized 6-month actual FTY plus a 3% increase for employee payroll and benefits. I&E Statement No. 1-SR at 15. Mr. Patel had disputed the Company's projections of its expense for filling the position of VP Engineering & Operations/COO.

On Rebuttal, the Company presented updated 9-month FTY data showing year-to-date expenditures of $63,103. Wellsboro Statement 1-R at 4. Annualized, with a 3% increase added, this results in a projection of $86,662. *Id.*

The Company requests that the Commission approve the Company's original expense claim of $106,704. As indicated in the response to discovery, the expense for this account varies due to the projects, maintenance, and repairs occurring from year to year. *See* I&E Statement No. 1, Exhibit No. 1, Schedule 2. The Company has detailed significant ongoing and escalating operational activities, including accelerating tree-trimming cycles from the current 7-8 year cycle to a 5-6 year cycle. *See* Wellsboro Statement No. 6 at 8. If the Commission denies Wellsboro's proposal to adopt an O&M adjustment based on the overall YTD FTY expense, the Commission should consider the trends likely to increase FTY costs going forward.

3. Miscellaneous Distribution Expense (Account 588)

The Company's claim for Account 588 was $219,007. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W). I&E witness Patel proposed a reduction of $29,016 for a total of $189,991. I&E Statement No. 1-SR at 20. Mr. Patel stated that the projected increase of "other" expense from the HTY to the FTY due to increase in the training requirements for new employees was not adequately supported. Mr. Patel selected the average "other" expense from 2016-2018 to develop his recommendation.

OCA witness Sherwood recommended a similar adjustment. OCA Statement No. 1 at 6. Ms. Sherwood recommended a reduction of $88,447 for a total allowance of $130,860 – a figure less than half of the actual HTY expense in this category. OCA Statement No. 1, Schedule SLS-1.

Despite OCA's and I&E's arguments, year-to-date data from September 30, 2019, indicates that Company expenses are running ahead for this account. The actual expense data for Account 588 totals $169,106. Annualized, plus the 3% inflation adjustment, brings this figure to $232,239 for the FPFTY – $13,232 above the Company's claim. Wellsboro Statement No. 1 at 4. This is consistent with the Company's expectation that there will continue to be retirements and employee turnover, meaning these expenses are not isolated events but will be recurring. As Mr. Farnsworth stated on Rejoinder:

> Well, we got several new employees at work. We got several that are . . . going to be retired here . . . in the next five years. We have potential to lose almost four people within the organization and if we go out ten years we're potentially going to lose eight [of] our employees, which is essentially 50 percent of our workforce. With that we've got to continue to stay current with our training.

Tr. 178. Mr. Farnsworth emphasized the need to continue to stay current with industry and technology developments. *Id.* As indicated above, with Wellsboro's anticipated turnover in the next few years, training expenses of this nature are likely to recur often.

Additionally, as noted by Mr. Farnsworth, Account 588 is running ahead of projections in almost the same amount as Account 590 is running behind projections, due to a Company employee who recorded more time on Account 588 activities than anticipated during the first three quarters of 2019. Wellsboro Statement No. 6-R at 9. In light of the information presented above, the Company's Miscellaneous Distribution Expense claim should be accepted by the Commission.

4. Maintenance Supervision & Engineering (Account 590)

For Account 590, the Company claimed $80,232. I&E Statement No. 1 at 11. As with other accounts, the Maintenance Supervision & Engineering account reflects employee labor and overhead for activities allocated to this account. Wellsboro Statement No. 6-R at 8. As operational needs change during the year, the expenses in this account can vary. *Id.* (noting that "labor and benefits for our employees are booked to specific General Ledger accounts based on the type of work that they are performing").

Mr. Patel argued on Direct Testimony that actual 6-month data supported a lower allowance of $60,661, a reduction of $19,571 to the Company's claim. I&E Statement No. 1 at 12.

However, actual 9-month data for the FTY, provided by the Company in Rebuttal Testimony, supports a projected FPFTY claim of $65,275. On Surrebuttal Testimony, Mr. Patel accepted the Company's projected FPFTY claim of $65,275.

The Company explained in a discovery response that the expense increase from the HTY to the FTY was largely based on filling the vacant position of VP Engineering & Operations/COO. I&E Statement No. 1 at 13; Exhibit No. 1, Schedule 4 at 1-2. Accordingly, as detailed by in Mr. Farnsworth's Rebuttal testimony, the shortfall in Account 590 is related to an employee who spent additional time on an Account 588 task, reducing Account 590 expenditures and increasing Account 588 expenditures (which will exceed FTY projections by $13,232 based on annualized 9-month FTY data). *See* Wellsboro Statement No. 6 at 9. Because of the shift in costs between Accounts 588 and 590, approving I&E's adjustments to both accounts would double count the expense reduction. Accordingly, the Commission should accept the I&E adjustment for Account 590 only if the Company's claim for Account 588 is accepted. Otherwise, the adjustment should be rejected.

5. Safety & Communication (Account 908)[9]

The Company's claim for Accounts 908-913 is $19,197. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W). I&E witness Patel proposed a reduction of $10,282 for an allowance of $8,915 based on normalized the Company's tri-annual Eligible Customer List expense and eliminating expense for advertising. I&E Statement No. 1 at 20-21. OCA witness Sherwood also normalized the tri-annual Eligible Customer List expense, but allowed the HTY advertising and customer assistance expense for a reduction of $9,941, or an allowance of $9,235. OCA Statement No. 1 at 9.

[9] The Safety and Communications account is generally referred to as "Account 908" but actually is an aggregate of Accounts 908-913. *See* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W).

On Rebuttal, the Company provided year-to-date data through September 30, 2019, resulting in an FPFTY projection of $5,013. Wellsboro Statement No. 1 at 4. On Surrebuttal, Mr. Patel stated that he accepted the updated FPFTY projection, which would reduce his Direct Testimony adjustment from $8,915 to $5,013. I&E Statement No. 1-R at 26.

Although the Company provided updated costs YTD and annualized cost projections as of September 30, 2019, the Company did not modify this expense claim as Mr. Patel suggests. The Company provided the detailed information to support its proposal to adjust total O&M expense based on annualizing the total YTD costs as of September 30, 2019; a proposal that Mr. Patel declined to accept. *See* Wellsboro Statement No. 1-R at 4-5.

Although FTY costs are below projections for Account 908, this shortfall is due in part to reduced demand for energy audits and includes costs for customer service. *See* I&E Statement No. 1, Exhibit No. 1, Schedule 7. The Company's claim for the FPFTY reflected projected amounts for customer assistance and advertising following a rate increase. Accordingly, the Commission should accept only the adjustment to normalize the Company's tri-annual Eligible Customer List expense and reduce that customer service component of the Account 908 claim by $6,497 from $10,815 to $4,318. *See* I&E Statement No. 1 at 20-22. The Company's FPFTY claim for the remaining components, advertising, and customer assistance, should be accepted without modification. *See* I&E Statement No. 1 at 20. This results in a FPFTY expense of $12,694 for Account 908.

6. Office Supplies (Account 921)

Wellsboro has proposed to recover Account 921 costs totaling $140,595. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W). These expenses include office supplies, as well as certain employee recognition expenses and benefits for employees. I&E Exhibit No. 1, Schedule 9 at 14-19. Mr. Patel proposed a reduction of $11,364 to $129,231 which excludes costs for employee recognition events and eliminates any increase from the HTY to the FTY. I&E Statement No. 1 at 26.

On Rebuttal, the Company provided YTD data through September 30, 2019, resulting in an FPFTY projection of $64,637. Wellsboro Statement No. 1 at 4. On Surrebuttal, Mr. Patel stated that he accepted the updated FPFTY projection. I&E Statement No. 1-R at 30.

The Company provided the detailed information to support its proposal to adjust total O&M expense based on annualizing the total YTD costs as of September 30, 2019; a proposal that Mr. Patel declined to accept. *See* Wellsboro Statement No. 1-R at 4-5.

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 I&E recommends disallowing employee recognition events.

Additionally, the fact that costs in the FTY are tracking below budget as of September 30, 2019, is not a reasonable basis to adjust expense for Account 908. As discussed in Mr. Farnsworth's rebuttal testimony, the Company's budgeted costs do not always track in accordance with the budget on a month to month basis. *See* Wellsboro Statement No. 6-R at 4. This reality is evidenced by review of the General Ledger of the Company's HTY expense for Account 908 showing increased costs in November and December. *See* I&E Statement No. 1, Exhibit No. 1, Schedule 9 at 8, 10 (showing increased phone/internet and miscellaneous expense for November 2018 and December 2018).

I&E's adjustment to Account 908 should be denied.

7. Maintenance of General Property (Account 932)

Wellsboro has proposed to recover Account 932 costs totaling $90,199. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W). OCA witness Sherwood proposed an adjustment of $43,242 to result in an allowance of $46,957. OCA Statement No. 1 at 10. To develop her proposal, Ms. Sherwood used a 3-year average of a single component of the Account 932 expense (a sub-account classified as "other") plus FTY expenses for the remaining categories, not including an inflation adjustment. *Id.* at 10.

On Rebuttal, the Company provided year-to-date data through September 30, 2019, resulting in an FPFTY projection of $70,602 for total Account 932 expense. Wellsboro Statement No. 1 at 4.

Ms. Sherwood's recommended FPFTY allowance of $46,957 would not even cover the Company's actual $51,409 expense incurred for Account 932 as of September 30, 2019. Ms. Sherwood's method of adjusting the total Account 932 costs because a single component of the total Account 932 is lower than historic levels is illogical. Moreover, considering that the Company represents that maintenance activities recorded under Account 932 vary from year to year, it is prudent to rely on the Company's budgeted experience.

The Company's $90,199 claim should be accepted.

8. Rate Case Expense

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. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-3 (W).

Neither I&E nor OCA opposed the Company's total rate case expense claim. 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 10.

While historic filing frequency is a factor considered in determining the normalization for rate case expense, 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. Pub. Util. Comm 'n,* 613 A.2d 74, 76 (Pa. Cmwlth. 1992), *aff'd,* 636 A.2d 627 (Pa. 1994). Prior to filing its 2018 rate case, 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.[10]

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.

Wellsboro Statement No. 1-R at 5-6. Mr. Farnsworth 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. Wellsboro Statement No. 1-R at 6; Wellsboro Statement No. 6-R at 6. Mr. Farnsworth further addressed the appropriate normalization period as follows:

> **Q. Are there other reasons justifying a shorter normalization period?**
>
> A. Yes. The electric industry is in a period of transition as distributed generation resources become more economical for customers. Similar to the projects underway in the Citizens' Electric Company of Lewisburg, PA ("Citizens'") service territory, Wellsboro expects its customers to install solar and combined heat & power ("CHP") resources in the years following this rate case. As I discuss further below, Wellsboro very recently received an interconnection application from a large industrial customer proposing to install solar generation. The expectation of

[10] *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.

> revenue loss due to a heightened pace of solar and CHP projects supports a shorter 36-month normalization period for rate case expense.

Wellsboro Statement No. 6-R at 6. Finally, Mr. Farnsworth 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, Wellsboro would have under-recovered its rate case expense by approximately 40%. Wellsboro Statement No. 6-R at 5-6. 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 12-13. 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 settled, not litigated, proceedings. *See* I&E Statement No. 1-SR at 12-13; *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 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 at 4.

C. CAPITAL STRUCTURE

Mr. D'Ascendis proposed to use a hypothetical capital structure for Wellsboro consistent with the average capital structure ratios in his Electric 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 0.62% preferred equity, 50.05% common equity for Wellsboro. *See id.* at 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 4.98% 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; *see generally I*&E Statement No. 2.

E. COST OF PREFERRED EQUITY

Mr. D'Ascendis proposed to use Wellsboro's actual cost of preferred equity of 4.00%, which no party opposed. *See* OCA Statement No. 3 at 3; *see also* I&E Statement No. 2 at 17.

F. 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 Return on Equity ("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, Wellsboro 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.

Notably, because Wellsboro is restricted by the $1 Million cap on its claim, Wellsboro's ROE may not be fully recognized in this case. As previously explained, Wellsboro has supported O&M expenses and other items of its revenue requirement that warrant an increase of approximately $1.1 Million. *See* Wellsboro Statement No. 1 at 2. To comply with the cap, Wellsboro's return on rate base would be reduced. The statements herein about a "fair" return for Wellsboro are based on an unadjusted return on rate base that produces the 10.3% ROE recommended by Mr. D'Ascendis.

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 Wellsboro of 7.33% 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 Wellsboro are significantly below the 9.55% ROE calculated by the Commission for electric utility DSICs 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 proposed increase is only $999,999. 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 Wellsboro. 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 Wellsboro, due to its smaller size. Thus, OCA and I&E's positions based on DCF become farther away from the appropriate ROE for Wellsboro.

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 Wellsboro's 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

Wellsboro 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. Wellsboro's Return on Common Equity Should Be Adopted.

a. <u>Summary of Wellsboro's ROE proposal</u>

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

> My recommendation results from applying several cost of common equity models, specifically the Discounted Cash Flow ("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 2

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 Wellsboro 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-SR 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%.[11]

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

[11] 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 3

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.

Joint Statement No. 2-R at 8 (emphasis added). The referenced financial literature clearly reinforces Mr. D'Ascendis' reliance on multiple ROE models to derive a recommended ROE for Wellsboro.

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* Joint Statement No. 2-R *citing Pa. PUC v. Columbia Water Company*, Docket No. R-2013-2360798 (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 4

<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 Main Brief Table 4, 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 Wellsboro, 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 ("PPL") in 2012 and an ROE of 11% for Aqua Pennsylvania, Inc. in 2008. Joint Statement No. 2-R at 5. Although market conditions may change, no empirical evidence supports adoption of ROEs 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 5

<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. 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"). 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. <u>I&E Unreasonably Excludes Consideration of the Company's Risk Premium Analyses.</u>

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 Main Brief Table 4. *See supra* at 69. 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. Consideration of DCF-Only Results Still Invalidates I&E's ROE Recommendation.

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 Wellsboro 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. 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 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 6.006% 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 the electric proxy groups. *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.

G. MANAGEMENT PERFORMANCE

Wellsboro has demonstrated effective management of operations and costs which warrants a performance adjustment. OCA and I&E are incorrect in their assertions that Wellsboro's 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.[12] *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.

[12] 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."

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.

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

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

In managing operations and costs, Wellsboro 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 Operations Officer Mr. Farnsworth described in his direct testimony, Wellsboro has accomplished the following: (1) low number of customer complaints; (2) favorable customer feedback; (3) high responsiveness to customer support calls; (4) excellent reliability metrics; (5) very low reportable injuries; (6) technological improvements in customer service by offering Smarthub use to customers and completing an Asset Verification Project, which improves outage reporting capabilities (used by approximately one-fifth of Wellsboro's customers); (7) a replacement program to replace all streetlights in its service area with LED lights; (8) tablets are being implemented for field personnel to use for maps and inspections; and (9) continued significant capital investment of approximately $1.25 million annually since the last rate case. Wellsboro Statement No. 6 at 3-5; *see also* Exhibit__(BF-5).

In order to highlight the gravity of the accomplishments Wellsboro has made, a few of these achievements will be explained in more detail. With respect to Wellsboro's low number of customer complaints, for the years of 2016 to 2018, Wellsboro received 13 informal complaints but no formal complaints. *See* Wellsboro Statement No. 4 at 4. Wellsboro's high responsiveness in customer support calls is reflected in Exhibit__(BF-4) attached to Mr. Farnsworth's direct testimony, which shows that, on average, Wellsboro responds to approximately 99% of customer phone calls within thirty seconds.

Wellsboro's significant capital improvements and expansions are the continuation of a long-term effort to replace aging distribution infrastructure, including reconductoring and pole replacements, and installing three-phase tie-points, automating the isolation of faults to reduce outages, and other reliability-enhancing improvements. Wellsboro Statement No. 6 at 5. Wellsboro is also investing approximately $850,000 in the substation and transmission work to facilitate a 115kV transmission line associated with MAIT that will increase the reliability of Wellsboro's electric supply. *Id.* at 6. Wellsboro has continued to invest approximately $1.25 million annually in system replacements and improvements which ultimately help the Company to continue providing excellent and reliable service to its customers. Wellsboro Statement No 6 at 4. Notably, Wellsboro implemented these system improvements through effective management of base rate revenues, without employing a DSIC. *See id.*

All the above discussed performance metrics show Wellsboro's 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 Wellsboro's commitment to providing reliable and quality service to its customers above and beyond what is required by the Public Utility Code. Based on Wellsboro's 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 Wellsboro 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 Wellsboro's efficiency, effectiveness, and adequacy of service, the Company has listed numerous performance metrics and provided evidence in support thereof. The Commission did not require Wellsboro 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 line personnel with tablets. Wellsboro implemented these service enhancements on its own initiative. The Advocates have failed to address whether Wellsboro 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, Wellsboro has provided evidence of performing above and beyond its compliance obligations under the Public Utility Code in greatly increasing the efficiency, reliability, and quality of service through the many listed performance metrics.

H. SIZE ADJUSTMENT

In considering the appropriate ROE for Wellsboro, 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, Wellsboro is a 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 Wellsboro 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 Wellsboro's 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 Wellsboro would understate the ROE demanded by investors. Wellsboro witness Eccher 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.). Wellsboro's 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 Wellsboro than it would larger EDCs.

Wellsboro Statement No. 4 at 6. As summarized by Mr. Eccher, 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.

Joint Statement No. 2 at 42. 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)

Joint Statement No. 2 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 Wellsboro's risk factors turns to whether Wellsboro 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, Wellsboro had a market capitalization of $6.358 million compared with an average company market capitalization of $16,675.447 million for the Electric Utility Proxy Group. *Id.* This amounts to a size difference of 2,622.8x.[13] *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 Group $16.7 billion market capitalization ranked in the 2nd decile, while

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

Wellsboro's \$6.358 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.

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.

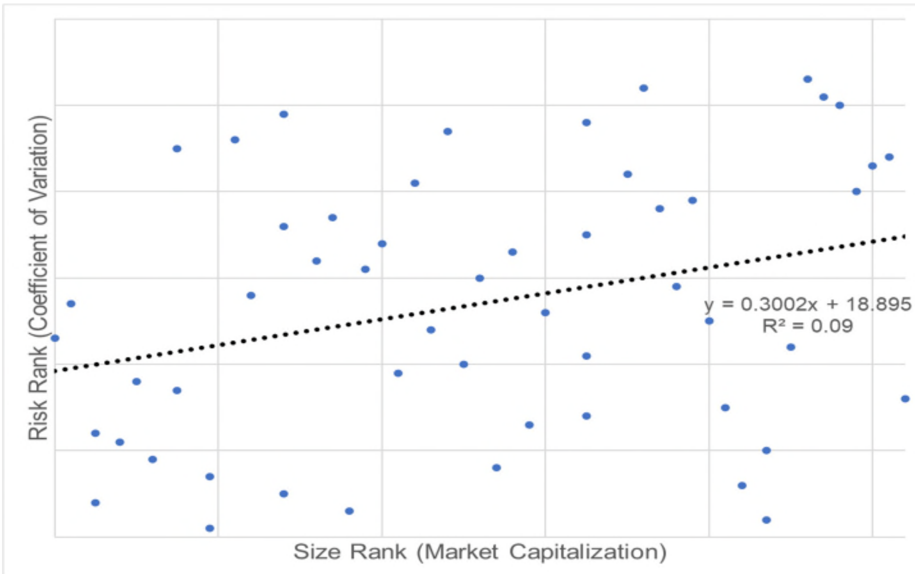
In addition to critiquing Dr. Wong's methods, Mr. D'Ascendis cited to a more recent article by Thomas M. Zepp which also criticized Dr. Wong's study and observed "[t]wo other studies discussed here support a conclusion that smaller water utility stocks are more risky than larger ones. To the extent that 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 6

<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 Wellsboro 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.

I. 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, Wellsboro implemented a voluntary surcharge ("TCJA Voluntary Surcharge") that served as a surcredit to flow back benefits to customers. Joint Statement No. 4 at 13. Wellsboro chose to decrease its distribution rates to reflect the sur-credit 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. 4 at 13. Subsequently, Wellsboro 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, Wellsboro 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. Wellsboro 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.

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 Wellsboro provide the final reconciliation of the TCJA Surcharges at a sooner point before final rates go into effect. OCA Statement No. 2 at 11.

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, Wellsboro 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. Wellsboro Statement No. 1 at 17. 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 (W), line 40) is carried forward to reduce Income tax expense (Schedule C1-4 (W), line 28). Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedules C1-4 (W), C1-6 (W). *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 10.

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.

Wellsboro 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. Wellsboro's Cost of Service Study Is Reasonable and Should Be Adopted.

The purpose of an allocated class cost of service study ("ACOS") is to assign the total distribution revenue requirement of a utility to the rate classes in its Tariff, on a cost-causation basis. Wellsboro Statement No. 1 at 19. 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. 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.*

Wellsboro's ACOS includes the following functions: (1) primary distribution (including substations as well as conductors operating primarily at voltages of > 600V to 12kV 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 21.

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 21-22. Mr. Gorman then assigned or allocated assets and costs, as set forth on Exhibit__(HSG-1), Schedules D (W) through D6 (W) attached to his Direct Testimony. *Id.*

Wellsboro's 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). Wellsboro Statement No. 1-R at 7; *see also* OCA Statement No. 4 at 4.

2. Wellsboro's 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 Wellsboro's ACOS. OCA witness Mierzwa found Wellsboro's primary plant classification as demand-related generally acceptable. He also accepted Wellsboro's 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.

Wellsboro Statement No. 1-R at 13. 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.Wellsboro's 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.

Wellsboro Statement No. 1 at 34. Consistent with these goals, Mr. Gorman evaluated the revenue requirement for each class. Wellsboro Statement No. 1 at 34; *see also* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule E-1 (W). The Company's proposed revenue allocation is set forth in Schedule B6-4 (W). *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 POL to CS and MSL. I&E Statement No. 3 at 28.

- **OCA.** OCA witness Mierzwa proposed that no class should receive a decrease. Mr. Mierzwa proposed to re-allocate the Company's proposed decrease to POL among other classes. OCA Statement No. 4 at 18-19.
- **OSBA.** OSBA witness Kalcic proposed that no class should receive a decrease. Mr. Kalcic proposed to re-allocate the decrease to POL proposed by the Company to RS and IS. OSBA Statement No. 1 at 8. 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. Mr. Kalcic claimed this was a more appropriate measurement than the relative rate of return guideline used by the Company. OSBA Statement No. 1 – Direct Testimony of Brian Kalcic ("OSBA Statement No. 1") at 6.

3. Wellsboro's Revenue Allocation Is Reasonable and Consistent with Controlling Precedent.

The Company maintains that a rate decrease for rate class POL 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 the 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." UGI Order at 164. The Commission adopted the ALJs' recommendation and approved UGI's revenue allocation, including the decrease for GS-4.

Similarly, the Commission should approve Wellsboro's 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." Wellsboro Statement No. 1-R at 8. In Surrebuttal, 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.

Wellsboro Statement No. 1-SR – Surrebuttal Testimony of Howard S. Gorman ("Wellsboro 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.

Wellsboro Statement No. 1-R at 15.

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 differences in the small classes," the Company's revenue allocation proposal met Mr. Kalcic's test. Wellsboro Statement No. 1-R at 15.

C. RATE DESIGN

1. Summary of Proposed Rate Design

Wellsboro's proposed rates for each rate class are set forth in Schedules B6-3 (W) and B7 (W) (in table format). In most respects, Wellsboro's rate design is consistent with prior rate designs approved by the Commission. However, to ensure the Company reasonably recovers its fixed costs, Wellsboro 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. The purpose of this design is to ensure recovery of the basic, minimal amount of demand used by virtually all residential and commercial ratepayers in order to align revenues and costs more closely and to help stabilize customers for both Wellsboro and its customers. Wellsboro Statement No. 1 at 38-40.

Specifically, the Company proposes to include $1.48 of demand costs in a $13.40 customer charge for residential customers and a similar structure for other customer classes.[14] Wellsboro Statement No. 1 at 43-44; *see* Exhibit__(HSG-1), Schedule E1-C (W).

This proposed rate design reflects several developments since Wellsboro's last rate case in 2016. First, Wellsboro is now functioning 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*. Wellsboro Statement No. 1 at 38. Second, in 2018, the General Assembly passed 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"), 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

[14] Under the Company's original filing, both demand costs and customer charges would have been greater. However, due to the revised filing that sought a revenue increase of $999,999, the customer charges and demand calculations have also been adjusted. In Mr. Gorman's Direct Testimony, he refers to these reduced figures as connected to the "Scaleback revenue requirement." *See* Wellsboro Statement No 1.

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, Wellsboro proposes to include a modest portion of demand-related costs reflecting minimum demand for Residential and Commercial customers in the respective fixed monthly charges.

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

As set forth below, multiple factors support Wellsboro's 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 RS (Residential Service), RSAE (Residential Service All Electric), NRS (Non-Residential Service), and NRH (Non-Residential Service Space Heating), Wellsboro proposes to increase the monthly charge from $10.79 to $13.40, with the balance of the revenue target to be recovered from the volumetric kWh charge. *See* Wellsboro Statement No. 1 at 43-44; Exhibit__(HSG-1), Schedule B7 (W). 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 $11.92 of the $13.40 customer charge.
- **Demand-related costs.** The demand-related costs total to $1.48 of the $13.40 and represent a portion of demand costs. Specifically, $1.48 represents the cost of 0.09 kW for RS, RSAE, and NRS, based on the $16.33 per kW-month demand costs applicable to those classes, as set forth in the ACOS. Statement No. 1, Exhibit__(HSG-1),

> Schedule E1-B (W). For NRH, the demand costs are slightly higher, so the demand portion of the fixed charge represents a slightly different amount of demand (i.e., not precisely 0.09).

Wellsboro Statement No. 1 at 43-44.

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. In conducting this analysis, Mr. Gorman found that 96.6% of Residential monthly customer bills had demand of 0.1 kW in 2018. Wellsboro Statement No. 1 at 43. Additionally, more than 98% of Residential customers had demand of 0.10 kW in at least one month during 2018. *Id.* Thus, if a cost based demand charge of $16.33 per kW-month was incorporated into the rate structure, at least 96.6% to 98% of the customer bills would assess a higher level of demand and demand costs than what Wellsboro is proposing to include in the fixed charge (depending on whether monthly demand or highest annual demand was used). Thus, the Company's proposal to allocate the cost for 0.09 kW-demand ($1.48 per month) to the Residential customer charge shifts only the minimum demand costs to the fixed charge. *See id.*

For commercial customers, the structure is similar. The Company proposes to increase the monthly fixed charge from $32.03 to $35.00 for CS (Commercial Service) and from $45.81 to $58.00 for CSH (Commercial Service Space Heaters), structured as follows:

- **Customer-related costs:** $20.71, representing the costs that have historically been included in the fixed monthly charge. Statement No. 1, Exhibit__(HSG-1), Schedule E1-C (W), line 27.

- **Demand-related costs:** The remainder of the fixed monthly charge goes toward demand-related costs. CS and CSH customers are required to have 7 kW of demand. Wellsboro Statement No. 1 at 45, 46.
    - For CS, which has a separate demand charge, this means the existing CS demand charge (at the rate proposed by the Company, at $6.60 per Schedule B7) will result in each CS customer paying a minimum of $46.20 in demand charges each month – far too little to cover the actual demand costs incurred by the Company for that customer. Wellsboro Statement No. 1 at 45. Specifically, those same 7 kW of demand are projected to cost the Company over $120.00 (Demand Cost of $17.53 (CS) or x 7 kW) (Schedule E1-B) *Id*. Consequently, the demand *costs* will far outpace the amount the Company collects in demand *charges*. Even when dedicating a small portion of the monthly fixed charge to demand costs, all CS customers will still pay less for demand than they cost the Company for their demand. Consequently, as explained by Mr. Gorman, "the same rationale supporting approval of the Residential monthly charge, including Act 58, applies to the CS monthly charge." *Id.* CSH also has a minimum demand of 7 kW but has no separate demand charge. Because those 7 kW of demand are projected to cost the Company over $120.00 (Demand Cost of $17.64 x 7 kW), demand costs will still far outpace the demand component of CSH's fixed monthly charge.
    - Similar to CS, all CSH customers will still pay less for demand than they cost the Company for their demand. Consequently, like CS, it aligns with cost-of-service ratemaking principles and can be supported by the same rationale that

supports approval of the Residential monthly charge. Wellsboro Statement No. 1 at 46.

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

As explained by Mr. Gorman, "costs to serve customers are mostly based on the peak demand that customers may impose on the system." Wellsboro Statement No. 1-R at 39. In other words, for a system like Wellsboro, demand is the primary factor allocating costs.

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. Wellsboro believes that incorporating demand costs into the monthly customer charge will be easier for residential customers to understand. To recognize cost of service in the proposal, Wellsboro chose a demand level attained by 98% of the RS accounts at least annually, and over 96.6% monthly. This also reflects a gradual approach to making this transition. Wellsboro Statement No. 1 at 43.

The Company's proposal balances many ratemaking goals – cost of service, simplicity, and gradualism. It will also enhance revenue stability for Wellsboro. The monthly customer charges are just, reasonable, and appropriate. By including only the portion of demand charges that effectively functions as the minimum demand for the affected customers, the Company realistically reflects cost-of-service principles while supporting rate stability and gradualism. Wellsboro Statement No. 1 at 41, 43.

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 7

#	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 Wellsboro Statement No. 1 at 40-42.

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 30-31. 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 31. 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. Mr. Gorman stated:

> [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.

Wellsboro Statement No. 1 at 38. Including the minimum customer demand in the fixed customer charge 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. Wellsboro's Scale Back Proposal

If the Commission approves a revenue requirement for Wellsboro that is less than Wellsboro's full requested increase, Wellsboro recommends that rates for each class be scaled back based on the cost of service study approved by the Commission in a proportional manner. Wellsboro 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. *Id*.

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-SR at 17.
- **OCA.** OCA proposed a proportionate scale back limited to the increase for each rate class. OCA Statement No. 4 at 19.
- **OSBA.** OSBA witness Kalcic recommended that scale backs be done proportionately to Mr. Kalcic's recommended increases in Schedule BK-3(W), with the exception of Rate Class RSAE, NRH, and CSH, which he recommended be excluded from any scaleback. OSBA Statement No. 1 - Direct Testimony of Brian Kalcic ("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. Wellsboro 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, "[T]he Company does not accept the proposal that no class should receive a decrease, because the ACOS indicated the POL class is significantly over-earning at present rates." Wellsboro 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). Wellsboro Statement No. 6-R at 9; *see also* I&E Statement No. 3 at 12-13.

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. Farnsworth, "[t]he Company should not be burdened with additional filing requirements unless those requirements are part of the regulations applicable to all EDCs. The information requested by I&E can be addressed in the Company's next base rate case." Wellsboro Statement No. 6-R at 9. *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.

B. EFFECT OF WELLSBORO'S REVISED REVENUE INCREASE REQUEST

As stated in the Introduction, *supra*, Wellsboro initially filed this base rate case seeking rate changes resulting in $1,419,610 in increased revenue. In Direct Testimony, Company witness and Chief Operations Officer Byron (Barney) Farnsworth, Jr. described Wellsboro's significant investment and planned investment in capital expenditures to provide safe, adequate, and reliable service. Wellsboro Statement No. 6 at 9. Mr. Farnsworth explained that even a $1 million increase request will likely result in Wellsboro filing for another base rate case in the near future. He stated, "Although we could attempt to borrow money to fund [the capital improvements and O&M projects], this would increase our debt service and result in an almost immediate need to file for additional rate relief if we are limited to $1 million." *Id.*

After failing to obtain a waiver from informational requirements for general rate increase requests in excess of $1 million as set forth in 52 Pa. Code § 53.53 of the Commission's regulations, Wellsboro filed replacement base rate schedules and tariff sheets supporting its Revised Revenue Request, which reflected an increase in distribution revenues of $999,999.[15]

In Direct Testimony, Mr. Gorman stated:

> I have attached schedules reflecting an increase in revenue of $999,967 for the FPFTY, which represents a decrease of nearly 30% from the $1,420,000 As-filed revenue increase presented in the July 1, 2019 rate filing, Exhibit __ (HSG-1), Schedules A (W) – E5 (W) ("Scaleback"). Unfortunately, this revenue increase would result in a rate of return on rate base of just 6.15% for the FPFTY, substantially below the rate of 8.06% that Company witness D'Ascendis has supported, and a return on equity of just 7.334% for the FPFTY, substantially below the return on equity of 11.15% that Mr. D'Ascendis has supported. These rates of return are clearly inadequate and, I am informed, would likely force the Company to proceed with a further rate filing within a year of a Final Order in this proceeding.

Wellsboro Statement No. 1 at 3-4.

In Rebuttal Testimony, Mr. Gorman agreed to various revenue adjustments by OCA and I&E. Upon reviewing these updates, Mr. Gorman calculated that the Company's need was for an increase of $1,108,000 as opposed to $1,419,610. Mr. Gorman reiterated that the Company's request is for an increase of only $999,999 and requested that the Commission grant approval of that rate relief. Wellsboro Statement No. 1-R at 5.

Wellsboro notes that, if Commission Regulations did not prevent it, Wellsboro would have a strong argument for a revenue requirement increase of approximately $1.1 million – an amount

[15] The updated testimony exhibits for Wellsboro's request, which account for the denial of the Joint Petition for Waiver, contain the designation "(W)" to distinguish them from the original filing exhibits.

calculated with a variety of concessions by the Company on expenses and rate of return. The Company's Rebuttal revenue proposal is based on actual YTD results and is informed by a significant amount of data requested by OCA, I&E, and OSBA.

The Company has reduced its request to under $1 million to adhere to Commission Regulations. However, in light of the Company's continued need for a greater than $1,000,000 increase, Wellsboro seeks the full $999,999 of rate relief from the Commission. As Mr. Gorman stated in Rebuttal Testimony, "The Company's claimed FPFTY costs and revenues indicate the need for an increase of $1,108,000. The Company's request is for an increase of only $999,999 and should be granted by the Commission." Wellsboro Statement No. 1-R at 5. Therefore, Wellsboro respectfully requests that the Commission grant the Company's full request of $999,999.

XI. CONCLUSION

WHEREFORE, Wellsboro Electric Company respectfully requests that the Pennsylvania Public Utility Commission approve the rate increase and other proposals set forth in Tariff-Electric PA. PUC No. 8.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By ______________________________

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Dated: January 8, 2020

Appendix A
Rate Case Tables

TABLE I
Wellsboro Electric Company
INCOME SUMMARY
R-2019-3008208

	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	5,234,499	0	5,234,499	0	5,234,499	1,108,599	6,343,097
Expenses:							
O & M Expense	2,983,310	0	2,983,310	0	2,983,310	0	2,983,310
Depreciation	1,366,345	0	1,366,345	0	1,366,345	0	1,366,345
Taxes, Other	321,712	0	321,712	0	321,712	0	321,712
Income Taxes:							
State	52,448	0	52,448	5	52,453	110,749	163,202
Federal	136,436	0	136,436	10	136,446	209,548	345,994
Total Expenses	4,860,251	0	4,860,251	15	4,860,266	320,297	5,180,563
Net Inc. Available for Return	374,248	0	374,248	(15)	374,233	741,791	1,116,025
Rate Base	14,614,186	0	14,614,186	0	14,614,186		14,614,186
Rate of Return	2.56%		2.56%				7.63658400%
Source:	C1 (R)						

(1) Company Main Brief

*Note: Per Secretarial Letter issued August 8, 2019, Wellsboro's potential rate increase is limited to under $1 million pursuant to the filing requirements at 52 Pa. Code § 53.52.

{*A7294293:2}

TABLE I(A)
Wellsboro Electric Company
RATE OF RETURN
R-2019-3008208

	Structure	Cost	After-Tax Weighted Cost	Effective Tax Rate Complement	Pre-Tax Weighted Cost Rate
Total Cost of Debt			2.45663400%		
Long-term Debt	49.33%	4.98%	2.45663400%		2.46%
Short-term Debt	0.00%	0.00%	0.00000000%		
Preferred Stock	0.62%	4.00%	0.02480000%	0.711079	0.03%
Common Equity	50.05%	10.30%	5.15515000%	0.711079	7.25%
	100.00%		7.63658400%		9.74%
Pre-Tax Interest Coverage	3.96				
After-Tax Interest Coverage	3.11				
Source:	C1-2 (R)	C1-2 (R)			

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TABLE I(B)
Wellsboro Electric Company
REVENUE FACTOR
R-2019-3008208

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
Wellsboro Electric Company
SUMMARY OF ADJUSTMENTS
R-2019-3008208

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)							5	10
TOTALS		0	0	0	0	0	5	10

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TABLE III
Wellsboro Electric Company
INTEREST SYNCHRONIZATION
R-2019-3008208

	Amount $
Company Rate Base Claim	14,614,186
ALJ Rate Base Adjustments	0
ALJ Rate Base	14,614,186
Weighted Cost of Debt	2.45663400%
ALJ Interest Expense	359,017
Company Claim (1)	359,071
Total ALJ Adjustment	53
Company Adjustment	0
Net ALJ Interest Adjustment	53
State Income Tax Rate	9.99%
State Income Tax Adjustment	5
Net ALJ Interest Adjustment	53
State Income Tax Adjustment	5
Net ALJ Adjustment for F.I.T.	48
Federal Income Tax Rate	21.00%
Federal Income Tax Adjustment	10

(1) Company Main Brief
Source: C1-4 (R)

{*A7294293:2}

TABLE IV
Wellsboro Electric Company
CASH WORKING CAPITAL - Interest and Dividends
R-2019-3008208

Accrued Interest	Long-Term Debt	Short-Term Debt	Preferred Stock Dividends	
Company Rate Base Claim	$14,614,186	$14,614,186	Company Rate Base Claim	$14,614,186
ALJ Rate Base Adjustments	$0	$0	ALJ Rate Base Adjustments	$0
ALJ Rate Base	$14,614,186	$14,614,186	ALJ Rate Base	$14,614,186
Weighted Cost of Debt	2.45663400%	0.00%	Weighted Cost Pref. Stock	0.02480000%
ALJ Annual Interest Exp.	$359,017	$0	ALJ Preferred Dividends	$3,624
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.	$984	$0	ALJ Daily Dividends	$10
Net Lag Days	-45.0	0.0	Net Lag Days	0.0
ALJ Working Capital	($44,280)	$0		$0
Company Claim (1)	$0	$0	Company Claim (1)	$0
ALJ Adjustment	($44,280)	$0		$0
Total Interest & Dividend Adj.	($44,280)			

(1) Company Main Brief.

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TABLE V
Wellsboro Electric Company
CASH WORKING CAPITAL -TAXES
R-2019-3008208

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	$0	$0	$0	$0	$0	$0.00	0.00	$0
Public Utility Realty	$12,000	$0	$12,000		$12,000	$32.88	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	$52,448	$5	$52,453	$110,749	$163,202	$447.13	0.00	$0
Federal Income Tax	$136,436	$10	$136,446	$209,548	$345,994	$947.93	0.00	$0
	$200,884	$15	$200,899	$320,297	$521,196			

Source: C1-3 (R)

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

(1) Company Main Brief

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TABLE VI
Wellsboro Electric Company
CASH WORKING CAPITAL -- O & M EXPENSE
R-2019-3008208

Description	Company Pro forma F.T.Y. Expense	ALJ	ALJ Pro forma Expenses	Lag Days	Lag Dollars
O&M	$2,983,310	$0	$2,983,310	45.00	$134,248,947
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
	$2,962,710	$0	$2,962,710	45.00	$133,321,947

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	$8,117	
ALJ CWC for O & M	($365,265)	
Less: Company Claim (1)	($362,964)	C1-6 (R)
ALJ Adjustment	($2,301)	

(1) Company Main Brief

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APPENDIX B

PROPOSED FINDINGS OF FACT

RESOLVED ISSUES

1. The Company initially proposed to add a Construction Work in Progress ("CWIP") amount of $59,971 to its FPFTY rate base total. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C2 (W).

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

3. Wellsboro's 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. Wellsboro Statement No. 1-R at 13.

4. The Company proposed to add $245,607 to rate base for materials and supplies. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W).

5. 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 Statement No. 2, Schedule LKM-3. I&E Statement No. 3 at 8; OCA Statement No. 2 at 3.

6. The Company accepted the Advocates' 13-month methodology and reduced its claim by $37,074 to $208,533. Wellsboro Statement No. 1-R at 6, 13.

7. The Company proposed to deduct $82,025 from rate base for customer deposits. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W).

8. 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 $5,810 adjustment to the Company's claim for customer deposits. OCA Statement No. 2, Schedule LKM-4.

9. The Company accepted OCA's 13-month methodology and reduced its customer deposits adjustment by $5,810 to $76,215. Wellsboro Statement No. 1-R at 13.

10. The Company proposed an expense of $107,341 for Regulatory Commission expense. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W).

11. I&E witness Patel proposed a reduction of $68,710, representing normalized rate case expense the Company included from the 2016 rate case included in the Company's FPFTY expense claim. I&E Statement No. 1 at 17.

12. The Company accepted I&E's adjustment and reduced its Regulatory Commission expense by $68,710 to $38,631. Wellsboro Statement No. 1-R at 4; *see also* I&E Statement No. 1-R at 24.

13. Wellsboro's revenue projections include flat sales due to customer losses and limited prospects for load growth. Wellsboro Statement No. 4 at 7.

14. Overall sales are projected to go from 106,161,461 kWh in the 2018 to 107,825,923 kWh for both 2019 and 2020. Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R).Additionally, the Company projects a flat customer count of 6,337 for the FTY and FPFTY, in line with the Company's customer count in the HTY. Schedule C5 (W).

15. I&E rejected Wellsboro's projection of a flat customer count from the HTY and proposed an increase to FPFTY present rate revenue from $5,132,321 to $5,168,495, an increase of $36,174; this projection was based on I&E witness Cline's projection of an increase of 18 customers in the FTY and 18 more customers in the FPFTY. I&E Statement No. 3, Exhibit No. 4, Schedule 7.

16. Wellsboro witness Farnsworth testified to the Company's customer count as of October 2019, which showed no growth from December 2018; and also referred to a new interconnection application for a large customer proposing to install a 1.5 MW AC solar array. Wellsboro Statement No. 6-R at 10.

17. On Surrebuttal, Mr. Cline withdrew his recommendation to increase present rate revenue by $36,174. I&E Statement No. 3-R at 10.

RATE BASE

18. The Company's claim for original cost utility plant in service of $29,325,470 is based on projected plant in service at the end of the FPFTY. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedules C1-6 (W), C2 (W), C3 (W), E-1A (W).

19. 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.

20. OCA proposes to average the plant in service balance on December 31, 2019 ($27,455,940 per OCA's adjustment for retirements) with the plant in service balance at the end of the FPFTY on December 31, 2020 ($28,255,040 per OCA's adjustment for retirements). *See* OCA Statement No. 2, Schedule LKM-2.

21. 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., PaPUC. Util. Comm'n, et al. v. PPL Electric Utilities Corporation*, Docket Nos. R-2012-2290597, et al., at 12.

22. OCA's proposal would eliminate half of benefits of using the FPFTY by only allowing half of Wellsboro's planned $1,599,100 in plant additions to count toward the Company's original plant in service. *See* OCA Statement No. 2, Schedule LKM-2.

23. 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.

24. OCA's FPFTY average balance calculation of $27,855,490 resulted in a $265,988 reduction in accumulated depreciation amount, for total accumulated depreciation of $13,800,728. OCA Statement No. 2, Schedule LKM-2.

25. OCA witness Morgan observes that the Company's calculation of Plant in Service did not reflect plant retirements; and that any adjustment to Plant in Service for retirements would require a parallel adjustment to accumulated depreciation. These parallel adjustments do not result in a material impact on the Company's rate base claim. Mr. Morgan recommended a $1,070,430 adjustment to Plant in Service and a $1,111,730 adjustment to accumulated depreciation. OCA Statement No. 2 at 4.

26. The Company agreed to a Materials and Supplies adjustment proposed by OCA and I&E, reducing its claimed increase from $245,607 to $208,533. Wellsboro 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. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-6 (W).

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 $388,475 to rate base. Wellsboro Statement No. 1, Exhibit__(HSG-1) Schedule C1-6 (W).

30. I&E and OCA do not oppose the 1/8 method proposed by the Company. I&E Statement No. 1 at 28; OCA Statement No. 1 at 9.

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 28; 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* Wellsboro Statement No. 1-R at 6, 11.

33. OCA proposed a $5,810 adjustment to Customer Deposits, which the Company accepted. *See* OCA Statement No. 2 at 7; *see also* Wellsboro Statement No. 1-R at 13.

34. ADIT addresses the difference between actual tax liability for accumulated depreciation paid by Wellsboro and the amount of tax expense for accumulated depreciation paid by ratepayers in the revenue requirement. Wellsboro Statement No. 1 at 17.

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%. Wellsboro Statement No. 1 at 17.

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 $14,614,186 is reasonable and, therefore, should be approved.

REVENUE

38. Wellsboro's anticipated system usage is projected to remain relatively flat, at 106,161,461 kWh in 2018 and 107,825,923 kWh in 2020. Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R); under present rates, this will reduce distribution revenues from $5,305,912 in 2018 to $5,247,047 in 2020. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1 (R).

39. Wellsboro testimony explained a variety of factors that are impeding growth. *See* Wellsboro Statement No. 4 at 6-7.

40. For 2020, the Company claimed $35,443 in revenue Forfeited Discounts (late payment charges). Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule B6 (W).

41. I&E witness Cline noted that Wellsboro's revenue claim for Forfeited Discounts was the same under both present and proposed rates; Mr. Cline proposed that the Company's claim for Forfeited Discounts be increased by $1,734 to $37,177 for the FPFTY; Mr. Cline recommended that the final Forfeited Discounts amount reflect the same percentage of the Company's projected revenue with final-approved rates as it does for projected revenue under present rates. I&E Statement No. 3 at 18-20.

42. Company witness Gorman acknowledged that Forfeited Discounts may increase with higher revenue but stated that Uncollectible Accounts expense is also likely to increase in approximately the same amount; 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. Wellsboro Statement No. 1-R at 7.

EXPENSES

43. 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. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W) at 3-4.

44. 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. 176-77.

45. As seen on the table, total 2019 O&M costs are, when annualized, projected to be $2,779,872. Wellsboro Statement No. 1-R at 4.

46. 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 $2,794,579, $284,157 less than the Company's FPFTY claim of $3,078,736. Wellsboro Statement No. 1-R at 4.

47. 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. Wellsboro Statement No. 6-R at 4.

48. Actual historic O&M expenses show an increase of over 18% from 2015 to 2018 (the last year full expense data is available) and 24% from 2012 to 2018. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W).

49. Mr. Farnsworth also testified on rejoinder that the Company anticipated increases to salaries, benefits, and vendor costs – specifically referencing a notice from the Company's primary source of materials that prices would be increasing by 2-5%. Tr. 179-182. 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. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 at 2 (W); Tr. 179-181; Wellsboro Statement No. 6-R at 5; Wellsboro Statement No. 4 at 5.

50. Account No. 593 includes expenses for Wellsboro right of way inspections, tree trimming and other vegetation management for customer service reliability; a primary reason that Wellsboro's costs in this account have increased relates to maintenance and repairs due to tree damage from the Emerald Ash Borer. Wellsboro Statement No. 6 at 7-8.

51. Wellsboro 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 Wellsboro's contracts; Mr. Farnsworth stated that the

Company's 2020 vegetation management budget "will be $60,000 higher than our 2019 trimming budget." Wellsboro Statement No. 6 at 8; Wellsboro Statement No. 6-R at 8.

RATE OF RETURN

52. 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.

53. Wellsboro 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.

54. 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.

55. 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.

56. The I&E and OCA recommended ROEs for Wellsboro 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.

57. 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.

58. 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.

59. 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.

60. 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.

61. 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.

62. 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.

63. 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.

64. 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.

65. 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.

66. 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.

67. 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.

68. 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.

69. 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.

70. 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.

71. 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.

72. 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.

73. 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.

74. 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.

75. 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.

76. 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.

77. 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.

78. 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.

79. 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.

80. 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.

81. Wellsboro has accomplished the following: (1) low number of customer complaints; (2) favorable customer feedback; (3) high responsiveness to customer support calls; (4) excellent reliability metrics; (5) very low reportable injuries; (6) technological improvements in customer service by offering Smarthub use to customers and completing an Asset Verification Project, which improves outage reporting capabilities (used by approximately one-fifth of Wellsboro's customers); (7) a replacement program to replace all streetlights in its service area with LED lights; (8) tablets are being implemented for field personnel to use for maps and inspections; and (9) continued significant capital investment of approximately $1.25 million annually since the last rate case. Wellsboro Statement No. 6 at 3-5.

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

83. 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; Wellsboro Statement No. 4 at 6.

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

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

86. 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.

87. Mr. D'Ascendis' market capitalization study observed that, as of March 29, 2019, Wellsboro had a market capitalization of $6.358 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 2,622.8x. Joint Statement No. 2 at 45.

88. 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.

89. The Electric Utility Proxy Group $16.7 billion market capitalization ranked in the 2nd decile, while Wellsboro $6.358 million market capitalization ranked in the 10th decile, resulting in a size premium spread of 4.70%. Joint Statement No.2 at 45.

90. 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.

91. 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.

92. 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.

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

94. 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.

95. 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.

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

97. 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.

98. 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

99. 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 a rate cases, Wellsboro 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; Wellsboro 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.

100. 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.

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

RATE STRUCTURE

102. 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. Wellsboro Statement No. 1 at 19.

103. 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.

104. Wellsboro's 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. Wellsboro Statement No. 1 at 19; UGI Order at 160.

REVENUE ALLOCATION

105. 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. Wellsboro Statement No. 1-SR at 2.

RATE DESIGN

106. The Company's proposal to allocate the cost for 0.09 kW-demand ($1.48 per month) to the Residential customer charge shifts only the minimum demand costs to the fixed charge. Wellsboro Statement. No. 1 at 43.

107. CS and CSH customers are required to have 7 kW of demand. Wellsboro Statement No. 1 at 45, 46.

108. The Company's proposal to allocate a portion of CS and CSH demand costs to the CS and CSH customer charges result in CS and CSH customers still paying less for demand than they cost the Company for their demand. *See* Wellsboro Statement. No. 1 at 45-46.

109. Wellsboro 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. Wellsboro Statement No. 1 at 43.

110. By including only the portion of demand charges constituting the minimum demand for customers, the Company reasonably aligns customer rates with costs. Wellsboro Statement. No. 1 at 41, 43.

111. 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* Wellsboro Statement No. 1 at 41, 43.

<u>APPENDIX C</u>

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).

APPENDIX D

PROPOSED ORDERING PARAGRAPHS

1. That Wellsboro Electric Company 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 $999,999, to become effective for service rendered on and after May 1, 2020.
2. That Wellsboro Electric Company 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 Wellsboro Electric Company 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 Wellsboro Electric Company 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 Wellsboro Electric Company consistent with its Final Order, the investigation at Docket R-2019-3008208 be marked closed.
6. That Wellsboro Electric Company 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-2019-3011959 be dismissed and marked closed.
8. That the complaint filed by the Office of Small Business Advocate in this proceeding at Docket Number C-2019-3012589 be dismissed and marked closed.