


COMMONWEALTH OF PENNSYLVANIA



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January 22, 2020

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

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

Dear Secretary Chiavetta:

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

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

A handwritten signature in blue ink that reads "Christy M. Appleby".

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cc: The Honorable Steve K. Haas, ALJ  
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Certificate of Service

\*282830

CERTIFICATE OF SERVICE

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

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

Dated this 22<sup>nd</sup> day of January 2020.

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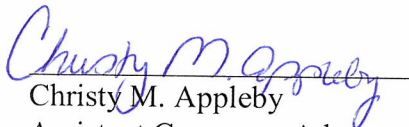
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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

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REPLY BRIEF  
OF THE  
OFFICE OF CONSUMER ADVOCATE

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## I. INTRODUCTION

### A. Wellsboro Electric Company

The Office of Consumer Advocate (OCA) submits this Reply Brief primarily in response to the Main Brief of Wellsboro Electric Company (Wellsboro or Company). The OCA also addresses arguments raised in the Main Briefs of the Commission's Bureau of Investigation and Enforcement (I&E) and the Office of Small Business Advocate (OSBA). The OCA's Main Brief contains a comprehensive discussion of the evidence and its position on all issues, thus the OCA will respond only to those matters raised by other parties that were not previously addressed or require further clarification. Nevertheless, the OCA does not waive its opposition on contested issues because it does not repeat arguments here. Accordingly, the OCA incorporates the arguments and analysis contained in its Main Brief herein by reference.

In its Introduction, Wellsboro states that it conducted an analysis that determined that an overall distribution rate increase of \$1,419,610 is necessary using the Fully Projected Future Test Year (FPFTY) ending December 31, 2020. The Company states that it accepted certain adjustments of the parties and has reduced its request to \$1.1 million. Wellsboro argues that because of the denial of its Petition for Waiver of the Commission's regulations, the Company is required to limit its request to \$999,999. Wellsboro M.B. at 1-3.<sup>1</sup> The Company argues that its return will decrease from 5.73 percent in 2018 to 2.56 percent in 2020 without an increase.

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<sup>1</sup> Pursuant to Section 1.91 of the Commission's regulations, on July 1, 2019, Wellsboro filed a Petition for Waiver of Filing Requirements under 52 Pa. Code Section 53.53 for the Company's Rate Increase Request Exceeding \$1,000,000. The OCA, OSBA, and I&E jointly filed an Answer to the Petition for Waiver, requesting the Commission deny the waiver. On August 8, 2019, the Commission denied the Petition. Wellsboro filed replacement schedules and tariff pages to amend their Tariff Supplement to no longer exceed \$1,000,000.

Wellsboro M.B. at 3. In support of its arguments that the full request is warranted, the Company also includes a list of activities planned and completed since 2016. See, Wellsboro M.B. at 3-5.

The OCA submits that after a thorough review of its filing, the Company has not met its burden of proof to justify an increase of \$999,999, let alone the \$1.1 million it identifies in its Main Brief. As detailed by the OCA witnesses in their proposed adjustments, the OCA has considered all of the factors identified in the Company's introduction as part of the OCA's recommended revenue requirement. Based on the evidence the Company has provided to support its claim and the applicable law, the Company's annual distribution revenues should increase by no more than the OCA's recommended \$645,212.

B. History of the Proceedings

The procedural history is set forth in the OCA Main's Brief. See, OCA M.B. at 2-4. On January 8, 2020, the OCA, I&E, OSBA, and Wellsboro filed separate Main Briefs.

C. Legal Standards

The OCA discusses the legal standard at pages 4 to 6 of its Main Brief. OCA M.B. at 4-6.

## II. SUMMARY OF ARGUMENT

In this Reply Brief, the OCA responds primarily to the arguments raised in the Main Brief of Wellsboro. The OCA notes that many of the arguments raised by the Company were fully addressed in the OCA's Main Brief and will not be repeated here. The OCA further notes that no averments in any of the parties' Main Briefs alter the OCA's position in this proceeding. The OCA continues to submit that Wellsboro has not met its burden of proof for its claims set forth in support of its revenue request. The OCA has proposed adjustments to the Company's proposed cost of equity; rate base including the Company's use of an end of test year rate base for the Fully Projected Future Test Year, and the corresponding depreciation adjustments; use of an across-the-

board 3.0 percent inflation factor; cash working capital; taxes; and net operating income items, including miscellaneous distribution expense, maintenance of overhead lines, safety and communication, maintenance of general property, and rate case expense.

Based upon the OCA expert witnesses' testimony, the OCA submits that an overall distribution revenue increase of \$645,212 is justified based on a 6.68% overall rate of return. This amount reflects necessary adjustments as well as a return on equity of 8.38%. The OCA's recommended increase allocated to customers in the manner discussed in this Reply Brief and the OCA's Main Brief results in just and reasonable rates. A summary of the OCA's adjustments are provided in its Table II attached to the OCA's Main Brief. See, OCA M.B. at App. A, Table II. Based on the evidence the Company has provided to support its revenue claim and the applicable law, the Company's annual distribution revenues should increase by no more than \$645,212.

### III. ISSUES RESOLVED AMONG THE PARTIES

As discussed more fully in the OCA's Main Brief, the following issues have been resolved: (1) Rate Base- Materials & Supplies and (2) Rate Base- Customer Deposits. OCA M.B. at 7-10; Wellsboro M.B. at 13-16. Wellsboro also identified that the Company had accepted I&E witness Patel's adjustment to regulatory Commission expense, and that I&E accepted the Company's present rate revenue calculations. Wellsboro M.B. at 15-16.<sup>2</sup>

The OCA also made an adjustment to the Company's inclusion of Construction Work in Progress (CWIP), and the Company partially agreed with the OCA's and I&E's adjustment. Wellsboro St. 1-R at 13. Company witness Gorman agreed in Rebuttal Testimony to remove the CWIP for purposes of the use of an end-of-test year rate base. Wellsboro St. 1-R at 13. For the

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<sup>2</sup> The OCA did not address in testimony or its Main Brief either the adjustment to regulatory Commission expense or the present rate revenue calculations.

reasons set forth below in Section IV and on pages 17 through 19 of the OCA’s Main Brief, the OCA does not agree that it is appropriate to include CWIP in rate base *either* using an end of test year or the average rate base test year method. See, OCA M.B. at 17-19.

#### IV. RATE BASE

##### A. Plant in Service

##### 1. Fully Projected Future Test Year

As discussed in the OCA’s Main Brief, prior to the passage of Act 11 and the utilization of a Fully Projected Future Test Year, the test year upon which rates were established ended at approximately the same time that new rates became effective. See, OCA M.B. at 11-17. Act 11 of 2012 permits, *inter alia*, utilities to use a Fully Projected Future Test Year (FPFTY) when applying for a general rate increase under Section 1308(d) of the Public Utility Code. 66 Pa. C.S. § 1308(d). The OCA submits that under the Company’s approach, “the end-of-year method will allow the Company to over-earn on its investment in the FPFTY while annual average method recognizes that capital investments will be made throughout the first year that new rates are in effect.” OCA M.B. at 13; OCA St. 1 at 4; see, Wellsboro M.B. at 19. To remedy this problem, the OCA submits that rates must be set based on the average rate base projected to be used and useful in the Fully Projected Future Test Year.

The Company argues that OCA’s position contradicts the Commission’s determination in the UGI Order; ignores the plain language of Act 11; and frustrates the goals of enacting Act 11. Wellsboro M.B. at 19, citing Pa. PUC v. UGI Utilities, Inc. – Electric Division, Docket No. R-2017-2640058, Order (Oct. 25, 2018)(UGI). In Rebuttal Testimony, Company witness Gorman argued that using the FPFTY average balances would “blunt the purpose of using FPFTY” and identified that the Commission had already addressed this issue in UGI. Wellsboro St. 1-R at 12-

13. Beyond those arguments, the Company did not provide any further justification for use of the end of test year instead of average rate base.

For its use of the end of test year, the Company relies upon the Commission's determination in UGI and also cites to the Commission's decision in Pa. PUC, et al. v. PPL Electric Utility Corporation, Docket No. R-2012-2290597 (Order entered Dec. 28, 2012)(PPL 2012). The Company's reliance on the PPL 2012 case is misplaced. The PPL 2012 case did not use a fully projected future test year. PPL 2012 at \*9. The PPL 2012 case used a Historic Test Year and Future Test Year. The FPFTY issue presented here did not exist in the PPL 2012 case. In the PPL 2012 case, the identified issue involved the OCA's proposed use of an annualized level of depreciation reserve with a non-annualized end of test year. PPL 2012 at \*12. In this case, the concern that the OCA has identified is that the use of the FPFTY with an end-of-test-year method means that customers will be paying for plant that is not used and useful at the effective date of rates. Generally, the future test year in cases prior to Act 11, like PPL 2012, coincided with the effective date of rates.

As to UGI, the OCA appealed the Commission's decision in UGI. See, Tanya J. McCloskey, Acting Consumer Advocate v. Pa. PUC, Case No.1529 C.D. 2018 (McCloskey). On January 15, 2020, the Commonwealth Court issued an Order affirming the Commission's Order in UGI. The OCA is reviewing the Court's Order at this time. The Court stated that this was a matter within the Commission's discretion, not clearly erroneous, and that it would not disturb the Commission's decision based on the record before it. McCloskey at 24-29. As a matter of discretion, the OCA would urge the Commission to consider the record and arguments here which clearly shows that the Company's earnings will be overstated if the end-of-year method is used.

The Company also argues that the use of the average rate base conflicts with Section 315(e) of Act 11 and would “weaken” the benefits provided by Act 11. Wellsboro M.B. at 20-21. The plain language of Section 315(e) does not support the argument that the General Assembly intended that the last day of the FPFTY be used to calculate a utility’s rate base and expenses. Section 315(e) defines FPFTY simply as “the 12-month period beginning with the first month that the new rates will be placed in effect...” 66 Pa. C.S. § 315(e). This language certainly specifies the timeline involved with a FPFTY but does not support the conclusion that rate base and other expenses should be calculated at the end of the 12-month period.

As pointed out in the OCA’s Main Brief, the year-end method would be the equivalent of an individual making a deposit into an interest-bearing savings account on Day 365, but requiring the bank to pay interest beginning on Day 1. The bank would likely deny such a request because interest is paid from the time of deposit, not one year in advance. See, OCA St. 1 at 4-5. The Company argues that the 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. Wellsboro M.B. at 22. The annual average method, however, will not cut Wellsboro’s earnings or eliminate half of its rate recovery. Rather, the annual average method calculates the rate base by properly reflecting investments as they are made throughout the entire time of the FPFTY and reflecting the return requirements as projects are placed in service throughout the FPFTY. Moreover, the Company has provided no support in its testimony for the Company’s argument other than Mr. Gorman’s statement that the use of the annual average method would “blunt the purpose of using FPFTY.” Wellsboro St. 1-R at 13. Indeed, the purpose of the FPFTY is to mitigate regulatory lag, not eliminate it, which is exactly what the average rate base method does.

The Company also argues that the OCA's approach would be internally inconsistent because the Company has used an end-of-test year method for the HTY and the FTY. Wellsboro M.B. at 22-23. The OCA submits that the Company has misunderstood the purpose of using the average rate base for the FPFTY. OCA witness Morgan explained the difference between using the end of test year plant in a FTY versus with the FPFTY:

I continue to believe that average test year plant is appropriate to use for the FPFTY. In rate cases that predated Act 11, the revenue requirements of utilities were established based on FTY costs. Because the FTY ended at approximately the same time that new rates were scheduled to take effect, it was appropriate to make adjustments to reflect the end of the test year because those costs would have been incurred before the new rates went into effect. Adjusting plant balances to year end levels is not appropriate now that a FPFTY is being used to establish rates because those costs will not be incurred when new rates go into effect. Adjusting costs to end of rate year levels and beyond would result in the Company recovering costs from ratepayers that are in excess of the costs that will be incurred during the rate year. Therefore, the end of period balance should be rejected.

OCA St. 2-SR at 2.

The Company's proposed end-of-test year method will result in rates that are unjust and unreasonable in direct contradiction to Section 1301 of the Public Utility. Section 1301 of the Public Utility Code requires that "[e]very rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or order of the commission." 66 Pa. C.S. § 1301. By law, a utility is only provided with a "rate that allows it to recover those expenses that are reasonably necessary to provide service to its customers as well as a reasonable rate of return on its investment." City of Lancaster (Sewer Fund) v. Pa. PUC, 793 A.2d 978, 982 (Pa. Commw. 2002). The utility bears the burden of "proving the reasonableness of its rates" and proving the "reasonableness of those expenses which form the basis for its rates." Carnegie Nat'l Gas Co. v. Pa. PUC, 433 A.2d 938, 942 (Pa. Commw. 1981); see also, Keystone Water Co., White Deer Dist. v. Pa. PUC, 477, Pa. 495, 609-610



(1978)(addressing the inclusion of a specific plant in rate base). Allowing a company to recover more than its necessary costs cannot be found to be just and reasonable.

The OCA submits that the reasons offered by the Company in support of utilizing an end of year rate base in the FPFTY do not justify requiring ratepayers to overpay the revenue requirement. The OCA submits that, for the reasons set forth above and those detailed in the OCA's Main Brief at pages 11 through 16, the average rate base should be used to establish a level of just and reasonable rates.

## 2. Retirements

OCA witness Morgan modified the Company's proposed retirements and contributions of plant in service in the FTY and the FPFTY. OCA M.B. at 16-17; OCA St. 2 at 4, Sch. LKM-1. In its calculation, the Company failed to exclude retirements, which caused the balances to be overstated. OCA M.B. at 16; OCA St. 2 at 4. Mr. Morgan also identified a corresponding effect on accumulated depreciation. OCA M.B. at 17; OCA St. 2 at 4, Sch. LKM-1. OCA witness Gorman did not specifically address Mr. Morgan's recommendations with respect to the plant retirements or related accumulated depreciation. See, Wellsboro St. 1-R at 12-13 (Gorman discussion of response to OCA witness Morgan's plant in service, Materials and Supplies, Customer Deposits, removal of CWIP, use of average rate base in the FPFTY, and EDIT recommendations). In its Main Brief, the Company only stated that the "these parallel adjustments do not result in a material impact on the Company's rate base claim." Wellsboro M.B. at 18. Without any further justification or argument, Wellsboro concludes that the Company's calculations of its Plant in Service and Accumulated Depreciation should be adopted without modification. Wellsboro M.B. at 18.

The Company has not addressed Mr. Morgan's concerns that the exclusion of retirements causes the year end balances to be overstated or denied that the balances are, in fact, overstated. OCA St. 2 at 4, Sch. LKM-1. Whether the Company considers the impact to be minimal or significant, the Company cannot justify including overstated balances in rates. The OCA submits that the Company has failed to meet its burden of proof to demonstrate that its proposed calculation of Plant in Service and Accumulated Depreciation are accurate. As discussed in the OCA's Main Brief, the year-end Plant in Service and Accumulated Depreciation should be adjusted to reflect the average FPFTY amounts for inclusion in rate base. OCA M.B. at 17; OCA St. 2 at 5, Sch. LKM-2; see also, OCA St. 1 at Sch. SLS-3.

B. Deductions from Rate Base

The Company included the Construction Work in Progress (CWIP) balance as of the end of the HTY in rate base. OCA St. 2 at 5; OCA M.B. at 17-20. The OCA and I&E proposed to remove the Company's inclusion of CWIP. OCA M.B. at 17-20; see also, OCA St. 5-6, Sch. LMK-3; I&E St. 3 at 10-11. The Company partially agrees with the OCA and I&E's adjustment, but states that if average rate base data for the FPFTY is used, the Company believes that retaining its CWIP claim is appropriate. Wellsboro M.B. at 14.

For the reasons set forth in its Main Brief, the OCA submits that it is not appropriate to include CWIP in rate base either using an end of test year or average rate base test year method. OCA M.B. at 17-20. In either case, the plant item will not be completed and placed in service during the FPFTY. See, OCA St. 2 at 6. Moreover, CWIP balance as of the end of the HTY is likely to already be included as part of the plant in service during the FTY and FPFTY. OCA St. 2 at 6. Inclusion of CWIP in rate base would result in a double count. OCA St. 2 at 6.

## V. REVENUES

The OCA did not propose any adjustments to Wellsboro's revenues. See, OCA M.B. at 19-20. OCA witness Sherwood did adjust her revenue calculation in her Surrebuttal Testimony, and her updated revenue adjustments are reflected in OCA's Table I. OCA M.B. at 19-20, App. A, Table I; OCA St. 1-SR (Revised) at 2, Sch. SLS-1 C.

## VI. EXPENSES

### A. Summary

In its Main Brief, the OCA addressed the following expense issues: 1) the across-the-board 3.0 percent inflation factor applied to all expenses; 2) miscellaneous distribution expense; 3) maintenance of overhead lines; 4) safety and communication; 5) maintenance of general property; 6) rate case expense; 7) the impact on cash working capital as adjusted by the OCA's recommended O&M expenses; and 8) depreciation expense. OCA M.B. at 20-32. For the reasons detailed in the OCA's Main Brief and Reply Brief, the following adjustments should be made to the Company's claim. See, OCA M.B. at 20-32.

### B. Inflation Factor

In its Main Brief, the Company argues that the proposed 3 percent inflation adjustment for FPFTY expenses is "conservative" and reflects the Company's experience and budget. Wellsboro M.B. at 36-39. The OCA submits that the proposed inflation factor is not conservative nor is it appropriate. As explained in the OCA's Main Brief, the proposed across-the-board 3.0 percent growth or inflation rate does not relate to actual costs. See, OCA M.B. at 20-25. OCA witness Morgan testified:

These inflationary adjustments are not actually known and measurable because they do not reflect the true cost of expenses. Inflation adjustments are typically blanket adjustments or increases which do not directly relate to actual costs expected to be incurred by the Company in the period in which rates are set. Costs should be based

upon evidence or documentation that supports the Company's adjustments. I do not believe the determination of expenses for the FPFTY was envisioned to be simply applying an inflation rate to expenses. Therefore, my recommendation to Ms. Sherwood is to remove the inflation adjustment from the revenue requirement determination.

OCA St. 2 at 7-8.

The Company argues that the OCA's position is to assume no cost increases from the FTY to the FPFTY as established in Act 11. Wellsboro M.B. at 38. The Company's argument is an inaccurate characterization of the OCA's position regarding the proposed inflation factor. The OCA has accepted many of the Company's proposed cost increases from FTY to the FPFTY; the OCA, however, does not accept a blanket inflation factor for the Company's expenses that were documented by the Company. Escalation of the historical amounts by an inflation factor is more accurately characterized as a proxy for anticipated (but not provable) increased costs. It is not an appropriate method of cost projection or consistent with Section 315 of the Public Utility. 66 Pa. C.S. § 315. As OCA witness Morgan testified:

In fact, the utility does not meet its burden of proof by applying the inflation to all its costs because there is no way to assess the reasonableness of the FPFTY expenses relative to the HTY or the FTY expenses. In my experience with other utilities filing a FPFTY, the utilities have been able to demonstrate and explain reasons for FPFTY cost changes based upon specific causes such as unit price increases, planned activities, and abnormal activity in the HTY. For Wellsboro, no such detail or causes can be provided because the only explanation is the choice of the inflation escalation rate.

OCA St. 2-SR at 5.

In its Main Brief, the Company argues that the Commission has long recognized the use of inflation factors in projecting costs. See, Wellsboro M.B. at 38, citing Pa. PUC v. Pennsylvania-American Water Company, Docket No. R-00038304, Order at 35 (Jan. 29, 2004); Pa. PUC v. Pennsylvania-American Water Co., et al., Docket No. R-880916, Order at 54 (Oct. 21, 1988). As

the OCA discussed in its Main Brief, the cases cited by Wellsboro are not applicable here. See, OCA M.B. at 22-23.

The basis of the cost of service in the Pennsylvania-American cases that the Company has cited differ substantially from the FPFTY filed in this matter. The inflation factor, in those cases, was applied to only a limited number of residual expenses. As OCA witness Morgan testified:

First, it is important to recognize that the cases cited by Mr. Gorman pre-date Act 11. In other words, those cases were not based upon Fully Projected Future Test Years (FPFTY). The cases cited by Mr. Gorman were filed at a time when utilities were limited to the use of either a historical (HTY) or the partially projected future test year (FTY). When developing the FTY or the adjusted HTY, the cost of service was based upon costs that were known, measurable and certain. Act 11 amended Chapter 3 of the public utility code to allow jurisdictional utilities to make rate case claims based on a FPFTY. However, utilities are not restricted or required to use the FPFTY. The partially projected future test year (FTY) can still be used.

Under the HTY and FTY approach, utilities are required to adjust their actual historical cost of service using the known and measurable principle. When the HTY and FTY approach is used, companies do not based their entire cost increases on an inflation escalation. Thus, in Pennsylvania-American Water Company (PAWC) rate cases, that company would typically adjust the various cost elements based on known and measurable cost increases, and only adjust residual expenses using an inflation factor. The residual expense adjustment generally turned out to be minor relative to the adjustments made and the total cost of service.

I disagree with the Company's approach to developing the cost of service because it is extremely improper since the Company's projections are not based upon planned activities or normal operations. The Company's very simplified blanket inflation approach is not a projection as envisioned by Act 11.

OCA St. 2-SR at 3 (footnote omitted)(emphasis added).

The Commission has found that across-the-board inflation factors, or attrition adjustments, should not be used to establish rates because they are speculative in nature. See, Pa. PUC v. Philadelphia Gas Works, 2007 Pa. PUC LEXIS 45 (Sept. 28, 2007)(PGW); Pa. PUC v. Philadelphia Electric Co., 1990 Pa. PUC LEXIS 155 (May 16, 1990)(rejection of attrition

adjustment related to Limerick 2); Pa. PUC v. Philadelphia Electric Co., 58 Pa. PUC 7, 11-12 (1983)(PECO 1983).

In its Brief, the Company argues that the PGW and PECO 1983 cases are not applicable to the Company's proposal. Wellsboro M.B. at 38-39. The Company argues that the cases pre-date Act 11 and that the inflation adjustment denial would have been consistent with the Public Utility Code at that time. As noted above, the two Pennsylvania-American cases cited by the Company also pre-date Act 11. Contrary to the Company's arguments in its Main Brief, there is a strong similarity between the instant case and the PGW case. The Company draws a distinction between the instant case and PGW because the PGW proposed to use a 2% inflation adjustor over a five year budget period instead of only across the 2020 FPFTY. Wellsboro M.B. at 39. The OCA submits, however, that the PGW proposed inflation factor is very similar to the inflation factor proposed in this case. The primary difference is that PGW proposed to use the inflation factor across its five year budget and Wellsboro proposes to use the inflation factor only in the FPFTY. PGW at \*26-\*28.

The Company argues that the PECO 1983 case is inapplicable because PECO proposed an overall increase of 2% to expense, revenue, and rate base. Wellsboro M.B. at 39. The fact that PECO applied the inflation factor as an attrition adjustment to expenses, revenues and rate base does not change the Commission's conclusion that the "proposed attrition adjustment must be rejected as speculative in nature." PECO 1983 at 12. The concern here is the same. The proposed across-the-board inflation factor is speculative and not a known and measurable change.

The Company argues that the OCA's position undercuts the purpose of the FPFTY authorized by Act 11. Wellsboro M.B. at 38-39, citing to 66 Pa. C.S. § 315(e). The OCA submits

that Act 11 may have allowed for a FPFTY, it did not eliminate the “known and measurable” standard. An “across-the-board” approach does not meet the known and measurable standard.

In further support of its argument, the Company cites to the example raised in Rejoinder Testimony of a notice received for a potential 2-5% price increase from its vendor, Hubbell Utility Solutions. Tr. 179-182. The OCA submits, however, that the individual expense cannot be viewed in isolation. Other expenses may also decrease. The Company has not limited its proposed inflation adjustment to expenses that it reasonably anticipates will increase. The Company’s inflation adjustment assumes that all expense will increase by a 3.0 percent inflation factor without providing evidentiary support for those proposed increases. As OCA witness Morgan explained, “[I]n this proceeding the Company is attempting to use an inflation escalation as the sole determinant of virtually all of the FPFTY expenses.” OCA St. 2-SR at 5-6. Mr. Morgan concluded:

It is not possible for the Company’s FPFTY expense projection to be accurate when it uses a blanket inflation rate that was determined based upon judgement and without regard to the planned activities during the FPFTY.

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To be clear, in my recommendation, I am not claiming that the use of an inflation escalation has not been accepted by the Commission. Neither am I claiming that an inflation escalation cannot be used to project certain future year expenses. Instead, I am recommending that the Company’s use of an inflation escalation as the sole basis for determining the FPFTY expenses is not appropriate. Therefore, it should be rejected by the Commission.

OCA St. 2-SR at 6.

If the Commission decides, however, to adopt an across-the-board inflation adjustment, the OCA opposes the Company’s calculation of the proposed 3.0 percent inflation factor. OCA M.B. at 24; OCA St. 2 at 9-10. Mr. Morgan testified that a better measure of inflation for ratemaking purposes would be the forecasted Gross Domestic Product-Price Index (GDP-PI) of 2.1 percent

for calendar year 2020. OCA St. 2 at 9. To be clear, the OCA is not suggesting that an across-the-board inflation factor is appropriate. The use of any inflation factor in the manner employed by the Company is not appropriate. If the Commission disagrees, however, a more appropriate inflation factor should be used.<sup>3</sup>

For the reasons set forth above and in its Main Brief, the OCA submits that the proposed 3.0 inflation factor applied to all expenses is not known and measurable nor consistent with the law. Moreover, the Company's proposed calculation of the 3.0 percent factor is flawed. The Commission should reject the Company's use of an inflation factor and adopt the OCA's adjustment.

C. Account No. 588: Miscellaneous Distribution Expense

The Company argues that expenses for Account 588 should equal \$219,007. Wellsboro M.B. at 44. In its Main Brief, the Company supports its projection by stating they have new employees, employees are retiring, and the cost of industry technology advancements. Wellsboro M.B. at 44-45. As explained more fully in OCA's Main Brief on pages 25 and 26, OCA witness Sherwood addressed these concerns through her testimony:

Although the overall budget for Account 588 is decreasing from HTY, the labor, overhead, and other expenses are still higher than in prior years (2015-2017). As noted in Table 1, the Company's FPFTY expenses are 168 percent, or \$88,323, higher than the average expenses from 2015 through 2017.

**Table 1. Wellsboro Account 588 Three-Year Average Expenses**

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<sup>3</sup> In its Main Brief, the Company also mischaracterizes OCA witness Morgan's testimony regarding the calculation of the inflation factor as being in conflict with "fundamental ratemaking." Wellsboro M.B. at 40. The Company attempts to utilize a quotation regarding the calculation of an appropriate inflation factor out of context. In Surrebuttal Testimony, OCA witness Morgan discussed why an across-the-board inflation adjustment is not known and measurable, but Mr. Morgan's discussion is not applicable to ratemaking in general. OCA St. 2-SR at 3. What Mr. Morgan stated is that in the cases identified by the Company, the utilities were limited to the use of a historical or partially projected future test year, and in those cases, the cost of service was based upon costs that were known and measurable. See, OCA St. 2-SR at 3.



	<b>2015 - 2017 Average Expense</b>	<b>FPFTY Projected Expense</b>	<b>Variance</b>	
Labor	\$ 75,224	\$ 100,981	\$ 25,757	134%
Overhead	45,542	75,693	\$ 30,151	166%
Other	9,918	42,333	\$ 32,415	427%
<b>Total:</b>	<b>\$ 130,684</b>	<b>\$ 219,007</b>	<b>\$ 88,323</b>	<b>168%</b>

Source: Company response to I&E-RE-5-D.

The Company cites new employee training and a limited overall work force as the reason for the increased cost; however, beyond the retirement of an employee in 2018, there appears to be no change in employees for 2019 and 2020. Furthermore, the new employee training costs are unlikely to continue in future years unless the Company plans to hire additional employees. Due to the variance of expenses in Account 588 over the years, I recommend that the three-year average (2015 – 2017) expense for this account. Using this methodology, I recommend that the total expense for Account 588 be \$130,860.

OCA St. 1 at 6. Expenses that are not normal should not be included in the forecast. See, Pa. PUC v. Philadelphia Gas Works, 2007 Pa. PUC LEXIS 45, \*26-27. (“The object of using a test year is to reflect typical conditions.”).

Additionally, in opposing OCA’s adjustments, the Company states 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 M.B. at 44. In rebuttal, the Company did not respond directly to the OCA’s recommendations concerning Account 588 but made general comments about all line items of O&M expenses. Wellsboro St. 1-R at 11. In response, OCA witness Sherwood testified:

While the Company has adjusted its O&M expenses based on the annualized expense for the FTY, that does not mean that it is an appropriate adjustment. During the year, there can be aberrations in the incurred expenses, including one-time or emergency expenses that should be adjusted when forecasting for the FPFTY. The Company is accepting the expenses based on nine-months of expense levels and then adding the average quarterly account expenses; essentially ignoring the historical expense trends

associated with the individual accounts. As with any year, there is potential for the FTY expenses to be higher or lower this year and not in another, which is why the historical expense trends should be considered along with known and measurable increases when setting rates . . . Overall, the Company should not simply take the FTY budget plus a three percent adder in order to adjust its FPFTY O&M expenses. This is proven by the fact that the Company has proposed, as part of its rebuttal testimony, a few account specific adjustments. The Company should have taken a more granular review of their expenses prior to making its adjustment.

OCA St. 1-SR (Revised) at 5-6.

The OCA submits Ms. Sherwood's recommendation to adjust Account 588 expense by \$88,147, this adjustment is reflected in SLS-4. OCA ST. 1 at 6; OCA M.B. at 26-27; App. A, Table II.

D. Account No. 593: Maintenance of Overhead Lines

In its Main Brief, the Company challenges the OCA's approach and adjustment to Account No. 593. Wellsboro M.B. at 43. The Company's criticism is without merit, as the OCA reviewed actual bid results to make its recommendation. OCA witness Sherwood analyzed the Company's most recent bids, which were offered as a confidential exhibit at the evidentiary hearing, as well as past actual costs, to recommend employing a three-year average to calculate expenses Account No. 593. Wellsboro Rejoinder Exhibit No. 4; TR at 180; OCA St. 1-SR (Revised) at 7-8.

As discussed in OCA's Main Brief on pages 27 and 28, Ms. Sherwood demonstrates that vegetation contractor costs vary by year, even taking into consideration the Company's recommendations in rebuttal regarding Account 593, the projected increases are not known and measureable. OCA St. 1-SR (Revised) at 8. I&E witness Patel also proposed a reduction to the Company's claim for account 593 due to the Company's "wide fluctuation in this expense category. . ." I&E St. 1 at 27.

Taking the fluctuating nature of this account, the OCA submits that it has provided ample evidence to rebut the Company's proposed vegetation management in this matter through OCA witness Sherwood's analysis of the Company's records, propriety bids, testimony, and actual costs incurred. See, OCA St. 1-SR (Revised) at 7-9; OCA M.B. at 27-28; App. A, Table II.

E. Accounts No. 908-913: Safety and Communication

The OCA's adjustment related to Accounts 908-913 is addressed in detail on pages 28 and 29 of the OCA's Main Brief. In its Main Brief, the Company argues that total cost for Accounts 908-913 equal \$19,197. Wellsboro M.B. at 46. As explained in OCA's Main Brief on pages 28 and 29, the Company's original claim included costs related to a tri-annual PUC required filing, which the OCA recommended be normalized across a three-year period. OCA St. 1 at 9; OCA M.B. at 28-29. OCA witness Sherwood demonstrated the normalized cost of the tri-annual PUC filing plus the HTY expense equal \$9,235, which is Ms. Sherwood's recommended amount for FPFTY safety and communication expenses. OCA St. 1 at 9; OCA M.B. at 28-29.

The Company agrees that the Commission should make "the adjustment to normalize the Company's tri-annual Eligible Customer List expense. . ." Wellsboro M.B. at 47.

As stated in the OCA's Main Brief, Ms. Sherwood's recommended downward adjustment should be adopted. The adjustment is reflected in Schedule SLS-6. OCA M.B. at 29.

F. Account No. 932: Maintenance of General Property

The Company projects that the total cost of maintenance of general property will be \$90,199. Wellsboro M.B. at 49. Additionally, the Company in its Main Brief argued that the OCA's approach to Account 932 to be "illogical." Wellsboro at 49. The OCA submits that this criticism is unfounded.

As detailed more fully in the OCA's Main Brief, OCA witness Sherwood's adjustments to Account 932 resulted from the Company failing to justify why the increase in the FTY would continue to the FPFTY. OCA M.B. at 29. OCA witness Sherwood testifies:

Without justification for the increase in expense, I recommend that the three-year average of 2016-2018 other expense plus the remaining FTY expenses be used to calculate the expense for FPFTY. The FTY expense levels are used to remove the Company's inflation factor. . . This would result in Account 932 FPFTY other expense decreasing from \$72,100 to \$46,957.

OCA St. 1 at 10; OCA M.B. at 29.

The OCA's adjustments to Account 932 result from lack of justifications by the company. The only justification provided by the Company is that since "maintenance activities recorded under Account 932 vary from year to year; it is prudent to rely on the Company's budgeted experience." Wellsboro at 49. Such justification is insufficient.

The three-year average of the expense in this account properly reflects the evidence of record. Wellsboro at 49. Without justification by the Company, the OCA's adjustment to Account 932 should be accepted. App. A, Table II.

G. Rate Case Expense

In its Main Brief, the Company asserted that its rate case normalization period of 36 months should be accepted because that would be "consistent with the anticipated frequency" going forward. Wellsboro M.B. at 49. According to the Company, although the "average is 48 months, the more typical filing interval is about 36 months." Wellsboro M.B. at 51. The OCA submits that the Company's speculation regarding the filing of future base rate cases is not determinative of this issue. Wellsboro M.B. at 51.

As discussed in detail in OCA's Main Brief, it is well settled that the normalization period for rate case expense is based on a company's historic filing of base rate cases. See, OCA M.B.

at 30-31, citing Pa. PUC v. Columbia Water Co., 2009 Pa. PUC LEXIS 1423 (2009); Pa. PUC v. City of Lancaster Sewer, 2005 Pa. PUC LEXIS 44 (2005); Popowsky v. Pa. PUC, 674 A.2d 1149, 1154 (Pa. Commw. Ct. 1996); Pa. PUC v. Roaring Creek Water Co., 73 Pa. PUC 373, 400 (1990); Pa. PUC v. National Fuel Gas Dist. Corp., 84 Pa. PUC 134, 175 (1995); Pa. PUC v. West Penn Power Co., 119 P.U.R. 4th 110, 149 (Pa. PUC 1990). Wellsboro's prior three rate cases have been 37 months, 75 months, and 34 months. Wellsboro M.B. at 51. As such, OCA witness Sherwood's recommendation to normalize Wellsboro rate case expense for this proceeding over 45 months should be adopted. This normalization period resulted in a downward expense adjustment of \$21,734. OCA St. 1-SR (Revised) at 9-10; OCA M.B. at 30-31.

The Company cites to Pa. PUC v. UGI Utilities, Inc. – Electric Division, Docket No. R-2017-2640058, (Order Entered October 25, 2018) (UGI Electric) in defense of its position of using a 36 month normalization period. The Commission's determination in the UGI Electric case, however, was distinguishable from the facts presented in the case at bar. In UGI Electric, the Commission weighed the lengthy 8-year average and increased capital spending to create a specific equitable solution in the unique circumstance presented in that case. See, Order at 58. UGI Electric does not support Wellsboro's contention that rate case expense should be based on the Company's speculative intention to file a rate case rather than the historical average interval between rate filings. The OCA has not recommended any adjustment to the level of expense claimed, but does recommend an adjustment to the 3-year normalization period proposed by the Company. OCA M.B. at 30-31. The OCA submits that a 45-month normalization period is appropriate.

#### H. Cash Working Capital

As discussed at page 32 of the OCA's Main Brief, the Company's cash working capital claim is based on one-eighth (12.5%) of its operating and maintenance expenses (O&M). The

Commission should ultimately modify the adjustment to cash working capital in accordance with the total operations and maintenance adjustments adopted in this proceeding. See, OCA App. A, Table II. The Company did not address this issue in its Main Brief except to revise its own cash working capital adjustment based on its revised O&M expense claim. Wellsboro M.B. at 25.

I. Depreciation Expense

As a result of Wellsboro's use of the end of test year rate base, Wellsboro has based its test year depreciation expense on the projected balance of plant in service as of the end of the FPFTY. OCA St. 2 at 7; OCA M.B. at 32. OCA witness Morgan recommends an adjustment to the depreciation expense in order reflect the OCA's proposed use of an average test year rate base instead of the Company's proposed end of test year rate base. OCA M.B. at 32; OCA St. 2 at 7. The OCA submits that the Company should base its depreciation expense on average plant in service in the FPFTY. For the reasons set forth at Section IV(A)(1) above and in the OCA's Main Brief, the OCA continues to recommend that the Company use an average test year rate base, and therefore, the accumulated depreciation expense should be reduced by \$21,292. OCA St. 2 at 8; OCA St. 1 at Sch. SLS-3.

VII. RATE OF RETURN

A. Introduction

As explained in the OCA's Main Brief at 33, the appropriate overall rate of return is 6.68%, which is calculated using the Company's capital structure<sup>4</sup> and an 8.38% equity cost rate. OCA St. 3 at 3. Contrary to the arguments made by the Company, this is not an unreasonable rate of return for the Company. Rather, it reflects the most accurate estimate of the cost of equity using

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<sup>4</sup> The OCA's witness Dr. Habr adopted the Company's capital structure as filed in Direct Testimony. OCA St. 3 at 3.

the Commission's preferred Discounted Cash Flow (DCF) methodology. The OCA submits that its rate of return recommendation based on current market conditions is appropriate for ratemaking, and will ensure that customers do not pay more than is reasonable. The Company's request for a higher than necessary return should be rejected. There is no evidence that the Company will not be able to continue to attract capital.

The discussion below will address the main areas of disagreement; however, the OCA's Main Brief contains a full discussion of the OCA's position.

B. Capital Structure

The OCA accepted the Company's Capital Structure.<sup>5</sup> OCA St. 3 at 2-3; OCA M.B. at 39.

C. Cost of Long Term Debt

The OCA accepted the Company's long-term cost of debt of 4.98%. OCA St. 3 at 3; OCA M.B. at 38.

D. Cost of Common Equity

1. Introduction

The OCA's recommended cost of equity is 8.38%, which is the median value of all the DCF and FERC 2-Step cost rates presented by Dr. Habr. OCA St. 3 at 21; OCA M.B. at 40. Half of the observations lie above 8.38% and half lie below it. OCA St. 3 at 21-25. This middle-of-the-pack value is appropriate for Wellsboro. For the reasons discussed in OCA Statement 3 and 3-SR and the OCA's Main Brief, the OCA's recommended cost of equity of 8.38% should be adopted for ratemaking purposes.

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<sup>5</sup> The Company's proposed capital structure filed in Direct Testimony is 50.05% common equity/ 0.62% Preferred Equity/ 49.33% debt. Wellsboro St. 2-R at 3.

The OCA's DCF derived cost of common equity is 8.38% for the proxy group. The OCA's recommended return on equity relies on the results of Dr. Habr's DCF analysis, because the DCF model provides the best measure of equity cost rates. See, OCA M.B. at 40-41. This approach is consistent with this Commission's long-standing utilization of the DCF methodology when establishing the cost of common equity for utilities. OCA M.B. at 40-41; see, UGI Electric at 104. The Company argues that its use of multiple valuation models is consistent with Commission precedent. Citizens' M.B. at 60. The Commission rejected the same argument in Pa. PUC v. City of Lancaster – Bureau of Water, 2011 Pa. PUC LEXIS 1685, \*56-57 (Lancaster 2011). The use of additional models, which have flaws, does not lead to a better result, contrary to the Company's position. The UGI Electric case states as follows:

[W]e shall adopt the positions of I&E and the OCA and shall base our determination of the appropriate cost of equity on the results of the DCF method and shall use the CAPM results as a comparison thereto. As both Parties noted, the use of the DCF model has historically been our preferred methodology. This was recently affirmed in Pa. PUC, et. al v. City of Dubois-Bureau of Water, Docket No. R 2016 2554150, et. al. (Order entered March 28, 2017). Like the ALJs, we find no reason to deviate from the use of this method in the instant case.

UGI Electric at 106; see, Pa. PUC v. Emporium Water Co., Docket No. R-00061297, Order at 55-56, (Dec. 28, 2006), Pa. PUC v. Emporium Water Co., 95 Pa. PUC 191, 208 PUR4th 502 (2001); Pa. PUC v. Roaring Creek Water Co., 81 Pa. PUC 285, 150 PUR4th 449 (1994); Pa. PUC v. York Water Co., 75 Pa. PUC 134, 159-69 (1991); Pa. PUC v. Philadelphia Suburban Water Co., 71 Pa. PUC 593 (1989); Pa. PUC v. Pennsylvania-American Water Co., 71 Pa. PUC 210, 279-82 (1989); Pa. PUC v. The Peoples Natural Gas Co., 69 Pa. PUC 1, 167-68 (1989); Pa. PUC v. Pennsylvania Power, 67 Pa. PUC 91, 164, 93 PUR4th 189, 266 (1988) (Penn Power 1988); Pa. PUC v. National Fuel Gas Distribution Corp., 67 Pa. PUC 264, 332 (1988).



The Company cites to Pa. PUC v. Emporium Water Co., Docket No. R-2014-2402324 (Jan. 28, 2015) (Emporium 2014) to support its position that multiple ROE models must be used to set an appropriate return on equity in this proceeding. Company M.B. at 68. The Company claims that the Commission approved a cost of equity developed from multiple models as used by Company witness D'Ascendis in this case. Id. A review of the Commission Order in Emporium 2014 shows that the Commission did not adopt the return on equity recommendation of any specific party in that proceeding. Order at 35. Thus, the Company's argument is without merit. As discussed in the OCA's Main Brief, the Commission relies on the DCF and informed judgment. OCA M.B. at 40-41.

## 2. Proxy Group

As explained in OCA's Main Brief, Dr. Habr's proxy group is appropriate and should be adopted because it contains companies of similar risk to Wellsboro. OCA M.B. at 42-45. Dr. Habr's proxy group, unlike Mr. D'Ascendis' proxy group does not include non-price regulated results, which should not be given any weight. OCA M.B. at 45-46.

The Company argues in its Main Brief, that the "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." Wellsboro M.B. at 65 (emphasis removed).

Mr. D'Ascendis' claim that his non-price regulated proxy firms are similar in risk to the electric proxy group he uses in his analysis is without merit. See, OCA St. 3 at 32. The OCA submits, that as explained in the OCA's Main Brief, Dr. Habr opposed Mr. D'Ascendis' proxy group which is comprised of companies that are not regulated electric utilities. OCA M.B. at 57. Dr. Habr demonstrated that Mr. D'Ascendis' use of non-price regulated firm results in establishing

his recommended allowed rate of returns invalidates his conclusions. OCA St. 3 at 31-32; OCA M.B. at 57. Table – 7 of Dr. Habr’s testimony shows that the common equity cost estimates for the non-price regulated proxy groups are systematically higher than his utility common equity cost estimates by 66 to 208 basis points.

**Table -- 7 Comparison of Mr. D'Asendis' Utility v. Non-Price Regulated Cost of Common Equity Results**

<b>Estimation Method</b>	<b>Proxy Group 19 Electric Companies</b>	<b>Proxy Group of 6 Non-Price Regulated Companies</b>	<b>Proxy Group of 7 Natural Gas Distribution Companies</b>	<b>Proxy Group of 6 Non-Price Regulated Companies</b>
<b>DCF</b>	9.03%	9.74%	8.63%	10.71%
<b>Risk Premium</b>	10.39%	11.05%	10.21%	11.53%
<b>CAPM</b>	9.42%	10.71%	10.15%	11.01%
<b>Average</b>	9.61%	10.50%	9.66%	11.08%

**Source:** Schedules DWD-1, page 2 and DWD-7, page 1.

OCA St. 3 at 32. The non-price regulated proxy group results should be given no weight in these proceedings.

3. OCA's Cost of Equity Models

a. OCA's Consideration of Multiple Cost of Equity Models

As explained in more detail in the OCA's Main Brief, Dr. Habr employs multiple DCF models in his calculations. OCA M.B. at 47-50. Dr. Habr conducted 3 sets of DCF analyses -- a Constant Growth DCF, the FERC-2-Step DCF, and the Two-Stage DCF -- for each Company in his Electric Proxy Group. OCA M.B. at 47-50. Additionally, Dr. Habr employed a CAPM analysis, and a CAPM/Risk Premium analysis as a check. OCA 3-SR at 5-6.

The Company incorrectly argues that Dr. Habr placed no weight on his two-stage DCF model, CAPM model, and CAPM/Risk Premium Model and instead only considers his DCF model. Wellsboro M.B. at 80. However, the Company is plainly mistaken, because as stated in both the OCA's Main Brief and Dr. Habr's Surrebuttal (OCA St. 3-SR), the combined results of the CAPM/Risk Premium model results were used to establish the common equity cost upper limits for the electric proxy group. OCA St. 3-SR at 5-6. Moreover, the combined results of the Two-Stage DCF model (Table 2, OCA St. 3 at 21), along with the combined results of the CAPM (Table 3, OCA St. 3 at 23-24), provided lower boundaries for the proxy group's common equity costs. OCA St. 3-SR at 5-6; See, OCA M.B. at 53.

Dr. Habr utilized the results of these additional models to establish reasonable upper and lower limits and provided a check on the results of his DCF analysis. The Company's claim that Dr. Habr "places no weight on these analyses" is incorrect and should be given no weight. Wellsboro M.B. at 80.

b. OCA's Non-Constant DCF Results

As explained in the OCA's Main Brief, Dr. Habr employed the use of additional DCF methods to temper the impact of an unsustainable 5-year analyst forecasts used in the constant

growth DCF model. OCA St. 3-SR at 6- 7; OCA M.B. at 52-53. Specifically, Dr. Habr explained that although multistage DCF models are generally used on firms early in their development to capture the different stages of growth, the use of these models “has nothing to do with the utility’s current growth stage.” OCA St. 3-SR at 7. Instead, Dr. Habr used these models because the constant growth DCF model used in utility regulation requires a sustainable long-term growth rate, analyst 5-year forecasts are just that, 5-year forecasts, they are not prepared for use in a utility regulatory framework OCA St. 3-SR at 7; OCA M.B. at 52-53.

The Company criticizes Dr. Habr’s use of the additional model, and suggest that the non-constant DCF should be rejected as an invalid ROE model. Wellsboro M.B. at 80. As Dr. Habr explained and as discussed in OCA’s Main Brief, these additional methods were used to temper the impact of unsustainable 5-year analyst forecasts on the constant growth DCF model. OCA St. 3-SR at 6- 7; OCA M.B. at 47-49. As Dr. Habr explains, his use of this model tempers the impact of unsustainable 5-year analyst forecasts on the constant growth DCF model. OCA St. 3 at 7; OCA M.B. at 47-49. Each method uses a weighted average of the analyst forecast growth rates and the forecast long-term GDP growth. OCA St. 3-SR at 6-7; OCA M.B. at 47-49. The Two-Stage DCF model was used to determine an implicit average long-term growth based on the assumption that the analyst forecasts were achieved for the first 20 years with the GDP growth applying to the years thereafter. OCA St. 3-SR at 6-7; OCA M.B. at 47-49. Both of these growth rates were then used in the standard dividend yield plus growth DCF. OCA St. 3-SR at 6-7.

The Company is incorrect to argue that Dr. Habr’s application of this DCF model has no merit as Dr. Habr has demonstrated its intricate role in balancing the unsustainable 5-year growth assumption. Wellsboro M.B. at 80.

c. OCA's CAPM Analysis is not Flawed and OCA's CAPM/Risk Premium Analysis is Proper in this Context.

The Company claims to have identified flaws in OCA's CAPM analysis, thereby "invalidating" it. Wellsboro M.B. at 81. Specifically, Mr. D'Ascendis claims that the OCA's CAPM analysis "fails to utilize a risk-free rate based on a forecasted period. . ." Wellsboro M.B. at 81. Additionally, Mr. D'Ascendis claims that this model departs from the CAPM's theoretical basis, because "it assumes no risk-free asset." Wellsboro M.B. at 82.

As more fully detailed in the OCA's Main Brief, Dr. Habr has addressed the Company's arguments in his Surrebuttal testimony:

Q: ON PAGE 65, LINES 10-12, OF HIS REBUTTAL TESTIMONY, MR. D'ASCENDIS OPINES THAT YOUR RISK PREMIUM APPROACH "IS A SUBSTANTIAL DEPARTURE FROM THE CAPM'S THEORETICAL BASIS SIMPLY BECAUSE IT ASSUMES NO RISK FREE ASSET." DO YOU AGREE WITH THIS STATEMENT?

A: No. My CAPM/Risk Premium does not assume no risk free asset. Mr. D'Ascendis' has apparently forgot that the risk free asset appears in two different places in the basic CAPM equation shown below, first as a "free standing"

$$k_e = R_f + \beta_e (R_m - R_f)$$

variable and second as part of the risk premium calculation. The arithmetic in the development of the CAPM/Risk Premium formula eliminates the "free standing" risk free asset, Rf, while still including the risk free asset, Rf, in the market risk premium calculation.

OCA St. 3-SR at 8-9; See, OCA M.B. at 50-53. Dr. Habr explained further that he uses the CAPM/Risk Premium Model as a check on his DCF analysis. The core problem with the basic CAPM is that the closest measure there is for a true risk free rate, is the rate on a short duration T-bill which is highly influenced by the Federal Reserve monetary policy and thus does not reflect a market determined risk free rate. OCA St. 3 at 15; OCA M.B. at 51-52. Following, the core problem with the risk premium model is the cost of common equity has to be estimated somehow

to come up with the risk premium to be added to the bond yield to determine the cost of equity. OCA St. 3 at 14-16; OCA M.B. at 51-52. Due to core problems with both models individually, combined they produce more accurate and useful results. OCA St. 3 at 14-16; OCA M.B. at 51-52.

As explained more thoroughly in OCA's Main Brief, Dr. Habr's CAPM/Risk Premium model yields maximum common equity estimates when it is applied assuming the bond betas equal zero as done in Dr. Habr's analysis. OCA St. 3-SR at 24; OCA M.B. at 53. The combined CAPM/Risk Premium median 8.76% and 8.92% average provide an upper limit for common equity cost rates. OCA St. 3-SR at 24; OCA M.B. at 53; see also OCA Exhibit DSH-5 at 1-4. Furthermore, the Company again incorrectly asserts that the OCA develops its recommended ROE solely on its constant growth DCF and FERC two-step DCF models, however as plainly stated by Dr. Habr, the CAPM/Risk Premium provided important limits that were used in analyzing the DCF results consistent with Commission precedent. OCA M.B. at 52-53.

#### 4. Management Performance Adder

The Company has requested that the Commission adopt a cost of equity for Wellsboro that includes an additional 25 basis points for what has been described as "effective management of operations and costs which warrants a performance adjustment." Wellsboro M.B. at 83. The OCA opposes the Company's request for a higher equity return rate on this basis. The Company's ratepayers have a right to receive safe and adequate service at rates which are just and reasonable, and to expect utility management to operate in an effective manner. 66 Pa. C.S. §§ 1301, 1501. The OCA recognizes that the Public Utility Code allows the Commission to "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.” 66 Pa. C.S. § 523(a). The evidence of record here, however, does not support the Company’s request.

In its Main Brief the Company opines that OCA, has “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.” Wellsboro M.B. at 92. OCA witness Dr. Habr did testify that an additional 25-basis point adjustment to ROE would be unduly burdensome for ratepayers. OCA St. 3 at 30-31. After review of all company testimony as it related to the performance factor adjustment, Dr. Habr found “descriptions of management doing the job they are expected to do.” OCA St. 3 at 30-31. Moreover, what the Company describes as going beyond what it is required to do, Dr. Habr describes as “taking actions any successful company has to take to efficiently maintain its operations and provide satisfactory customer service.” See, Wellsboro M.B. at 59; OCA St. 3 at 31. This is evident in the fact that Wellsboro’s purported evidence for this adder includes low number of customer complaints, favorable customer feedback, high responsiveness to customer support calls, low number of reportable injuries, and technological improvements in customer service. Wellsboro M.B. at 84.

Accordingly, the OCA submits that the evidence of record, taken as a whole, does not support the Company’s request for a 25-basis point ROE adder. See, OCA M.B. at 59.

##### 5. Size Performance Adder

The Company has also requested that the Commission adopt a cost of equity for Wellsboro that includes an additional 100 basis points for what has been described as “size adjustment to account for the greater risk faced by smaller public utilities. . .” Wellsboro M.B. at 87. Both I&E and the OCA oppose the Company’s request for a higher equity return rate on this basis.

In its Main Brief the Company states that OCA contests the proposed size adjustment based on misunderstanding Company testimony and “irrelevant condemnations of small utility operations.” Wellsboro M.B. at 91. OCA witness Dr. Habr testifies that an additional 100-basis point adjustment to ROE would be unduly burdensome for ratepayers. OCA St. 3 at 29-30. After review of all Company testimony as it related to the size adjustment, Dr. Habr found that the economic literature would, in fact, support a downward adjustment if any. As Dr. Habr explained:

The size premiums on Schedule DWD-8, page 1 do not tell the whole story. Duff & Phelps also provides the OLS (ordinary least squares) betas associated with each of the size deciles shown on this page. Table -6 below shows the size premium and OLS beta for each size decile from an earlier Duff & Phelps study.

**Table -- 6 Duff & Phelps Size Premium and Associated OLS Betas**

Market Capitalization (\$Mil)				
Decile	Low	High	Size Premium	OLS Beta
1	\$24,361.659	\$609,163.498	-0.35%	0.92
2	\$10,784.101	\$24,233.747	0.61%	1.04
3	\$5,683.991	\$10,711.194	0.89%	1.11
4	\$3,520.556	\$5,676.716	0.98%	1.13
5	\$2,392.689	\$3,512.913	1.51%	1.17
6	\$1,571.193	\$2,390.899	1.66%	1.17
7	\$1,033.341	\$1,569.984	1.72%	1.25
8	\$569.279	\$1,030.426	2.08%	1.30
9	\$263.715	\$567.843	2.68%	1.34
10	\$2.516	\$262.891	5.59%	1.39

Source: Duff & Phelps, Valuation Handbook, 2017, p. 7-11 and Appendix 3.

When the OLS betas and size premiums for all ten deciles are taken into account, it is clear that regulated utility companies have more in common with the first decile.

What this table shows is that positive size premiums are associated with OLS betas that are greater than one. All of the utility holding companies in the proxy groups in this proceeding have betas that were calculated using ordinary least squares and have values less than one. This suggests that if any adjustment is made for size, it should be negative rather than positive.



OCA St. 3 at 29-30. (Footnote omitted). Accordingly, the OCA submits that the evidence of record, taken as a whole, does not support the Company's request for a 100-basis point ROE adder. As Dr. Habr states the Company's ratepayers "should not be required to pay higher costs associated with inefficient utility operations. If a utility company chooses to operate at such a small scale that its cost of common equity is truly increased, there is no reason for the utility's captive customers to pay any increased costs resulting from the utility's inefficient size." OCA St. 3 at 30; OCA M.B. at 59.

## VIII. TAXES

### A. EDIT

In its Main Brief, the Company maintains that rates were changed to reflect the flow back of the Excess Accumulated Deferred Income Taxes (EDIT). Wellsboro M.B. at 96-97. The OCA submits, however, that the Company did not provide any evidence to demonstrate that the EDIT has, in fact, been returned to customers, commencing in 2018. As shown on the Appendix C, Attachment C, Page 2 of Wellsboro's filing, the Company has not identified any flowback of the EDIT in the determination of the Company's rate reduction in 2018. OCA St. 2-SR at 10. The Company did not provide any evidence in Rejoinder, or in response, to demonstrate it has, in fact, returned the EDIT to customers. Since the Company has failed to provide any evidence that the rates had been changed to flow back the EDIT, OCA witness Morgan recommended an adjustment on Schedule LMK-6 to reverse the flowback of EDIT reflected in the Company's filing. This adjustment increases the EDIT balance by \$2,267 and reduces rate base by the same amount. OCA St. 2 at 10-11, Sch. LMK-6; see, OCA witness Sherwood's flow-through of OCA witness Morgan's adjustment at OCA St. 1 at 3, Sch SLS-3; OCA St. 1-SR (Revised) at Sch. SLS-1SR (Revised); OCA M.B. at 62-65, App. A, Table II.

### B. Deferred Regulatory Liability

In Docket No. M-2018-2641242, the Commission ordered each utility to create a deferred regulatory liability account to record the tax savings associated with the TCJA for the January 1, 2018 through June 30, 2018 time period. Tax Cuts and Jobs Act of 2017, Docket No. M-2018-2641242, Order (May 17, 2018); see also, OCA St. 2 at 11. As discussed in the OCA's Main Brief, the Company received a waiver to maintain the current distribution rates reflecting the TCJA Voluntary Surcharge during the pendency of the rate case. OCA M.B. at 65; see also, Tax Cuts

and Jobs Act- Wellsboro Electric Company, Docket No. R-2018-3000562, Order (November 8, 2018). For the reasons set forth in the OCA’s Main Brief, the OCA recommends that the tax savings collected from January 2018 through June 2018, including accumulated interest, should be returned to customers as soon as possible. OCA M.B. at 65-66. The OCA respectfully requests that the Commission require the Company to provide a more concrete plan for the return of these customer funds.

## IX. CUSTOMER RATE STRUCTURE

### A. Allocated Cost of Service Study

In its Main Brief, Wellsboro argues that the Commission should accept its Allocated Class Cost of Service Study (ACCOSS) without modification. Wellsboro M.B. at 97. The OCA accepted many aspects of the Company’s ACCOSS, including Mr. Gorman’s classification of primary distribution as demand-related and classification of services and meters as customer-related. See, OCA M.B. at 68. As discussed in its Main Brief, OCA witness Mierzwa proposed modifications to the Company’s ACCOSS to change the Company’s classification of a significant portion of the secondary distribution plant upstream of meters and services as customer-related. OCA M.B. at 68-77. As OCA witness Mierzwa explains, the secondary portion of upstream distribution plant should be classified as 100% demand-related. OCA St. 4 at 4, 10; OCA M.B. at 69-70. Secondary distribution plant should be classified as 100 percent demand-related as these costs are incurred to meet the coincident loads of the customers served by the Company. Moreover, the “zero-load” analysis performed by Company witness Gorman did not provide a reasonable basis to classify upstream secondary distribution plant as customer-related. See, OCA M.B. at 71-72.

The OCA submits that Company witness Gorman's classification of a significant portion of secondary distribution plant costs upstream of the meters and service drops as customer-related is improper. See, OCA M.B. at 69-70. As OCA witness Mierzwa explains, the secondary portion of upstream plant should be classified as 100 percent demand-related. OCA St. 4 at 4, 10. OCA witness Mierzwa explained why classification of a significant portion of upstream secondary distribution plant as customer-related is counter to the purposes of the plant. Mr. Mierzwa testified:

The size and costs of the required plant are a function of the diversity of the customers' loads that must be served from this plant, as well as the expected future coincident loads that may have to be served from these facilities as growth occurs on the system. There is no direct relationship between the number of customers and the size or the cost of poles, conductors or transformers. That is clearly the case for poles and conductors, but it is also true in most cases for transformers. While transformers generally serve more than one customer, there is no requirement to install a transformer for a given number of customers on many systems. The Companies have previously acknowledged that there is no standard number of customers per transformer. The number, sizes (and therefore the costs) of transformers will depend on the diversity of the loads of the customers in the locality, the mix of customers served from the system in the area, the density of the population in the area, and probably the general configuration of the distribution system in that locality. To hypothetically carve out some portion of that cost as customer-related is simply inappropriate.

OCA St. 4 at 10.

Company witness Gorman, however, classifies a significant portion of secondary distribution plant as customer related using the two methodologies to determine the customer-related component. As discussed in the OCA's Main Brief, Mr. Gorman uses a minimum system approach to estimate the customer-related portion of line transformers and what he terms a "zero-load analysis" to estimate the customer-related portion of all other upstream secondary distribution plant (poles; towers, fixtures, overhead conductors and devices; underground conduit; and underground conductors and devices). OCA St. 4 at 9. In determining the classification for

secondary distribution plant as customer-related, Company witness Gorman failed to account for how the distribution system is engineered and how it is designed to work on a day-to-day basis. See, OCA M.B. at 70; see also, OCA St. 4 at 10-12. Even if one were to accept that a portion of secondary distribution plant should be classified as customer-related, Mr. Gorman's methodologies are flawed and cannot be relied on for use in this proceeding.

In its Main Brief, the Company argues that the minimum system method is an appropriate method of making this classification and attempts to justify the approach by citing to the UGI Order and PPL 2012 Order. Wellsboro M.B. at 99, citing UGI Order at 157, 160; PPL 2012 at 113. The OCA submits, however, that the Company's Main Brief does not address the flaws OCA witness Mierzwa identified in Company witness Gorman's approach and methodology as discussed below.

For the reasons set forth below, the Company's claims should be rejected, and the OCA's ACCOSS should be used as a guide in this proceeding.

1. Mr. Gorman's "Zero-Load Analysis" Is Flawed.

Company witness Gorman performed "zero-load analysis" in order to determine a customer-related portion of the secondary distribution plant other than line transformers. OCA M.B. at 71-72. That "zero-load analysis" is fundamentally flawed and cannot be relied upon by the Commission. OCA witness Mierzwa explained the problem with this analysis as follows:

I would agree that the installation of no material would result in a system that has zero load-carrying capability. **But, at the same time, I cannot envision a system that has no material (i.e., no actual conductor and no actual poles) connecting customers to the system, which is the basic concept behind classifying some portion of upstream secondary distribution plant as customer-related.** There are no facilities to connect the customer to the system. Further, the very idea of sending a crew out to undertake work to construct a secondary distribution system with no material has no basis.

When a distribution line is upgraded, the costs of doing so are integrated. If new conductor is added, or new poles installed, there is no rationale in trying to separate out the costs of labor, vehicle and overhead as customer-related while only the costs of the poles and the conductor are related to demand. Without the poles and the conductor there would be no distribution line upgrade, and that upgrade was no doubt required because the expected future coincident demand to be imposed on those facilities required the upgrade. Mr. Gorman's separation of these installation costs into customer- and demand-related is artificial, and merely has the effect of shifting cost responsibility to those classes with numerous small customers.

OCA St. 4 at 11 (emphasis added).

As can be seen, Mr. Gorman's "zero-load analysis" has no basis in how secondary distribution costs are actually incurred or the reason for the incurrence of such costs. Secondary distribution plant costs are incurred to meet the coincident loads of customers and the size and costs are a function of the diversity of customers' loads and expected future coincident loads. OCA St. 4 at 10. The artificial assumptions used by Mr. Gorman improperly shift cost responsibility and should be rejected.

## 2. Mr. Gorman's Minimum System Analysis Is Flawed.

Company witness Gorman's minimum system analysis is also fundamentally flawed.<sup>6</sup> The OCA addressed the flaws in the minimum system study in its Main Brief at pages 72 through 73. Mr. Gorman's methodology does not reflect how coincident load drives transformer costs. Nor does Mr. Gorman's analysis account for the load-carrying capability of the hypothetical minimum system. As OCA witness Mierzwa explained:

For Wellsboro, the minimum size transformer was determined to be a 10 kVa transformer serving one customer...He then multiplies this minimum size transformer cost for each of the Companies by the number of line transformers on the system to arrive at the portion of total line transformer costs that he defines as customer-related. As indicated earlier, there is no direct relationship between the

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<sup>6</sup> Mr. Gorman used a minimum system analysis for the portion of secondary distribution plant represented by line transformers to determine the percentage that is customer-related. OCA St. 4 at 9. A minimum system hypothetically reconstructs the distribution system with the smallest size poles, conductors, and transformers possible. In this case, it was applied to line transformers. The cost of the hypothetical system is deemed to be customer-related and the remaining actual cost is deemed to be demand-related. OCA St. 4 at 9; OCA M.B. at 72.

number of customers and the cost of line transformers. The total transformation capacity will depend upon the coincident loads that must be met by the local neighborhood distribution systems. The reasons for making transformer investments are the need to meet those local coincident loads. Finally, the so-called minimum size transformer has significant load-carrying capability and so the investment is not made simply to connect the customer to the system. For all of these reasons, Mr. Gorman's classification of these costs should be rejected and 100 percent of these costs should be classified as demand-related.

OCA St. 4 at 12.

Company witness Gorman fails to reflect that the number, size, and costs of transformers will depend on the diversity of loads of the customers in a locality, the mix of customers served from the system in the area, the density of the population and the general configuration of the distribution system in the locality. OCA St. 4 at 12. Mr. Gorman has presented no evidence to demonstrate the correlation between the length or mileage of Citizens' secondary distribution system and the number of customers served by Wellsboro's system. OCA St. 4-SR at 2. Moreover, the size of the transformer Mr. Gorman has deemed minimum, in fact, has significant load carrying capability. For these flaws in the analysis, the OCA submits that Company witness Gorman's proposed minimum system analysis for line transformers should be rejected.

At pages 74 to 77 of the OCA's Main Brief, the OCA discusses OCA witness Mierzwa's modified ACCOSS which classifies upstream secondary distribution plant as 100 percent demand-related. OCA M.B. at 74-77. Mr. Mierzwa's proposed ACCOSS should be adopted.

B. Revenue Allocation

Company witness Gorman's revenue allocation proposal would provide for a rate decrease of 19.9 percent for the POL rate case when other rate classes are experiencing significant rate increases. OCA St. 4 at 18. Such a rate decrease for Rate POL when others' rates are increasing is not appropriate. Mr. Mierzwa explained:

[N]o class should receive a rate decrease at a time when rates are increasing. I would note that in Citizens' 2010 base rate proceeding, Mr. Gorman agreed with this additional objective. While I generally find Mr. Gorman's proposed revenue distribution for Wellsboro to be reasonable, I disagree with Mr. Gorman's proposed rate decrease for the POL rate class. Mr. Gorman also essentially proposes no increase for the MSL rate class, which I do not believe is reasonable; however, any change to the increase proposed for this class would have an immaterial impact on the remaining classes.

OCA St. 4 at 18. OCA, I&E, and OSBA all agree that the proposed revenue decrease is not appropriate.

The OCA submits that the rate decrease proposed for the POL rate class should be eliminated and proportionately distributed to the remaining rate classes. OCA St. 4 at 19. Mr. Mierzwa's recommendations are summarized in Table 4 of his Direct Testimony:

Class	Present Rates	Proposed Rates	Increase	Percent
RS	\$2,619,792	\$3,249,171	\$629,379	24.0%
RSAE	25,825	32,931	7,106	27.5
NRS	390,322	455,866	65,544	16.8
NRH	1,395	1,788	393	28.2
CS	1,322,797	1,461,702	138,905	10.5
CSH	1,109	1,420	311	28.0
IS	656,296	812,409	156,113	23.8
MSL	20,906	21,147	241	1.2
POL	86,066	86,066	0	0.0
EU	7,813	9,788	1,975	25.3
<b>Total:</b>	<b>\$5,132,321</b>	<b>\$6,132,288</b>	<b>\$999,967</b>	<b>19.5%</b>

OCA St. 4 at 19.<sup>7</sup>

<sup>7</sup> As discussed in Section D below, if Wellsboro's authorized increase is less than its requested increase, the Commission should proportionately scale-back the increase for each class. OCA St. 4 at 19.



In support of Wellsboro’s proposed revenue allocation, the Company relies upon the Lloyd v. Pa. PUC decision. Wellsboro M.B. at 101, citing Lloyd v. Pa. PUC, 904 A.2d 1010, 1015 (Pa. Commw. 2004)(Lloyd). The Company is correct that the Commonwealth Court provided that the “polestar” for determining the level of revenue for the different rate classes should be the cost of providing service to those different rate classes. See, Wellsboro M.B. at 101; Lloyd at 1020. “Polestar” is a literary reference meaning “directing principle” or a “guide.”<sup>8</sup> The OCA submits, however, that the evaluation of a cost of service study involves more than just an examination of the level of revenue for the different rate classes, and those additional factors support Mr. Mierzwa’s proposal to eliminate the proposed rate decrease for Rate POL.

The Commission has long regarded cost of service studies as more of an art form and a guide rather than as a source of actual data. Application of Metropolitan Edison Company for Approval of Restructuring Plan Under Section 2806 of the Public Utility Code, 1998 Pa. PUC LEXIS 160, \*159 (1998); Pa. P.U.C. v. Pa. Power & Light, 55 P.U.R. 4<sup>th</sup> 185, 249 (Pa. PUC 1983); Pa. PUC v. Aqua Pa., Inc., Docket No. R-00072711, Order (July 31, 2008). Factors such as gradualism, rate shock, rate continuity, competitive concerns, and principles of fundamental fairness must also weigh in the determination. See, Lloyd at 1020-1021. In City of DuBois, the Commission correctly stated that “while *Lloyd* establishes cost of service rates as the polestar of ratemaking, it does not preclude consideration of other factors.” Pa. PUC v. City of DuBois, Docket No. R-2016-2554150, slip. op. at 26 (May 18, 2017). Mr. Mierzwa has included these important considerations in developing his alternative recommendations concerning revenue allocation.

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<sup>8</sup> The American Heritage Dictionary, Houghton Mifflin Co. (1985).

The Company also argues that, in the UGI case, the Commission approved a rate decrease because it would move the classes towards a system average rate of return. Wellsboro M.B. at 101, citing UGI Order at 164. In this case, however, OCA witness Mierzwa's proposed revenue allocation would move all classes, including Rate POL, closer to the system average. Mr. Mierzwa testified:

As indicated earlier, movement toward the cost of service for a particular rate class can be evaluated by comparing the percentage cost of service contribution of that rate class under present versus proposed rates. That is, for a rate class whose revenues currently exceed the cost of service and the percentage contribution is decreasing, the class is moving closer to the cost of service, and if the percentage contribution is increasing, the class is moving away from the cost of service. Revenues from the POL rate class currently exceed the indicated cost of service. In this proceeding, the cost of service at proposed rates is likely to be higher than the cost of service at present rates. Under my proposed revenue distribution, POL rate class revenues would remain unchanged. Since the cost of service under proposed rates would be higher than at present rates, the percentage contribution of the POL rate would decrease, resulting in a movement toward the cost of service. OCA St. 4-SR at 7.

Moreover, in the PPL 2012 base rate proceeding, the Commission rejected providing rate decreases in a general base rate proceeding, holding, "as a matter of fairness, those customer classes that have not been allotted any rate increase via the Company's original revenue allocation should not receive rate decreases as argued by the OSBA and PPLICA." Pa. PUC v. PPL Electric Utilities Corp., Docket No. R-2012-2290597, Order at 124 (March 30, 2018)(PPL 2012). Moreover, OCA witness Mierzwa noted in testimony that Company witness Gorman has also previously supported the concept that a rate class should not be allocated a rate decrease when other rate classes are being increased. See, OCA M.B. at 83; OCA St. 4-SR at 5.

As discussed in the OCA's Main Brief, the OCA, I&E and OSBA all propose variations on how to reallocate the proposed rate decrease, but the OCA, I&E, and OSBA all agree that a customer class should not be given a rate decrease when other customer rates are increasing. OCA

M.B. at 81-82. OCA witness Mierzwa's proposal will move all classes towards the system average rate of return, even Rate POL. For the reasons set forth above and in the OCA's Main Brief, the OCA submits that the OCA's proposed revenue allocation modifications should be adopted as proposed in OCA witness Mierzwa's Table 4 in his Direct Testimony. OCA M.B. at 77-83; OCA St. 4 at 19.

C. Rate Design

The Company proposes to include \$1.48 of demand-related costs in its proposed \$13.40 customer charge. Wellsboro M.B. at 103; Wellsboro St. 1 at 43-44, Exh. HSG-1, Sch. E1-C(W). The OCA does not dispute the \$11.92 of customer-related costs (at the Company's full revenue increase) that the Company proposes to include in the residential customer charge. OCA St. 4 at 24. The customer-related cost component calculated by the Company is based upon the service, meter, customer accounting software investment costs and the related operation and maintenance expenses that have been identified in the Company's cost of service study. OCA St. 4 at 24. At the Company's full request, the OCA recommends approval of an increase of the residential customer charge from \$10.79 to \$11.92. OCA St. 4 at 23-24. For the reasons set forth in the OCA's Main Brief, the OCA opposes the inclusion of demand charges in the customer charge. OCA M.B. at 83-92. I&E also opposes the Company's proposed inclusion of demand charges in the customer charge. See, I&E M.B. at 62-68.

In its Main Brief, the Company argues that the purpose of the 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 revenue for Wellsboro and its customers. Wellsboro M.B. at 103. Wellsboro claims that demand charges should be included in the customer charge because the Company's advanced metering infrastructure now allows

Wellsboro to move towards rates that reflect demand-related costs. The Company argues that the proposed inclusion of demand charges is also consistent with policy objectives identified in the Commission's Final Policy Statement Order regarding alternative ratemaking. Wellsboro M.B. at 103; Fixed Utility Distribution Rates Policy Statement, Docket No. M-2015-2518883, Order (July 18, 2019) (Final Policy Statement Order). The Company finally argues that inclusion of the minimum customer demand is consistent with cost-causation principles, retains price signals, and respects the principle of gradualism. Wellsboro M.B. at 110.

The OCA submits that the Company's proposal does not align with the goals enumerated in the Fixed Utility Distribution Rates Policy Statement and Final Policy Statement Order implementing the Policy Statement, does not retain price signals, and is not consistent with cost-causation principles. The Commission's Policy Statement and Order clearly encourage efficient use of electricity. See, OCA M.B. at 86-92.

OCA witness Mierzwa and I&E witness Cline both oppose the proposed inclusion of demand charges in the customer charge. See, OCA St. 4 at 23-29; I&E St. 3 at 28-38; OCA M.B. at 83-92; I&E M.B. at 62-68. The OCA does not agree that the purposes of the Commission's Policy Statement are met by the Company's proposal. As stated, the purposes of the Commission's Policy is to promote the efficient use of electricity, and the Company's proposal would be contrary to that objective. As OCA witness Mierzwa testified:

The efficient use of a resource such as electricity requires that the resource be priced to discourage wasteful consumption. As indicated previously, the cost structures of Wellsboro and Citizens' largely reflect costs that vary with changes in demand. The proposal of Wellsboro and Citizens' to include demand costs in the fixed monthly charge will not provide price signals that are particularly relevant to the cost structure. The volumetric energy charge is the primary source of price signals. Therefore, inclusion of demand charges as proposed by Wellsboro and Citizens' will not promote the efficient use of energy.

OCA St. 4 at 27.

Moreover, as Mr. Mierzwa explained, following Mr. Gorman's recommendations to the final steps and logical conclusion would result in the entire cost of service for Wellsboro being recovered through monthly customer charges. OCA witness Mierzwa testified:

This would send customers inappropriate price signals, significantly reduce the incentive for customers to conserve energy and reduce consumption, and increase total costs in the long term. The Commission should not embrace a policy that will ultimately lead to these results.

OCA St. 4 at 26.

As discussed more fully in the OCA's Main Brief, Section 69.3302 identifies 14 factors to be considered in support of the proposed ratemaking mechanisms. See, OCA M.B. at 88-89. Mr. Gorman's proposed inclusion of demand charges as a part of the customer charge fails to meet the necessary criteria to be approved. Mr. Gorman's Direct Testimony responds to each of these 14 factors, but the OCA submits that the Company's responses do not align with the goals identified by the Final Policy Statement Order. See, Wellsboro St. 1 at 39-42.

I&E witness Cline specifically addressed each of these 14 factors in his Direct Testimony. I&E St. 3 at 34-36; see also, OCA M.B. at 89-91. In particular, Mr. Cline did not agree that the proposed rate design aligns revenues with cost causation principles because demand costs should not be counted as fixed costs. I&E St. 3 at 34. I&E witness Cline also identified concerns about the impact on price signals to customers; the impact on incentives to engage in energy conservation measures; and the potential disproportionate impact on low-income customers. I&E St. 3 at 34-36; see also, I&E M.B. at 66.

The Company argues that OCA and I&E ignore the fact that the Company has allocated a small portion of the demand charges to the volumetric price. Wellsboro M.B. at 110. The OCA and I&E do not ignore this fact. Specifically, I&E witness Cline testified that "an energy charge is far superior to allocating demand-related costs to all residential customers equally through the

fixed customer charge.” I&E St. 1 at 30; I&E M.B. at 62; see also, OCA St. 4-SR at 9. The inclusion of demand charges in the volumetric charge does not create the same problem created by the Company’s proposed inclusion of demand charges in the customer charge. The Company cannot overcome the fact that inclusion of demand charges in the customer charge would not allow customers to receive price signals and would be contrary to the objectives identified in the Commission’s Final Policy Statement.

For the reasons set forth above and in the OCA’s Main Brief, the Company’s proposed inclusion of demand charges in the fixed customer charge should be denied. See, OCA M.B. at 83-92. The Company has not provided a sufficient basis to demonstrate that the proposed change would facilitate the stated energy efficiency purposes of the Commonwealth or the Commission’s Policy Statement. Moreover, the proposed customer charge would unduly prejudice low usage customers and would not provide a price signal to encourage customer conservation.

D. Scale Back

The OCA, I&E, OSBA and the Company agree that the revenue allocation should be proportionately scaled back if the Commission authorizes less than the Company’s full requested increase. OCA M.B. at 92-93; I&E M.B. at 68-69; OSBA M.B. at 10; Wellsboro M.B. at 111-112. The parties, however, differ with respect to which classes the proportionate scale back should be applied.

In its Main Brief, Wellsboro argues that a scale back should be applied proportionately based on the cost of service approved by the Commission. Wellsboro M.B. at 111. The Company includes a rate decrease for Rate POL. The Company states that “[t]his includes a proportional scale back of both increases and decreases.” Wellsboro M.B. at 111. As detailed in the OCA’s Main Brief, OCA witness Mierzwa recommended a proportionate scale back of the revenue

allocation to reflect the increase actually authorized by the Commission, but did not support the Company's proposal to decrease rates for Rate POL. OCA St. 4 at 19. The OCA's revenue allocation does not propose decreases for any class at a time when rates are increasing. OCA St. 4 at 19; see City of DuBois at 26; see also, PPL 2012 at 124. I&E witness Cline also recommended a proportionate scale back with a similar exception that only those customer classes that received a proposed increase should be scaled back. I&E St. 3-SR at 17.

As discussed in the OCA's Main Brief, OCA witness Mierzwa modified his revenue allocation scale back proposal in response to concerns identified by OSBA witness Kalcic. See, OCA M.B. at 93. OSBA witness Kalcic argued that under Mr. Mierzwa's proposed scale back, the RSAE, NRH, and CSH rate classes would move away from the cost of service and those classes should be excluded from any scale back. OCA witness Mierzwa modified his proportionate scale back proposal as follows:

I recommend that the increases proposed for the RSAE, NRH, and CSH classes not be scaled back until the increase for each class reaches 1.5 times the system average increase. I would note that the RSAE, NRH, and CSH rate classes represent less than 1.0 percent of Wellsboro's total cost of service. Therefore, any scale back of the increases initially proposed for each of these rate classes would likely have a minimal impact on the rates of the other rate classes served by Wellsboro.

OCA St. 4-SR at 6.

For the customer charge, the OCA recommends that the residential customer charge be scaled back to match the percentage increase authorized by the Commission, *i.e.*, the customer charge would be scaled back 50 percent if the Commission authorizes 50 percent of the Company's requested increase. OCA St. 4 at 28; OCA M.B. at 92.

If the Commission authorizes less than the Company's proposed full revenue requirement request, the OCA submits that the customer charge and the revenue allocation should be scaled back in accordance with OCA witness Mierzwa's recommendations.

E. Summary

For the reasons set forth herein and in the OCA's Main Brief, the OCA submits that the Commission should reject the Company's ACCOSS. The Commission should also reject the Company's proposed revenue allocation and adopt the OCA's modified revenue allocation. The OCA's revenue allocation provides reasonable progress toward moving classes to the cost of service, applies the principles of gradualism, and reflects basic fairness. Additionally, the OCA submits that the Commission should reject the Company's proposed customer charge of \$13.40 per month (including demand components) and adopt the OCA's proposed customer charge at the Company's full revenue increase of \$11.92 per month (including only customer-related components). The revenue allocation and customer charge should be scaled back in accordance with OCA witness Mierzwa's recommendation if the Company is not authorized to recover its full request.

X. MISCELLANEOUS ISSUES

A. Reporting Requirements

The OCA did not take a position on I&E's requested additional reporting requirements in its testimony in this proceeding.

B. Effect of Wellsboro's Revised Revenue Increase Request

In its Brief, the Company argues that, but for the Commission's denial of its Petition for Waiver of the filing requirements at 52 Pa. Code § 53.53, the Company could have supported a revenue increase of \$1.1 million. Wellsboro M.B. at 113-115; see, 52 Pa. Code § 53.53. The Company states that it reduced its request to \$999,999 only as a result of the denial of the waiver, and contends that the Company, therefore, should be entitled to the maximum allowable under the Commission's regulations, \$999,999. Wellsboro M.B. at 113-115. The OCA submits that the



merits of the Company's filing do not support a revenue increase of \$999,999. The merits of the filing support OCA's recommended revenue increase of \$645,212.

The Company has not met its burden proof to demonstrate the need for an annual distribution revenue increase of \$999,999, let alone the \$1.1 million it states it can support. The OCA has proposed adjustments to the Company's proposed cost of equity,<sup>9</sup> rate base including the Company's use of an end of test year rate base for the Fully Projected Future Test Year including the corresponding depreciation adjustments, use of an across-the-board 3.0 percent inflation factor, cash working capital, taxes and net operating income items, including miscellaneous distribution expense, maintenance of overhead lines, safety and communication, maintenance of general property, and rate case expense. I&E has also made its own adjustments to the Company's proposed revenue increase. A summary of the OCA's adjustments are provided in its Table II. See, OCA M.B. at App. A, Table II. Based on the evidence the Company has provided to support its revenue claim and the applicable law, it is clear that the Company's annual distribution revenues should increase by no more than \$645,212.

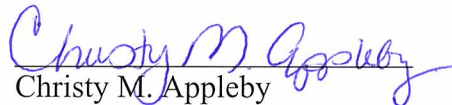
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<sup>9</sup> The OCA's recommended cost of equity is 8.38%, which is lower than the Company's claim of a 10.3% cost of equity in support of its \$1.1 million revenue increase or its 9.31% cost of equity incorporated into its revenue request of \$999,999. See, e.g., I&E St. 2-SR at 4-5; Wellsboro M.B. at App. A, Tables I, II.

XI. CONCLUSION

For the reasons set forth in this Reply Brief and the OCA's Main Brief, the OCA respectfully submits that the Commission should adopt the OCA's adjustments and modifications to the Company's rate increase request. The Company's as-proposed rate increase request will not result in just and reasonable rates and will not reflect sound ratemaking and Pennsylvania law. A fair revenue allocation, monthly residential customer charge, and return on equity must be adopted in this proceeding.

Respectfully Submitted,



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Date: January 22, 2020  
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