BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY BRIEF
OF WELLSBORO ELECTRIC COMPANY

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Statutes

52 Pa. Code § 53.52(a), (b), and (c)

52 Pa. Code § 53.56

52 Pa. Code § 57.47

52 Pa. Code § 69.3302

66 Pa. C.S. § 315(a)

66 Pa. C.S. § 315(e)

66 Pa. C.S. § 523

66 Pa. C.S. § 1330

Act of February 14, 2012, Pub. L. 72, No. 11

Act of July 1, 1978, P.L. 598, *as amended*, added by Act of June 28, 2018, P.L. 58, 66 Pa. C.S. § 1330

Other Authorities

Fixed Utility Distribution Rates Policy Statement, Final Policy Statement Order, Docket No. M-2015-2518883 (Order entered July 18, 2019)

I. INTRODUCTION[1]

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

On July 31, 2019, Wellsboro filed a revised Supplement No. 125 ("Supplement No. 125") modifying the proposed revenue increase to approximately $999,999 for compliance purposes and therefore seeks a revenue increase lower than that supported by the Company's analysis.[2] The Company's analysis continued to support the $1,419,610 increase in revenue. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1 (W).

In its Rebuttal Testimony, Wellsboro maintained its proposed increase of approximately $999,999, but reflected acceptance of several adjustments to its rate analysis. Wellsboro Statement No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R).[3] The Rebuttal position shows the Company can support a revenue increase of approximately $1.1 million, but the Company requests that the Commission approve the proposal to increase base rate revenues by approximately $999,999.

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[1] A complete procedural history of the case was provided in the Company's Main Brief and is incorporated by reference as if stated herein. Additionally, any terms undefined in this Reply Brief shall be understood to have the meanings defined in the Company's Main Brief.

[2] The requested revenue increase was reduced to $999,999 to maintain Wellsboro's ability to use simplified rate case procedures under 52 Pa. Code § 53.52. *See* Wellsboro Main Brief, Section X.B.; *see also* Wellsboro Exhibit No. 1, Exhibit__(HSG-1), Schedule C5-1 (W).

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

On January 8, 2020, Wellsboro filed a Main Brief in support of its proposed $999,999 revenue increase. On the same date, Wellsboro received Main Briefs from the Commission's Bureau of Investigation and Enforcement ("I&E"), Office of Consumer Advocate ("OCA"), and Office of Small Business Advocate ("OSBA").

II. SUMMARY OF ARGUMENT

The Main Briefs received from OCA, I&E, and OSBA generally restate each party's positions on the rate base, revenue, expense, rate design, and rate structure issues as addressed in Wellsboro's Main Brief. This Reply Brief will further respond to the arguments advanced in parties' Main Briefs by referencing the applicable responses in Wellsboro's Main Brief and identifying additional record evidence in support of Wellsboro's positions.

III. ISSUES RESOLVED AMONG ALL PARTIES

Wellsboro's Main Brief reviewed several issues resolved among all parties. The I&E and OCA Main Briefs generally affirmed the agreements recounted in the Wellsboro Main Brief, including parties' agreements on Materials & Supplies, Customer Deposits, and Present Rate Revenue / Customer Counts. *See* I&E Main Brief, at 14-15; *see* OCA Main Brief, at 7-9. As such, Wellsboro will not further address these matters in this Reply Brief.

With regard to Construction Work in Progress ("CWIP"), OCA's Main Brief noted a partial agreement among the parties but clarified a remaining point of dispute. OCA recognized that Wellsboro accepted the OCA and I&E proposals to remove CWIP from rate base for the FPFTY. *See* OCA Main Brief at 18-19. However, OCA correctly observed that Wellsboro conditioned its removal of CWIP from the FPFTY plant in service instead of the end-of-year plant in service. *See* OCA Main Brief at 19; *see also* Wellsboro Main Brief at 14. OCA argues that CWIP should be removed from rate base regardless of the Commission's resolution of the disputed FPFTY rate base calculation. *See* OCA Main Brief at 16. The merits of OCA's position on CWIP will be addressed in Section IV.D, *infra*.

IV. RATE BASE

A. DISPUTED ISSUES

As indicated above, the parties concur on most rate base items raised in this proceeding. The rate base disputes are limited to OCA's adjustments to reflect plant retirements, OCA's proposal to calculate FPFTY plant in service and accumulated depreciation using average rate base instead of end-of-year rate base, the parallel proposal to remove CWIP from the FPFTY, and the EDIT adjustment. Regarding plant retirements, OCA proposes two parallel adjustments that do not materially impact the rate base calculation developed by the Company. More substantively, OCA continues to defy the Commission's established precedent in arguing that plant in service and accumulated depreciation should be calculated based on the average FPFTY plant-in-service balance. This position ultimately translates into OCA's inability to accept the Company's reasonable condition to remove CWIP from rate base only if the Commission reaffirms its decision to rely on end-of-year plant in service. OCA additionally opposes the Company's rate base deduction for EDIT. All of these positions should be denied for the reasons set forth in the Company's Main Brief and further addressed herein.

B. ORIGINAL COST UTILITY PLANT IN SERVICE

1. Adjustments for Plant Retirements

OCA proposes to adjust the Company's calculations of plant in service and accumulated depreciation to reflect plant retirements. *See* OCA Main Brief at 16-17. As stated in the Company's Main Brief, these adjustments do not materially impact the Company's rate base claim. *See* Wellsboro Main Brief at 18. Accordingly, the Company recommends approval of its plant in service and accumulated depreciation claims without modification.

2. End-of-Year vs. Average Rate Base Methodology

In its Main Brief, OCA continues to ask the Commission to completely reverse its findings from *Pa. PUC v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Order Entered October 25, 2018) ("UGI Order") and calculate the Company's rate base by averaging the beginning-of-test-year and end-of-test-year plant balances. All of the arguments, cases, policies, and analysis presented in support of OCA's position were exhaustively considered by the Commission in its UGI Order, which has now been affirmed by the Commonwealth Court. Further, OCA's arguments cannot overcome the plain language of Act of February 14, 2012, Pub. L. 72, No. 11 ("Act 11") explicitly clarifying that Act 11 constitutes an exemption to the general "used and useful" limitation on rate base. Accordingly, the Commission should reject OCA's attempt to re-litigate the precise issue so recently disposed of in the UGI Order.

In its Main Brief, OCA cites to a then-pending appeal to justify its continued opposition to the Commission's determination in the UGI Order. The arguments OCA offers in support of its proposed average rate base methodology mirror the arguments set forth in the UGI Order. These arguments, including the OCA's reliance on an isolated precedent from the Illinois Commerce Commission, were rejected by the Commission. UGI Order at 25-26.

Additionally, on January 15, 2020, the Pennsylvania Commonwealth Court entered an Order affirming the UGI Order and dismissing OCA's appeal. *McCloskey v. Pa. Pub. Util. Comm'n* (Pa. Cmwlth., No. 1549 C.D. 2018, filed January 15, 2020) (a copy of the slip opinion is attached as Attachment A.) The Court concludes:

> The Commission reviewed this language and concluded, within its particular expertise in the complex statutory scheme that is the [Public Utility] Code [citation omitted], that a year-end methodology could be applied to the FPFTY for UGI's rate case. This interpretation is supported by Section 315(e)'s plain language, but also by the purposes of Act 11, which were to mitigate the risks of regulatory lag and to aid in the resolution of the aged and aging nature of Pennsylvania's utility infrastructure.

Id. at 26. As such, there exists no basis for further consideration of OCA's proposed average rate base methodology.

While the Company submits that OCA's proposal should be rejected outright due to affirmation of the UGI Order, Wellsboro alternatively requests that the Commission again deny OCA's proposed average rate base methodology on the merits. The Company's Main Brief reviewed the myriad of flaws invalidating OCA's proposed methodology for calculating the FPFTY rate base. Wellsboro Main Brief at 18-23. Chief among them is OCA's failure to accept the plain language in the Act. No party to this proceeding disputes that the Commission has historically used end-of-year plant in service to determine rate base for the FTY. *Id*. As a result, the General Assembly's decision to authorize use of the FPFTY by paralleling the language developed to implement FTY contradicts OCA's effort to limit end-of-year plant in service to the FTY and require average plant in service for the FPFTY.

C. ACCUMULATED DEPRECIATION

Consistent with its proposal to adjust the Company's rate base based calculating the average plant in service throughout the FPFTY, the OCA proposed to adjust the Company's FPFTY $15,178,447 claim for accumulated depreciation. Wellsboro Main Brief at 23.

As addressed in the Company's Main Brief, the distinction between OCA's position and the Company's position on accumulated depreciation flows directly from the two parties' different approaches to calculating the original cost of plant in service. Consistent with its Main Brief recommendation, as stated above, the Company contends that original cost of plant in service should be calculated based on the FPFTY year-end balance, consistent with the Commission's holding in the UGI Order.[4]

D. CONSTRUCTION WORK IN PROGRESS

As referenced above, Wellsboro accepted OCA's proposal to eliminate CWIP from the FPFTY calculation but conditioned such acceptance on the Commission's rejection of OCA's proposal to calculate rate base and accumulated depreciation based on average FPFTY plant in service instead of the end-of-test-year data. *See* Wellsboro Main Brief at 14. OCA rejects this condition and alleges that CWIP should be removed from the FPFTY even if the Commission adopts its proposal to use the average FPFTY plant in service to set the Company's rate base and accumulated depreciation. OCA Main Brief at 19.

To support this argument, OCA alleges "that it is not appropriate to include CWIP in rate base either using an end of test year or the average rate base test year method because *in either case, the plant item will not be completed and placed in service during the FPFTY*." *See* OCA Main Brief at 19 (emphasis added). This statement reinforces the Company's argument because OCA's proposal to use average plant in service to calculate rate base and accumulated depreciation would exclude plant that *will be completed and placed in service during the FPFTY*. *See* Wellsboro Main Brief at 22. The same principle underlying OCA's adjustment of CWIP contradicts its proposal to use an average rate base method. Accordingly, the Company's proposal that inclusion of CWIP should be permitted only if the Commission rejects the end-of-test-year method for rate base and accumulated depreciation is reasonable and should be conditionally accepted.

[4] OCA's "averaging" adjustment to accumulated depreciation must be rejected for both original plant in service and accumulated depreciation. However, if the Commission reduces the Company's claim for original cost plant in service, there should be a commensurate reduction in accumulated depreciation as well.

E. EDIT

OCA's Main Brief proposes an adjustment to the Company's calculation of EDIT. This adjustment is addressed in Section VIII, *infra* and will not be restated here. For the reasons explained therein, the Company's position should be adopted, and OCA's adjustments should be rejected.

F. CONCLUSION AS TO RATE BASE

For the reasons fully explained above, the rate base adjustments proposed by OCA should be rejected.

V. REVENUES

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

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

A. FORFEITED DISCOUNTS

I&E continues to propose that revenue from Forfeited Discounts be increased by $1,734 to $37,177 for the FPFTY. *See* I&E Main Brief at 13.

As previously explained in the Company's Main Brief, there is a correlation between Forfeited Discounts and Uncollectible Accounts. Wellsboro Main Brief at 28. Company witness

Gorman explained that with increased Forfeited Discounts, Uncollectible Accounts expense is likely to go up as well. *Id.* Consequently, I&E's adjustment should be rejected.

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

VI. EXPENSES

As recounted in the Company's Main Brief, Wellsboro developed expense proposals to recover expenses necessary to provide service to its customers and to earn a fair rate of return on the investment and plant used and useful in providing service. *Butler Township Water Co. v. Pa. PUC*, 81 Pa. Cmwlth. 40, 43-44, 473 A.2d 219, 221 (1984) *("Butler Township"). See also T.W. Phillips Gas and Oil Co. v. Pa. PUC*, 81 Pa. Cmwlth. 205, 474 A.2d 355 (1984). In their Main Briefs, I&E and OCA convert the standard into an overly narrow bookkeeping exercise that runs contrary to the practical operations of smaller public utilities. In reviewing the proposed adjustments, the Commission should remain cognizant that Wellsboro will be deprived of a portion of what it calculates to be the expenses necessary to provide service and the fair rate of return to which it is entitled. Wellsboro's analysis supports a $1.1 million rate increase, but Wellsboro is limiting its request to $999,999.

For the reasons set forth in the Company's Main Brief and further discussed below, the Commission should approve the Company's expense claims, including approval of the 3% inflation adjustment for FPFTY O&M expenses.

A. COMPANY PROPOSAL

1. OCA is Incorrect, the Company's Inflation Adjustment is a Reasonable and Appropriate Means of Projecting FPFTY Expenses

OCA's Main Brief asks the Commission to deny the Company's proposed 3% inflation adjustment for FPFTY O&M expenses on the grounds that it is not consistent with Section 315 of the Public Utility Code. *See* OCA Main Brief at 21, 24. OCA also alleges that the 3% inflation adjustment is an inappropriate calculation and should be modified if the Commission determines any inflation adjustment to be appropriate. *See id.*

The Company's Main Brief extensively addressed the legal basis for the 3% inflation adjustment, referencing the Commission's prior approval of inflation adjustments in two Pennsylvania-American Water Company rate cases. *See* Wellsboro Main Brief at 38. OCA argues that these cases are not applicable because they predate Act 11 and inflation adjustments were only applied to residual expenses. OCA Main Brief at 22. The Company agrees that the circumstances of its proposed inflation adjustment differ due to the intervening passage of Act 11. However, Wellsboro submits that the Commission's prior approval of inflation adjustments for residual expenses in FTY cases supports the Company's proposal to apply a similar adjustment to FPFTY O&M expenses where specific expense increases cannot be determined at the time the rate case is prepared. *See* Wellsboro Main Brief at 38-39.

With regards to OCA's claim that the 3% calculation is an inappropriate measure of inflation for ratemaking purposes, the Company's Main Brief extensively reviewed the empirical basis for the proposed 3% inflation adjustment developed from the Producer Price Index ("PPI") and supported by the Company's historical year-to-year O&M expense escalations, projected expense increases, and budgeted 2020 expenses. *See id.* All of these indicators support the Company's conservative claim that overall O&M expenses will increase by *at least* 3%. *See id.* However, if the Commission denies the Company's proposed 3% inflation adjustment, the Commission should approve OCA's alternative inflation adjustment of 2.1% based on the Gross Domestic Product-Price Index ("GDP-PI"). *See* OCA Main Brief at 24. To accept OCA's primary position, rejection of any inflation adjustment, would assume no cost increases for the Company's O&M expenses from the FTY to the FPFTY. This is not only inaccurate and unrealistic; it is contrary to the purpose of the FPFTY as established in Act 11.

2. The Company's Primary Proposal to Approve the Claimed FPFTY Expenses Based on the Annualized FTY Data Should be Accepted

I&E characterizes the Company's use of annualized FTY data to support the FPFTY expense claim as an attempt to "wholesale revise its O&M position in rebuttal testimony." *See* I&E Main Brief at 15. This argument grossly misconstrues the Company's testimony. The Company did not change its as-filed O&M expense claim. *See* Wellsboro Main Brief at 33. Rather, it reviewed the YTD FTY expenses as of September 30, 2019, and provided the annualized information in Rebuttal Testimony to show support for its O&M expense claim. *See id*. It is incorrect for I&E to state this information should have been introduced in direct testimony when the updated 9-month data was not available when the Company filed its Direct Testimony on August 2, 2019.

Moreover, the Company's rationale does not render intervenor challenges meaningless as claimed by I&E, but instead addresses the operations of smaller utilities. For smaller utilities, labor and overhead comprise the majority of the Company's O&M expenses.

The Company's Main Brief described the significant differences in staffing between smaller public utilities and their larger counterparts, as smaller public utilities generally do not have a specific team of employees assigned to tasks in specific accounts, but rather allocate work for all O&M accounts across a small base of employees. *See* Wellsboro Main Brief at 34. As a result, employee activities and costs incurred to support a variety of accounts or portions of accounts that can differ from the accounts anticipated when the budget was prepared based on operational needs. *See* Wellsboro Main Brief at 34. If the Company were to manage every expense to meet the line item budget, the unintended consequence would be to remove operational flexibility. If the I&E's proposals are accepted, it would penalize the Company for efficient and effective workforce management.

I&E is also incorrect that the Commission's approval of the Company's proposal would handicap intervenor review of rate proposals from larger public utilities. *See* I&E Main Brief at 16. As the entire basis of the Company's proposal derives from the Company's smaller size, approval of the Company's O&M recommendation would not be precedential for larger public utilities. The evidence submitted by Wellsboro is Company-specific.

The Commissions' role in evaluating a rate case is *not* to ensure that it achieves a desired percentage decrease to the as-filed request. The Commission's role is to set rates that allow the utility to recover its reasonable and prudently incurred expenses. *Pa. PUC v. National Fuel Gas Distribution Corp.*, 54 Pa. PUC 401, 416-417 (1980). This requires the Commission to evaluate the circumstances of the particular utility, which may vary from the other utilities that the Commission regulates. *Id.* It is contrary to the public interest to reduce a small utility's O&M expense claim because costs shift between O&M expense accounts during the year in comparison to original allocations or because expenses may be concentrated in particular quarters (like the 3rd or 4th). Wellsboro is providing ratepayers with the benefit of reducing its ROE claim based on the most up-to-date financial data. It should be afforded the flexibility to support its O&M expense claim as it has done.

The Company submits that under the circumstances presented in this proceeding, its proposal to approve the FPFTY expense claim based on annualized O&M FTY expense and the 3% inflation adjustment is reasonable and should be approved.

B. COMPANY RESPONSE TO SPECIFIC ADJUSTMENTS

As stated above, the Company believes its primary proposal to approve its FPFTY expense claim based on annualized FTY O&M expense plus the 3% inflation adjustment is reasonable. To the extent the Commission disagrees, the Company responds to the specific expense adjustments proposed by the Advocates as set forth below.

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

In their Main Briefs, both I&E and OCA propose adjustments to Wellsboro's $669,615 claim for Maintenance of Overhead Lines expense. I&E proposes to adjust Wellsboro's claim to $580,364, based on the annualized FTY expense as of September 30, 2019 plus the 3% inflation adjustment for the FPFTY. *See* I&E Main Brief at 23. OCA proposes to adjust Wellsboro's claim to $563,460, which reflects the annualized FTY expense without the 3% inflation adjustment. *See* OCA Main Brief at 28.

The Advocates' proposals are rooted in historic expenses and fail to account for the reality that Wellsboro's tree-trimming costs and vegetation management costs are escalating. As described in Wellsboro's Main Brief, the Emerald Ash Borer presents reliability concerns in Wellsboro's service territory as impacted trees become more of a significant risk to distribution lines. *See* Wellsboro Main Brief at 41. While Wellsboro proposed to accept an across-the-board adjustment based on the annualized FTY expense as of September 30, 2019, plus the 3% inflation adjustment, the Advocates oppose that proposal in favor of an account-specific adjustments. On an account-specific basis, the annualized FTY expense as of September 2019 does not accurately reflect Wellsboro's FTY costs for Account No. 593.

As explained in Wellsboro's Main Brief, $65,000 of funds budgeted for 2019 were expected to be spent in the 4th quarter. *See* Wellsboro Main Brief at 42. I&E declined to reflect these expenses in its adjustment based on the on-the-record data request response provided by the Company showing that as of November 2019, the annualized FTY expense would be $596,519.33. *See* I&E Main Brief at 23, Appendix E. Wellsboro submits that the annualized FTY costs remain supportive of Wellsboro's FPFTY claim.

As clarified in the same on-the-record data response referenced by I&E, the Company's 2019 FTY expense was negatively impact by employee absences in November and December that are not expected to recur. *See* I&E Main Brief at 23, Appendix E. However, even accounting for the lower-than-projected 2019 FTY expense, Wellsboro's expenses for Account No. 593 have been increasing annually since 2014, with 2018 being the sole exception. *See* I&E Statement No. 1, I&E Exhibit No. 1, Schedule 8 at 1. This clear trend of increasing tree-trimming and vegetation management expense reflects the Company's escalating efforts to address the Emerald Ash Borer epidemic and improve system reliability, as encouraged by the Commission's Bureau of Technical Utility Services ("TUS"). *See* Wellsboro Main Brief at 41. And as Company witness Mr. Farnsworth confirmed at the evidentiary hearing, the bids received from the Company for 2020 contractors show higher costs than the 2019 bids. *See id.* at 42-43.

The totality of evidence demonstrates that a solely backwards-looking analysis of Wellsboro's Account No. 593 expense will almost certainly understate future expenses. Consistent with the intent of the FPFTY, the Commission should consider the historical upward trend of the Company's tree-trimming expense, the unabated spread of the Emerald Ash Borer, and the Company's increasing contractor costs and accept the Company's full expense claim.

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

In its Main Brief, I&E modifies the adjustment proposed in testimony by I&E witness Mr. Patel and relies on the annualized FTY expense plus the 3% inflation adjustment to propose an adjustment of $20,042 to the Company's $106,704 claim for Account No. 580. *See* I&E Main Brief at 17. I&E characterizes this adjustment as an acceptance of the Company's updated claim, but the Company's Main Brief clarified that the Company continues to support its original expense claim of $106,704. *See* I&E Main Brief at 17; *but see* Wellsboro Main Brief at 43.

The Company's Main Brief addressed the record evidence indicating Wellsboro's FPFTY claim remains reasonable. *See* Wellsboro Main Brief at 44. As noted by Wellsboro witnesses in response to discovery from I&E, 2019 (the FTY) was the first full year of employment for the new VP of Engineering & Operations/COO position. *See* I&E Statement No. 1, I&E Exhibit No. 1, Schedule 2. The VP of Operations & Engineering/COO served as a witness in the rate case, but will resume normal operational duties in the FPFTY. *See* Wellsboro Statement No. 6 at 1. As the FTY is the only year of relevant historical data, Wellsboro submits that the Commission should take a cautious approach to any downward adjustment to the Company's FPFTY claim. Accordingly, the Company's claim should be accepted.

3. Miscellaneous Distribution Expense (Account No. 588)

I&E proposed a $29,016 adjustment to the Company's $219,007 claim for Account No. 588. *See* I&E Main Brief at 44. OCA recommended a similar adjustment. OCA Statement No. 1 at 6. OCA recommended a reduction of $88,447 for a total allowance of $130,860, a figure less than half of the actual HTY expense in this category. OCA Main Brief at 26. Both adjustments are based on illogical analysis and should be rejected.

I&E bases its adjustment not on the total account expense, but on year-to-year fluctuations for a single sub-category within Account No. 588. *See* I&E Main Brief at 19. OCA examines the total account expense, but bases its adjustment on the average expense incurred from 2015-2017, thereby incorporating expense levels experienced *5 years* prior to the FPFTY. *See* OCA Main Brief at 26.

These adjustments should be rejected by the Commission as inconsistent with current data, inconsistent with HTY data, and inconsistent with the Company's projections. First, despite OCA's and I&E's arguments, year-to-date data from September 30, 2019, indicates that Company expenses are running ahead for this account. Wellsboro Main Brief at 33. The actual expense data for Account No. 588 totals $169,106. Annualizing and adding the 3% inflation adjustment brings this figure to $232,239 for the FPFTY – $13,232 *above* the Company's claim.[5] Wellsboro Main Brief at 44.

Second, the claimed expenses are conservative in light of the HTY expense, which was $275,580 – well above the Company's FPFTY claim and more than double OCA's recommended allowance. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W) at 1.

Finally, the record supports the Company's expectation that there will continue to be retirements and employee turnover. As explained in Wellsboro's Main Brief, this trend points toward these expenses not being isolated events but recurring. Wellsboro Main Brief at 45. As Mr. Farnsworth testified on Rejoinder, approximately 50% of Wellsboro's workforce has the potential of retiring within ten years. *Id.* at 45. In addition to the need to continue to stay current with industry and technology developments, to which Mr. Farnsworth testified, Wellsboro's anticipated turnover in the next few years indicates training expenses of this nature are likely to recur often. *Id.* at 45.

In light of the information presented above, the Company's Miscellaneous Distribution Expense claim should be accepted by the Commission.

4. Maintenance Supervision & Engineering (Account No. 590)

In its Main Brief, I&E proposes a $14,957 adjustment to the Company's $80,232 claim for Account No. 590. *See* I&E Main Brief at 18. As discussed above and in the Company's Main Brief, the expense shortfall in Account No. 590 directly relates to an expense overage for Account No. 588 due to an employee recording more time than anticipated to Account No. 588 instead of Account No. 590. *See* Wellsboro Main Brief at 46. As set forth in the Company's Main Brief,

[5] Additionally, as noted by Mr. Farnsworth, Account No. 588 is running ahead of projections in almost the same amount as Account No. 590 is running behind projections, due to a Company employee who recorded more time on Account No. 588 activities than anticipated during the first three quarters of 2019. *See* Wellsboro Main Brief at 46.

approving I&E's proposed adjustment to both Account Nos. 588 and 590 would result in a double count. *See id.* at 46. However, the Company's Main Brief erred in observing that I&E's adjustment to Account No. 590 should be approved only if the Company's claim for Account No. 588 is approved. *See id.* at 46. Because the record reflects that the $14,957 expense shortfall in Account No. 590 directly caused the $13,232 expense overage in Account No. 588, I&E's adjustment to Account No. 590 should be denied.

5. Safety & Communication (Account No. 908)[6]

I&E witness Patel initially proposed a reduction of $10,282 to the Company's claim for Account No. 908 for an allowance of $8,915 based on normalized the Company's tri-annual Eligible Customer List expense and eliminating expense for advertising. I&E Main Brief at 21.

Based on year-to-date data provided by the Company through September 30, 2019, Mr. Patel then stated that he accepted the updated FPFTY projection, which would reduce his Direct Testimony adjustment from $8,915 to $5,013. I&E Statement No. 1-R at 26. I&E adopted this position in its Main Brief. I&E Main Brief at 21.

OCA witness Sherwood also normalized the tri-annual Eligible Customer List expense; Ms. Sherwood added the HTY expense for Account No. 908 for a reduction of $9,941, or an allowance of $9,235. OCA Main Brief at 28-29.

As explained in Wellsboro's Main Brief, the Company agrees only with the adjustment to normalize the Company's tri-annual Eligible Customer List expense. *See* Wellsboro Main Brief at 47. As explained in the Company's Main Brief, the Company provided detailed YTD information to support its proposal to adjust total O&M expense based on annualizing the total YTD costs as of September 30, 2019; a proposal that Mr. Patel declined to accept. *See id.* The Company did

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

not propose to adjust each individual account based on YTD data. Based on this adjustment, the Company projects a FPFTY expense of $12,694. *Id*.

This adjusted claim should be accepted by the Commission. As explained in Wellsboro's Main Brief, there has been reduced demand in the FTY for energy audits. *Id.* at 47. The Company submits that, a projected increase in customer assistance and advertising expense is reasonable following a rate increase. *Id.* Consequently, the Company's FPFTY claim for the remaining components, advertising, and customer assistance, should be accepted without modification, resulting in a final claim of $12,694 after normalizing for the tri-annual Eligible Customer List expense.

6. Office Supplies & Expenses (Account No. 921)

The Company's claim for Account No. 921 is $140,595. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W). I&E witness Patel proposed a reduction of $11,364 to $129,231 by disallowing costs for employee recognition events and eliminating any increase from the HTY to the FTY. I&E Statement No. 1 at 26. In its Main Brief, I&E states "accepts the Company's revised claim of $64,367." I&E Main Brief at 24. I&E's adjustments to Account No. 921 should be denied for the following reasons.

First, as explained above, Wellsboro has not revised its specific claim to $64,367; rather, the Company is willing to accept across-the-board expense adjustments matching the September 30, 2019 year-to-date data plus a 3% adjustment for the FPFTY projection. For purposes of I&E's preferred account-specific review, Wellsboro maintains its position as stated in its Main Brief.

Second, as described in the Company's Main Brief, the fact that costs in the FTY are tracking below budget as of September 30, 2019, is not a reasonable basis to adjust expense for Account No. 921. The Company's budgeted costs do not always track in accordance with the budget on a month-to-month basis. *See* Wellsboro Statement No. 6-R at 4. Review of the General Ledger of the Company's HTY expense for Account No. 908 shows increased costs in November and December. *See* I&E Statement No. 1, Exhibit No. 1, Schedule 9 at 8, 10 (showing increased phone/internet and miscellaneous expense for November 2018 and December 2018). Consequently, annualized year-to-date data may not accurately reflect total FTY expenses for this account. Supporting that point, Account No. 921 expense from 2012 to 2018 (all years on record in Exhibit__(HSG-1)) has always significantly exceeded $64,367. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W) at 2. In fact, HTY expense for this account was $125,467.

Finally, employee activity expenses may be claimed when they are "for the purpose of employee recognition." UGI Order at 70. In the UGI Order, the Commission pointed to Commission precedent that distinguished between activities involving "employee recognition" and those that did not. Based on this precedent, I&E recommended disallowance for employee recognition events should be rejected by the Commission.

In light of the above factors, I&E's adjustment to Account No. 921 should be denied.

7. Regulatory Commission Expense (Account No. 928)

I&E proposes to disallow $68,710 of the Company's claim for Regulatory Commission Expense, reducing I&E's recommended allowance to $38,631. I&E avers that Wellsboro included 2016 rate case expense in its current rate case claim. I&E Main Brief at 20.

As stated in the Company's Main Brief, the Company agrees to I&E's proposal and accepts an allowance of $38,631 as reflected in Company witness Gorman's Rebuttal Testimony. *See* Wellsboro Main Brief at 15.

8. Maintenance of General Property (Account No. 932)

The Company's claim for Account No. 932 is $90,199. Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W). OCA proposes an adjustment of $43,242 resulting in an allowance of $46,957. OCA Main Brief at 29-30. This proposal is based on a 3-year average of a single component of the Account No. 932 expense (a sub-category classified as "other") plus FTY expenses for the remaining sub-categories, not including an inflation adjustment. *Id*.

OCA's adjustment should be rejected. As explained in the Company's Main Brief and in Rebuttal Testimony, the Company provided actual year-to-date expenses of $51,409 through September 30, 2019, supporting a FPFTY projection of $70,602 for total Account No. 932 expense. Wellsboro Main Brief at 33; Wellsboro Statement No. 1 at 4. OCA's recommended $46,957 is not even sufficient to cover the Company's actual expense *for the first nine months of 2019*, let alone a full future year. As explained in the Company's Main Brief, adjusting the total Account No. 932 costs because a single component of the total Account No. 932 is lower than historic levels is illogical. Wellsboro Main Brief at 49. Moreover, considering that the Company represents that maintenance activities recorded under Account No. 932 vary from year to year, it is prudent to rely on the Company's budgeted experience. *See* Wellsboro Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 (W) at 2. The Company's $90,199 claim should be accepted.

9. Rate Case Expense – Normalization Period

I&E and OCA proposed adjustments to the Company's recommended rate case normalization period based on pure historical rate case filing dates. I&E proposed a normalization period of 48 months based on the Company's last three base rate case filings and OCA proposed 45 months, based on the average time between the Company's last four rate case filings. I&E Main Brief at 26; OCA Main Brief at 30.

The Company's Main Brief provided clear evidence that a filing gap of the length proposed the Advocates is extremely unlikely. *See* Wellsboro Main Brief at 51-52. Consistent with the Commission's recent affirmation in the UGI Order that rate case expense normalization period "may be based on future expectations," the Company's proposed 36-month normalization period should be approved. *See id.* at 50 *citing* UGI Order at 59-60.

C. CONCLUSION

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

VII. FAIR RATE OF RETURN

A. RATE OF RETURN STANDARDS

In their respective Main Briefs, both OCA and I&E continue advocating for Commission approval of returns on common equity that would eviscerate the principal benchmarks for a fair rate of return set forth in *Bluefield Water Works & Improvement Company v. P.S.C. of West Virginia*, 262 U.S. 679 (1923) (*"Bluefield"*) and affirmed by *Federal Power Commission v. Hope Natural Gas.*, 320 U.S. 591, 603 (1944) (*"Hope")* and *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989). The Advocates' efforts to drive Wellsboro's return to industry-wide lows should be rejected.

The Commission should also note that the Company's proposed ROE reflects updated market data available as of September 30, 2019. While OCA and I&E vehemently criticize the Company for updating O&M expense data, neither party expressed such concerns with regards to the Company's updated ROE, presumably because the updates reduced the Company's recommended ROE from 11.15% to 10.30%. *See* Wellsboro Main Brief at 59. The Company's willingness to proactively adjust its recommended ROE to reflect the most current available market data irrespective of the result should be considered in assessing the reasonableness of the Company's overall ROE/rate of return recommendations and the Company's overall recommended revenue requirement.

B. ELECTRIC PROXY GROUP

Both I&E and OCA applied different selection criteria than Company witness Mr. D'Ascendis. As discussed below, neither raised objections meriting modification of Mr. D'Ascendis' selection criteria or results. The Commission should accept the 17-company proxy group ("Electric Utility Proxy Group") set forth on page 4 of Mr. D'Ascendis' Rebuttal Testimony. *See* Wellsboro Main Brief at 54.

1. I&E Proxy Group

I&E's selection criteria differed from Mr. D'Ascendis' in two material respects. *See* I&E Main Brief at 31-32. The first is that I&E's proxy group includes only companies operating in states with deregulated electric utility markets. *See* I&E Statement No. 2 at 14. The second is that Mr. D'Ascendis excluded companies that did not have 70% or greater total operating income derived from and 70% of total assets attributed to regulated electric distribution operations in fiscal year 2017. *See id.* Other than the companies excluded under these two criteria, Mr. D'Ascendis' inclusion of the Otter Tail Corporation is the only difference between the two proxy groups. *See* Joint Statement No. 2-R at 4; *see also* I&E Statement No. 2 at 13-15.[7]

I&E excludes ALLETE, Inc., Alliant Energy Corporation, Avista Corporation, Edison International, OGE Energy Corporation, and Pinnacle West Capital Corporation from its proxy group on grounds that they do not operate in a deregulated electric utility market. *See* I&E Statement No. 2 at 14. Conversely, Mr. D'Ascendis' includes each of the aforementioned 5 companies, but excludes Consolidated Edison, Inc., FirstEnergy Corp., PPL Corporation, and CMS Energy Corp. because they do not have sufficient operating revenue and assets attributed to

[7] I&E's Direct Testimony references other differences between the two proxy groups, noting that I&E's proxy group included Entergy Corporation ("Entergy") and excluded Dominion Energy, Inc. ("Dominion"), AVANGRID, Inc. ("AVANGRID"), and El Paso Electric Company ("El Paso"). *See* I&E Statement No. 2 at 13-15. Mr. D'Ascendis' Rebuttal Testimony confirmed that his final Electric Utility Proxy Group includes Entergy and excludes Dominion, AVANGRID, and El Paso. *See* Joint Statement No. 2-R at 4.

regulated distribution utility operations. I&E claims that only companies operating in regulated markets face risks similar to Wellsboro. *Id.* However, the Company submits that Mr. D'Ascendis' criteria confirming that all companies in his proxy group have 70% of total operating income *and* 70% of total assets attributable to regulated *electric distribution operations* better addresses I&E's concern that the proxy group companies operate under similar risk profiles to Wellsboro. *See* Joint Statement No. 2 at 12. A company that is in a deregulated market but attributes more than 30% of its revenue from activities other than distribution is not similar to Wellsboro, which attributes all of its revenues from distribution. Accordingly, the Commission should accept Mr. D'Ascendis' proxy group.

2. OCA Proxy Group

OCA's Main Brief affirms that its rate of return witness, Dr. Habr, accepted the proxy group developed by Mr. D'Ascendis with two exceptions. OCA Main Brief at 44. OCA claims Mr. D'Ascendis' Electric Utility Proxy Group should be modified to exclude AVANGRID and El Paso. *See id.* As discussed above, Ms. D'Ascendis eliminated both of these companies from his proxy group in his Rebuttal Testimony. *See* Joint Statement No. 2-R at 4. Accordingly, OCA's opposition is rendered moot.

C. COST OF COMMON EQUITY

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

In their Main Briefs, both I&E and OCA request Commission approval of demonstrably unreasonable ROEs of 8.10% and 8.38% respectively. I&E Main Brief at 31; OCA Main Brief at 42. In doing so, both Advocates attempt to discredit the Company's application of other ROE models to address limitations of the DCF model under current market conditions. These arguments conflict with Commission precedent affirming the DCF as the Commission's preferred model but also acknowledging the Commission's willingness to consider other models when the DCF produces unreasonable results. Additionally, both I&E and OCA ignore evidence from the Company demonstrating that consideration of DCF-only results would require higher ROEs than the 8.10% and 8.38% recommendations.

a. <u>The I&E and OCA ROE Proposals are Objectively Unreasonable</u>

The Company's Main Brief reviewed various objective benchmarks illustrating the unreasonableness of the I&E and OCA ROE recommendations. The Company pointed to Mr. D'Ascendis' testimony comparing the I&E and OCA recommendations to historic utility ROEs, noting that Commission approval of either I&E's or OCA's proposed ROE would subject Wellsboro to an allowed ROE below any ROE awarded to a major electric utility in the nation according to Regulatory Research Associates ("RRA"), a division of Standard and Poor's ("S&P"). Wellsboro Main Brief at 71-72. The ROEs recommended by the Advocates also fall well below ROEs granted to investor-owned public utilities by the Commission in recent years, including the 9.85% ROE approved for UGI Utilities, Inc. – Electric Division in October 2018. *See* Wellsboro Main Brief at 72. As further discussed below, the I&E and OCA recommended ROEs also fall below the ROE developed by the Commission in calculating the 9.55% ROE applicable for the electric Distribution System Improvement Charge ("DSIC") if the EDC's last rate case settled without an explicit ROE.

The benchmarks collectively reveal the critical flaw in the Advocates' ROE position to be a lack of judgment and market awareness. While both I&E and OCA commit technical errors as well, their results suffer from an unwillingness to observe the core tenet of *Bluefield*, which is that Wellsboro is entitled to a fair return based on what investors would demand from an enterprise of similar risk.

b. **I&E and OCA Place Undue Reliance on DCF Results**

Both the I&E and OCA Main Briefs emphasize the Commission's historic reliance on the DCF model as the primary analysis for determining utility ROEs in support of their ROE recommendations. *See* I&E Main Brief at 40; *see also* OCA Main Brief at 41. In doing so, I&E and OCA fail to appropriately consider the Commission's clarification that the DCF is not an immutable model. As detailed in the Company's Main Brief, Mr. D'Ascendis presented thorough evidence affirming that DCF results in the current market environment will understate the return demanded by investors, which the Advocates failed to credibly rebut. *See* Wellsboro Main Brief at 68-70. Accordingly, Mr. D'Ascendis' reliance on multiple models is appropriate for this proceeding.

The Company acknowledges the Commission's historical preference for the DCF model but avers that the arguments from OCA and I&E unreasonably downplay flaws affecting the reasonableness of DCF results and overstate flaws impacting other models. I&E and OCA reference various Commission precedents and aver that the Commission relies on DCF results over other models. *See* I&E Main Brief at 40; *see* OCA Main Brief at 41. While the Commission has expressed a preference for reliance on the DCF, it has not hesitated to reference other methodologies where a DCF-only analysis would produce unreasonable outcomes. As stated in the Wellsboro Main Brief, the Commission declared in its UGI Order that "where evidence based on other cost of equity models indicates that the DCF-only results may understate the utility's cost of current equity capital, we will consider those other methods, to some degree, in evaluating the appropriate range of reasonableness for our equity return determination." Wellsboro Main Brief at 69.

In addition to reiterating its responsibility to consider other models where a DCF-only analysis would produce unreasonable results, the Commission has issued ROE determinations developed in reliance on multiple models. I&E attempts to deny this reality and claims Wellsboro witness Mr. D'Ascendis is incorrect in claiming the Commission relied on multiple ROE models in the recent *Columbia Water* and *Emporium Water* rate cases.[8] *See* I&E Main Brief at 42. A review of the cases belies I&E arguments. For example, in *Columbia Water* OCA recommended an ROE of 9.10% based on the midpoint of its DCF and CE analyses, I&E recommended an 8.89% return based on its DCF analysis, and the company recommended a 10.3% ROE based on its DCF, RP, and CAPM analysis and a 0.75% size adjustment. *Columbia Water* at 35. The Commission noted its consideration of "cost models presented" and awarded a 10.00% ROE. *See id.* Both the Commission's language and the end result strongly indicate that the Commission gave considerable weight to the company's multiple-model analysis in that case.

In this case, the Company offered compelling evidence showing that the DCF results will understate the appropriate ROE in the current market environment. Wellsboro witness Mr. D'Ascendis relies on both his own analyses and corroborative financial literature affirming the relationship between market-to-book ratios and DCF results, including the following analysis from Dr. Morin:

> *The third and perhaps most important reason for caution and skepticism is that application of the DCF model produces estimates of common equity cost that are consistent with investors' expected return only when stock price and book value are reasonably similar, that is, when the M/B is close to unity.* As shown below, application of the standard DCF model to utility stocks understates the investor's expected return when the market-to-book (M/B) ratio of a given stock exceeds unity. This was particularly relevant in the capital market environment of the 1990s and 2000s where utility stocks were trading at M/B ratios well above unity and have been for nearly two decades. The converse is also true, that is, the DCF model overstates that investor's return when the stock's M/B ratio is less than unity. *The reason for the distortion is that the DCF market return is applied to a book value rate base by the regulator, that is, a utility's earnings are limited to earnings on a book value rate base.*

[8] *See Pa. PUC v. Emporium Water Company,* Docket No. R-2014-2402324 (Order Entered January 28, 2015); *see also Pa. PUC v. Columbia Water Company*, Docket No. R-2013-2360798 (Order Entered January 23, 2014).

See Joint Statement No. 2 at 10-11 (emphasis added). I&E does not dispute the underlying premise that market-to-book ratios for electric utilities significantly exceed unity, (i.e. a market-to-book ratio of 1.0), but alleges that this relationship should not impact the Commission's analysis because investors are aware that regulators assess utility returns based on book value. *See* I&E Main Brief at 48. Other than a conclusory statement from its witness with no reference to financial literature or empirical analysis, I&E offers no support for its assertion that the Commission should disregard the impact of higher market-to-book ratios on the reasonableness of DCF results.

OCA responds to the Company's market-to-book analysis by presenting a litany of caselaw addressing leverage adjustments.[9] OCA Main Brief at 61-62. Notably, as confirmed at the evidentiary hearing, Mr. D'Ascendis has not proposed a leverage adjustment in this proceeding. Tr. 48. Rather, Mr. D'Ascendis proposed that the Commission acknowledge the current environment where market-to-book ratios significantly exceed unity as a limitation on the reasonableness of DCF results. This is consistent with the Commission's finding in the 2012 PPL rate case cited by OCA, where the Commission declined to grant a leverage adjustment to compensate for risk related to PPL's market-to-book ratio, but also clarified that this decision was made "in the context of our determination, *supra,* of a reasonable return of equity for PPL of 10.28%." *See* OCA Main Brief at 61. The 10.28% ROE set in the 2012 PPL case was *higher* than the 8.38% - 9.69% range of DCF results calculated by I&E, OCA, and the utility in that proceeding. *Pennsylvania. Pub. Util. Comm'n v. PPL Electric Utilities Corp,* Docket No. R-2012-2290597 (Order Entered December 28, 2012) at 82 ("PPL 2012 Order"). Similarly, Mr. D'Ascendis

[9] OCA cites to various caselaw from other jurisdictions addressing the relationship between market-to-book ratios in the context of proposed leverage adjustments. OCA Main Brief at 61. The Company submits that the Commission has addressed market-to-book ratios and leverage adjustments in numerous dockets such that the OCA's non-contextual references to decisions from other state regulatory commissions are of questionable persuasive value and should be given no weight.

references the current market-to-book ratios not as support for a leverage adjustment to his DCF results, but as evidence of the necessity to reference other models due to the potential for DCF results to produce unreasonable results when market-to-book ratios exceed unity.

c. **Even Consideration of DCF-Only Results Would Not Support the I&E and OCA ROE Recommendations**

In criticizing the Company's reliance on multiple ROE methods and supporting their historically low proposed ROEs, I&E and OCA overlook the fact that their recommendations are unreasonable even under a DCF-only analysis. I&E's ROE recommendation is based on the average growth rates of its proxy group while OCA uses a median growth rate. *See* I&E Main Brief at 34; *see* OCA Main Brief at 49. As discussed in the Company's Main Brief, the Commission's calculation of the DSIC ROE supports the Company's contention that I&E and OCA significantly understate the appropriate ROE. *See* Wellsboro Main Brief at 79-83. Specifically, in the most recent Quarterly Report publishing the DSIC ROE on November 14, 2019, the Commission considered results within a standard deviation of the midpoint and set the DSIC ROE at the higher end of that range. *See id.; see also* Tr. 45. While this result would understate the risk profile of the Company due to its size and overlook consideration of management effectiveness, it serves as yet another objective indication that the I&E and OCA recommendations are untenable and would severely understate the ROE necessary to ensure the Company has an opportunity to earn a reasonable return.

d. **I&E's Criticisms of the Company's Non-DCF ROE Models Have Been Thoroughly Rebutted**

I&E offers numerous critiques of the CAPM, RP/PRPM, and non-price regulated proxy group ROE analyses performed by the Company. I&E Main Brief at 37-48. The factual assertions underlying I&E's arguments were addressed and rebutted in the Company's Main Brief. *See* Wellsboro Main Brief at 72-79. Additionally, the Company will address certain points herein.

I&E criticizes the CAPM model as generally subject to manipulation and further rejects the Company's CAPM analysis for reliance on growth projections through 2030, use of the 30-year Treasury Bond as the applicable growth rate, and reliance on an ECAPM analysis.[10] I&E Main Brief at 41. With regards to I&E's position that the CAPM is uniquely subject to manipulation, the Company's Main Brief explained that all ROE models can be manipulated by poor inputs, including the DCF. *See* Wellsboro Main Brief at 74. The Company's Main Brief also noted that I&E's observation that projections out to 2030 are unreliable is completely arbitrary. *See id.* I&E provides no empirical analysis explaining why its 5-year projection should be deemed reliable, but the Company's 10-year projection should be rejected. *See* I&E Main Brief at 46. To the contrary, the Company supported its position by explaining that the source relied on by both I&E and the Company, Blue Chip Financial Forecasts, projects interest rates out to 2030. *See* Wellsboro Main Brief at 75. As this information is available to investors, I&E's assumption that this published interest rate data is not relevant to the CAPM growth forecast conflicts with basic economic principles assuming that investors rely on all publicly available information. *See id.* at 75.

The Company's Main Brief also addressed I&E's opposition to using the 30-year Treasury Bond as the CAPM growth rate. *See* Wellsboro Main Brief at 74. The Company acknowledged that the Commission previously accepted the 10-year Treasury Note as the appropriate CAPM growth rate in its UGI Order, but encouraged the Commission to reconsider this finding based on the extensive financial literature cited by Mr. D'Ascendis in support of matching the long-term risk-free rate to the long-term nature of utility operations. *See* Wellsboro Main Brief at 74. I&E's

[10] I&E's Main Brief references the Company's use of growth rate projections extending out to 2029. *See* I&E Main Brief at 45. This forecast was updated in the Company's Rebuttal Testimony to extend out to 2030, consistent with the available forecast data. *See* Wellsboro Main Brief at 64.

representation that the September 18, 2019, Federal Open Market Committee reduction to the target range for the federal funds rate only underscores I&E's misconception that the risk-free rate for utility investments should reflect short-term market conditions. *See* I&E Main Brief at 46. Rather, as evidenced by the Company's review of financial literature, "[b]ecause common stock is a long-term investment and because the cash flows to investors in the form of dividends last indefinitely, the yield on very long-term government bonds, namely, the yield on 30-year Treasury bonds, is the best measure of the risk-free rate for use in the CAPM… " *See* Wellsboro Main Brief at 74. Additionally, Mr. D'Ascendis' updated analysis, incorporating data available as of September 30, 2019, would have reflected the Federal Open Market Committee meeting. *See* Joint Statement No. 2-R at 3.

I&E's final critique of the Company's CAPM analysis rejects any reliance on the ECAPM based on a completely unsupported assertion that the ECAPM "merely adds a measure of subjectivity" to the CAPM. *See* I&E Main Brief at 48. I&E presents no coherent analysis to which Wellsboro can respond. By way of contrast, the Company reviewed financial literature explaining that the traditional CAPM assumes an overly steep predicted Security Market Line that is corrected by the empirical Security Market Line in the ECAPM. *See* Wellsboro Main Brief at 76.

The Company also rebutted I&E's criticism of the PRPM model. I&E opposes any reliance on the PRPM model for being: (1) an indirect measure of the cost of equity; and (2) available only through proprietary software. *See* I&E Main Brief at 48. As confirmed in the Company's Main Brief, both claims are false. Company witness Mr. D'Ascendis explained that the PRPM model directly measures the risk-return relationship and cited to financial literature explicitly stating the PRPM estimates risk "directly from asset pricing data." *See* Wellsboro Main Brief at 77 *citing* Joint Statement No. 2-R at 39 (emphasis added). The Company's Main Brief also clarified that while Mr. D'Ascendis used proprietary software, he also made his workpapers available to all parties in this proceeding. *Id.* Mr. D'Ascendis also confirmed that the PRPM model can be run on free software. *See id.*

Similarly, the arguments offered by I&E in opposition to the Company's analysis of non-price regulated companies ignores the record evidence presented in the Company's Main Brief. I&E argues that the Company has not demonstrated that the non-price regulated companies have risk profiles similar to Wellsboro's solely because the ROE models show higher returns when applied to the non-price regulated proxy group. *See* I&E Main Brief at 43. This is a textbook Catch-22 as the only way this standard could be met is if the non-price regulated companies showed returns equal to the Company's Electric Utility Proxy Group, which would also render the analysis superfluous. While the Commission has expressed concerns that comparisons to non-price regulated companies involve a degree of judgment, the selection criteria employed by Mr. D'Ascendis are highly specific, targeting companies with beta-coefficients and residual standard errors within plus or minus two standard deviations of the Electric Utility Proxy Group. *See* Wellsboro Main Brief at 78. As the selection criteria narrowly defines the proxy group risk profiles, these non-price regulated companies are similar in risk to the Electric Utility Proxy Group.

e. OCA's Proposed DCF and Hybrid CAPM/Risk Premium Models are Flawed

OCA's Main Brief presents its recommended 8.38% ROE based on the FERC 2-step DCF model, while additionally conducting flawed CAPM/Risk Premium analyses. OCA has failed to offer persuasive evidence supporting its proposed departure from the Commission's application of a traditional DCF analysis in favor of the FERC 2-step DCF model. Further, as observed in Wellsboro's Main Brief, OCA's CAPM and Risk Premium analyses suffer from numerous flaws and are unsupported by financial literature.

As discussed in the Company's Main Brief, OCA conducts a reasonable constant growth analysis, but distorts these results by incorporating a FERC-2-step DCF designed to address the theory that company growth rates cannot sustainably exceed GDP. *See* OCA Main Brief at 47-48. Mr. D'Ascendis provided an example illustrating that any adjustment to the traditional DCF to account for GDP growth is a solution in search of problem as even the fastest growing industry sector would require thousands of years of sustained growth to overcome GDP. *See* Wellsboro Main Brief at 81.

Additionally, FERC's ROE analysis relies in part on a CAPM model incorporating size adjustments and also applies a low-end outlier that eliminates DCF and CAPM proxy group results that fall below the yields of generic corporate Baa bonds + 20% of the CAPM risk premium. *See Ass'n of Bus. Advocating Tariff Equity, v. Midcontinent Indep. Sys. Operator, Inc.,* Opinion No. 569, 169 FERC ¶ 61,129 (2019) ("Opinion No. 569"), at 52. To the extent the Commission considers OCA's proposal to incorporate FERC's 2-step DCF model, it should also reflect FERC's clear signal that DCF results alone are insufficient to determine just and reasonable ROEs.

The Company's Main Brief also observes that the CAPM analysis conducted by OCA is highly unorthodox and should be denied. While not evidently clear through OCA's references to use of a "time frame that includes the time frame he used in his DCF analysis," OCA's witness proposes to determine the CAPM risk-free rate based on the six-month average ending August 2019 instead of a forecast. *See* OCA Main Brief at 51; *see also* Wellsboro Main Brief at 56. This proposal is contrary to the forward-looking nature of ROEs and should be rejected. *See* Joint Statement No. 2 at 56.

Mr. D'Ascendis also highlights numerous errors in the risk premium calculations applied to OCA's CAPM/Risk Premium model. Wellsboro Main Brief recounts that Mr. D'Ascendis identified several flaws invalidating Dr. Habr's reliance on two historical and two projected risk premiums. *See* Wellsboro Main Brief at 81. First, Dr. Habr's historical market premium contradicts established financial literature disfavoring shorter term data series by calculating a historical risk premium based on U.S. Treasury bill returns from 1983 to 2018, compared to the Company's reliance on data from 1926 to 2018. *See* Joint Statement No. 2-R at 59. Second, the remaining three market risk premiums all rely on the S&P 500 index, but manipulate the data to remove non-dividend paying companies. *See id.* at 60. This adjustment excludes 19% of the S&P's market capitalization and thus distorts the results of these analyses. *See id.* at 61. At minimum, Dr. Habr should have removed the S&P non-dividend paying companies from the index used to calculate the beta-coefficients for the proxy group to preserve an appropriate correlation between the risk premiums and the proxy group companies. *See id.* at 61.

Finally, in attempting to defend its DCF and CAPM/Risk Premium models, OCA argues the Company's DCF, CAPM, and non-price regulated proxy group models are inappropriate. Specifically, OCA claims the Company's DCF model fails to account for long-term GDP growth, that the CAPM model incorrectly relies on a 30-year Treasury Bond growth rate, and non-price regulated proxy group presents differing risk profiles compared to the Electric Utility Proxy Group. These arguments are addressed throughout the above responses to I&E's arguments, except that long-term GDP growth is addressed in Section VII.C.1.e, *supra.* As set forth above, OCA's arguments have no merit and should be denied.

f. <u>Size Adjustment</u>

The I&E and OCA Main Briefs oppose the Company's proposed size adjustment. *See* I&E Main Brief at 47-48; *see* OCA Main Brief at 59-60. The Company fully addressed the concerns raised by the Commission in its UGI Order regarding utility-specific support for a size adjustment by presenting both technical literature and independent analysis affirming the reality that smaller utilities face considerable size risk. Wellsboro Main Brief at 88-94.

Per the Company's Main Brief, I&E's efforts to discredit the existence of a size risk, the relevance of the size risk analysis from Dr. Zepp, and Mr. D'Ascendis' independent size risk analysis are not credible and should be disregarded. I&E first references an Ibbotson *Stocks, Bonds, Bills, and Inflation: 2015 Yearbook* ("SBBI Yearbook") showing year-to-year variance in returns for large and small-capitalization stocks listed on the NYSE, AMEX, and NASDAQ and argues that the fact that large capitalization stocks outperform small capitalization stocks at times refutes the existence of size risk. I&E Main Brief at 50. However, the very analysis cited by I&E also invalidates I&E's characterization of the study as a conclusive rebuttal to the existence of size risk, noting that the findings merely "led some market observers to *speculate* that there is no size premium." *See* I&E Main brief at 50 note 151 (emphasis added). More substantively, Mr. D'Ascendis points to the fact that Duff and Phelps bought the SBBI Yearbook from Ibbotson and continued publishing size premiums, which were referenced in this proceeding by both OCA and Company witnesses. *See* Tr. 51; *see* OCA Main Brief at 59; *see also* Joint Statement No. 2, Exhibit__(DWD-1), Schedule DWD-8. The Company's reliance on published industry data affirming continued acceptance of size risk far outweighs I&E's reference to speculation among some unquantifiable observers in the industry.

I&E's suggestion that Dr. Zepp's study is irrelevant must also fail. The Company's Main Brief presented arguments affirming Dr. Zepp's study as an authoritative and utility-specific rebuttal to the flawed study conducted by Dr. Wong.[11] *See* Wellsboro Main Brief at 92-93. With that argument addressed, I&E pivots to arguing that the Zepp article is not *electric utility* specific because it relies on data from water utilities. *See* I&E Main Brief at 52. This argument directly conflicts with I&E's reliance on the Commission's *City of DuBois – Bureau of Water* case to

[11] The Commission should also note that I&E's claim that only utility-specific analyses are relevant to assessing size risk is entirely undercut by I&E's failed effort to refute the Company's size adjustment by referencing the non-utility specific 2015 Ibbotson SBBI. *See* I&E Main Brief at 50.

support its proposed ROE methodology. *Id.* at 40. Rate of return fundamentals are uniform among water and electric utilities, as even the seminal *Bluefield* case addressed rate of return for a water utility. Accordingly, the Zepp article is a relevant and credible rebuttal to Dr. Wong's study.

Lastly, I&E's criticism of Mr. D'Ascendis' size study as having limited explanatory power ignores Mr. D'Ascendis' comments explaining his findings. Mr. D'Ascendis' utility size study produced an R-Squared value of 0.09, meaning that 9% of the change in risk is explained by size. *See* Wellsboro Main Brief at 93. Mr. D'Ascendis' readily acknowledged that an R-Squared value of 0.09 would not ordinarily have strong explanatory power, but in this case, it exceeds the R-Squared value of the beta-coefficients used by the I&E and OCA in their CAPM analyses. *See* Tr. 50; see also Joint Statement No. 2-R at 36. In other words, Mr. D'Ascendis' study has significantly more explanatory power than commonly accepted risk measures, such as beta coefficients. I&E improperly emphasizes only Mr. D'Ascendis' general observation without reference to the context explaining that his study confirms the inverse relationship between utility size and risk.

OCA's criticism of the Company's market capitalization analysis based on the size premiums reported by Duff and Phelps is similarly misguided. *See* OCA Main Brief at 58. The Company's Main Brief reviewed Mr. D'Ascendis' market capitalization study, which calculated the market capitalization of the Company and the Electric Utility Proxy Group. *See* Wellsboro Main Brief at 93-94. Mr. D'Ascendis then referenced 2019 data from Duff and Phelps that calculates size premiums for ten deciles, each defined by a market capitalization range. *Id.* Under this analysis, Wellsboro ranked in the tenth size decile while the proxy group ranked in the second size decile, resulting in a size premium spread of 4.70%. *See* Joint Statement No. 2 at 45.

OCA claims that OLS (ordinary least squares) betas are the more relevant indicator of company size than the market capitalization referenced by Mr. D'Ascendis. *See* OCA Main Brief at 58. OCA presents 2017 data from Duff and Phelps that includes both the market capitalization and OLS betas for each of the ten size deciles. *See* OCA Main Brief at 58. OCA then finds that the electric proxy group has a similar OLS beta to the first size decile, which has a negative size premium.[12] *See* OCA Main Brief at 59. On that basis, OCA argues that any size adjustment should be negative. As stated in the Company's Main Brief, this argument defies logic since the relevant size premium justifying Mr. D'Ascendis' 100 basis point adjustment is not simply the size premium for to the electric proxy group decile, but rather the *spread* between the size premiums for the Company's size decile and the electric proxy group size decile. *See* Wellsboro Main Brief at 94. Even under OCA's analysis, the spread well exceeds 100 basis points and thus supports Mr. D'Ascendis' size adjustment.

g. <u>Performance Adjustment</u>

I&E and OCA both oppose the Company's proposed performance adjustments based on nothing more than disagreement with the General Assembly's recognition that effective management merits a rate premium. I&E emphasizes that Section 523 of the Public Utility Code requires the Commission to consider a performance adjustment but does not compel the Commission to award one. *See* I&E Main Brief at 51-52. The Company agrees with this premise but notes that I&E and OCA also contradict the statute by averring that management effectiveness is its own reward and should not be recognized in rates. *See* I&E Main Brief at 53; *see also* OCA Main Brief at 59. This position is not consistent with the statute or Commission precedent.

The Commission has recognized the validity of performance adjustments and previously granted a 22-basis point performance adjustment to Aqua, Pennsylvania Inc., citing water quality and customer service among the qualifying factors. *See Pennsylvania Pub. Util. Comm'n et. al v. Aqua Pennsylvania Inc., Docket No.* R-00072711 (Order entered July 31, 2018) at 50.

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[12] The size premiums differ between the 2017 and 2019 data cited by OCA and the Company, but in both cases, only the first size decile is assigned a negative size premium. *See* OCA Main Brief at 58; *but see* Joint Statement No. 2, Exhibit__(DWD-1), Schedule DWD-8.

Accordingly, the Commission should dismiss the arguments of I&E and OCA opposing the principle of a performance adjustment and proceed to address the merits of whether Wellsboro has performed above and beyond its regulatory obligations to merit a performance adjustment. For the reasons detailed in the Wellsboro Main Brief, this question should be answered in the affirmative and the proposed 25-basis point performance adjustment should be accepted.

D. CONCLUSION AS TO RATE OF RETURN

The Company is entitled to the opportunity to earn a fair and reasonable return consistent with *Bluefield*. The ROE recommendations from I&E and OCA reflect both technical errors and misguided judgment. Determination of a reasonable rate of return requires not just review of the financial models, but also an understanding and appreciation for the economic signals impacting investors and markets. Accordingly, the Commission should be wary of the I&E and OCA ROE recommendations falling below all objective ROE benchmarks, including its own DSIC ROE calculated simultaneously with the development of the record in this proceeding. Rather, the Commission should award ROEs that facilitate access to capital and support the Company's efforts to continue accelerating replacement of aging infrastructure and providing safe and adequate public utility service. To that end, the Commission should adopt the Company's proposed cost of common equity of 10.30%, which results in an overall rate of return of 7.62% after adjusting for the Company's unopposed capital structure and debt cost rate.

VIII. TAXES

A. TCJA / DEFERRED REGULATORY LIABILITY

In its Main Brief, the Company explained the impact of the Tax Cuts and Job Act of 2017 ("TCJA"), which reduced the Federal Income Tax rate from 34% to 21%. Wellsboro Main Brief at 95. The Company created a tariff rider ("TCJA Voluntary Surcharge") and elected to reduce its distribution rates rather than implementing a surcharge line item on its bills. *Id.* On

November 8, 2018, the Commission approved a petition by Citizens' and Wellsboro to maintain the regular reconciliation process for the TCJA Voluntary Surcharge until the Companies submit rate cases. *Id.* Wellsboro submitted a reconciliation statement in May 2019 but proposed to keep the distribution rates at the current levels pending resolution of this rate case. In this proceeding, Wellsboro proposed to a final reconciliation of the TCJA Voluntary Surcharges within 120 days after new rates take effect. *Id.*

I&E and OSBA do not oppose the Company's proposal. *See* I&E Main Brief at 54; OSBA Main Brief at 6. However, OCA argues that the Company should provide the necessary reconciliation before the rates in this proceeding are determined to allow the over- or under-recovery to be reflected in the rates from this proceeding. OCA Main Brief at 66. OCA urges that the tax savings collected from January 2018 to June 2018 should be returned to customers as soon as possible. *Id.*

While the Company agrees that January to June 2018 tax savings should be returned in a reasonable time frame, final 2019 tax data is necessary to conduct the reconciliation. As explained in the Company's Main Brief, the 2019 tax data necessary to prepare the reconciliation will not be available until March or April of 2020. *See* Wellsboro Main Brief at 96. In the interest of assuring an accurate and complete final reconciliation of the TCJA Voluntary Surcharge, Wellsboro maintains its position seeking Commission approval to file a final reconciliation of the TCJA Voluntary Surcharge, within 120 days after new rates take effect. Wellsboro Main Brief at 96; Joint Statement No. 3 at 14.

B. EXCESS ACCUMULATED DEFERRED INCOME TAXES

OCA also proposed an adjustment to the Company's proposed treatment of the EDIT. OCA Main Brief at 64-65. EDIT results from the benefit the Company received by taking extra depreciation expense for tax purposes while the Federal tax rate was 34%.[13] Wellsboro Main Brief at 96. In his Main Brief, the Company proposed to flow back the benefit of the tax reduction by amortizing the EDIT balance over the life of the assets – ten years. *Id.*

OCA does not oppose the flowback of the EDIT generally but argues that rates were not changed in 2018 to reflect the flowback of the EDIT. OCA Main Brief at 64. The Company's Main Brief explains the rate adjustments reflecting the TCJA and EDIT. *See* Wellsboro Main Brief at 96. Specifically, the Company cites to the following testimony from Wellsboro witness Gorman:

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

Id.; Wellsboro Statement No. 1-R at 13. For this reason, the Commission should deny OCA's proposed adjustment and accept the Company's EDIT claim for 2018.

IX. RATE STRUCTURE

A. ALLOCATED CLASS COST OF SERVICE STUDY

As explained in the Company's Main Brief, Wellsboro developed an ACOS to assign the total distribution revenue requirement of a utility to the rate classes in its Tariff, on a cost-causation basis. Company witness Gorman followed the traditional three-step process: (1) functionalization of rate base and costs; (2) classification of functionalized costs as demand-related, commodity-

[13] The EDIT reflects straight line depreciation assumptions in its revenue requirement in prior cases. Wellsboro Main Brief at 96.

(cont'd footnote)

related, or customer-related; and (3) class allocation of the functionalized, classified costs among the rate classes.[14] Wellsboro Main Brief at 97.

I&E and OSBA do not oppose the Company's proposed ACOS. OSBA Main Brief at 6; I&E Main Brief at 55. While OCA does not generally oppose the Company's ACOS, OCA opposes classification of portions of secondary distribution plant (Accounts Nos. 364, 365, 366) and Transformers (Account No. 368) as customer related. OCA Main Brief at 68-69, 74.

As set forth below, Wellsboro has demonstrated that its ACOS adheres to well established cost-causation principles and is reasonable. The Company's ACOS should be approved, and OCA's position should be rejected.

1. Wellsboro's Classification of Secondary Distribution Plant As Part Demand-Related and Part Customer-Related is Appropriate and Should be Approved

OCA does not oppose the Company's classification of primary distribution as demand-related or the meters and service drops as customer related. OCA Main Brief at 68. OCA's disagreement with the classification of facilities in the Company's ACOS is limited to secondary distribution plant upstream of the meters and service drops. *Id.* at 68-69. In its Main Brief, OCA argues that there is no direct relationship between the number of customers and the size or cost of poles, conductors, and other equipment. *Id.* at 70. OCA argues that Company witness Gorman's minimum system analysis is flawed, and that Mr. Gorman inaccurately classified upstream secondary distribution plant as customer-related. *Id.* at 70.

OCA's arguments should be rejected. As explained in its Main Brief, the Company's approach to classification of secondary distribution plant (a) appropriately identifies customer

[14] Wellsboro's ACOS includes the following functions: (1) primary distribution (including substations as well as conductors operating primarily at voltages of > 600V and related assets); (2) secondary distribution (facilities designed to move power from primary distribution system to customers' premises; includes services); and (3) billing (includes meters as well as assets and activities related to enabling the distribution of electricity to customers and billing and collecting revenue). Wellsboro Main Brief at 97-98.

costs in upstream distribution plant; (b) uses a well-established method to calculate these customer costs; and (c) adheres to longstanding Commission precedent. Wellsboro Main Brief at 98-100. The Company's approach in developing its ACOS is well supported and should be approved.

First, fundamental utility accounting practices recognize that upstream distribution plant (e.g., transformers, conductors, poles, and towers) all contain customer costs. Wellsboro Main Brief at 99. Mr. Gorman testified in this proceeding, "It has been well-established that the costs of Secondary distribution plant are partly driven by the number of customers; the same is also true for Transformers, which are even closer to the customer than Secondary plant." *Id.* (quoting Wellsboro Statement No. 1-R at 13).

Second, the Company reasonably used the minimum system method to identify and calculate the customer portion of upstream distribution plant. OCA's criticisms of Mr. Gorman's classification of upstream secondary distribution plant using a minimum system analysis stand in conflict with the widely accepted reality that labor costs to install poles, fixtures, and other upstream secondary plant (conceptualized as the zero-load component of the Secondary system) "represents [sic] the cost of extending service to all customers, without regard to peak or average load, and is therefore customer-related." Wellsboro Statement No. 1 at 25. Additionally, absent the use of the minimum system, the distribution costs are incorrectly allocated to each class, because using a demand allocator alone assumes that transformer and conductor capacity is the same for all classes – which is an inaccurate assumption. *See* Wellsboro Main Brief at 99.

Finally, the Company's minimum system approach to classification of secondary distribution plant is well-grounded in Commission precedent. As explained in the Company's Main Brief, the Commission rejected OCA's similar arguments in both PPL's 2012 rate case and in UGI Electric's 2018 rate case. *See*, e.g., PPL 2012 Order, p. 113; *see also* UGI Order at 157-160. In the UGI Order, the Commission specifically found that the minimum system method is "consistent with the NARUC Manual and more accurately reflects cost-causation principles than the ACOSS methodology proposed by the OCA." UGI Order at 160.

Wellsboro's classification of upstream distribution plant as both customer- and demand-related is well supported, consistent with Commission precedent, and should be accepted.

B. REVENUE ALLOCATION

As explained in the Company's Main Brief, the Company's revenue allocation proposal was developed with two key objectives: (1) to move each class closer to its cost of service, as computed in the ACOS; and (2) to mitigate extreme rate impacts on rate classes and on customer subgroups. See Wellsboro Main Brief at 100.

I&E, OCA, and OSBA do not generally oppose the Company's revenue allocation; however, the Advocates each oppose the proposed rate decrease for POL. Specifically, I&E proposes that the decrease for Rate Class POL be reallocated to Rate Classes CS and MSL. I&E Main Brief at 58-59. OCA proposes reallocating the decrease for POL proportionately to other classes. OCA Main Brief at 80. OSBA proposes to reallocate the decrease for POL to RS and IS, while adjusting the individual RS and IS class increases so as to provide for the same movement toward cost of service.[15] OSBA Main Brief at 9.

As described in the Company's Main Brief, Wellsboro's revenue allocation is reasonable; appropriate to bring all classes closer to cost of service; and consistent with controlling precedent. Wellsboro Main Brief at 100-02. Cost-causation is the "polestar" of utility ratemaking. *Lloyd v. Pa. PUC*, 904 A.2d 1010, 1015 (Pa. Cmwlth. 2006). In the UGI Order, the Commission noted the ALJs affirmation of UGI's proposed revenue allocation as providing significant movement toward

[15] OSBA witness Kalcic proposed to measure movement toward cost of service by measuring the change in the absolute level of class subsidies at present and proposed rates, rather than changes in relative rates of return. OSBA Main Brief at 7. The Company disagrees with Mr. Kalcic's measurement as the primary way to measure movement toward cost of service. Wellsboro Main Brief at 102.

cost of service. UGI Order at 163. The Commission approved UGI's revenue allocation, including a decrease for one class. Wellsboro Main Brief at 101.

Consistent with ACOS and the Commission's determination in the UGI Order, the Company respectfully requests that the Commission approve Wellsboro's proposed revenue allocation.

C. RATE DESIGN

In most respects, Wellsboro's rate design is consistent with prior Company rate designs approved by the Commission. However, to ensure the Company reasonably recovers its fixed costs and in furtherance of several Commission policies, Wellsboro proposes to include a small portion of demand costs as part of its monthly customer charges for certain residential, non-residential, and commercial classes.[16] This demand component is designed to reflect minimum demand for these customers pursuant to the ACOS.

I&E and OCA oppose the Company's proposal to include a portion of demand costs in the monthly fixed charge for customers. OCA Main Brief at 84-92; I&E Main Brief at 62-68. Specifically, I&E argues: (1) the Company's proposal is not how the Company has traditionally developed its rates; (2) the Company's proposed rate design does not send appropriate price signals; and (3) the proposal runs counter to some Commission policies pertaining to alternative ratemaking. *Id.* OCA partially relies on I&E's analysis to make similar arguments. OCA Main Brief at 84-92. As explained below, the arguments by I&E and OCA are in error, contrary to the policy shift towards alternative ratemaking, and should be rejected by the Commission.

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[16] Specifically, the Company proposes to include $1.48 of demand costs in a $13.40 customer charge for Classes RS (Residential Service), RSAE (Residential Service All Electric), NRS (Non-Residential Service), and NRH (Non-Residential Service Space Heating). For CS (Commercial Service) and CSH (Commercial Service Space Heaters), the Company proposes that $20.71 of a proposed $35.00 and $58.00 demand charge, respectively, will cover customer costs, with the remainder covering demand-related costs. Wellsboro proposed rates for each rate class are set forth in Wellsboro Statement No. 1, Exhibit__(HSG-1) (W), Schedules B6-3 and B7.

1. The Company's Proposal is Supported by Commission Policies

OCA and I&E claim that the Company's approach to rate design represents a change from traditional development of customer charges. OCA Main Brief at 85; I&E Main Brief at 63. The Company agrees that its proposal expands the costs recovered through traditional customer charges but submits that its proposed customer charges should be deemed reasonable under the Commission's standard customer charge analysis and the recent policies implemented to foster alternative ratemaking in the Commonwealth.

While the Commission has generally limited customer costs to direct costs such as billing costs, its traditional policies preserve discretion to include other costs. In a 2004 decision, the Commission affirmed that allocated portions of other (indirect) costs such as "employee benefits, local taxes and other general and administrative costs . . . are costs which may be considered for inclusion in the customer charge, but such claims are subject to scrutiny on a case-by-case basis." *Pa. PUC v. Aqua Pennsylvania Inc.*, 2004 Pa. PUC LEXIS 39 (Order entered Aug. 5, 2004) at *98. Accordingly, the Commission has always reserved authority to approve customer charges that incorporate more than direct customer costs. *See,* e.g., 2012 PPL Order at 131 ("We find that the I&E proposed limitation of costs to only services and meters excludes all other customer costs that should be included in a customer charge and is unreasonably narrow.").

Further, the Company's customer charge proposal comes in the wake of Act 58 and the Commission's policy statement on alternative ratemaking. Act of July 1, 1978, P.L. 598, *as amended*, added by Act of June 28, 2018, P.L. 58, 66 Pa. C.S. § 1330 ("Act 58"); *Fixed Utility Distribution Rates Policy Statement, Final Policy Statement Order*, Docket No. M-2015-2518883 (Order entered July 18, 2019) ("Final Policy Statement"). Act 58 further confirms the Commission's authority to approve rates and rate designs outside of "traditional" practices, and the later Final Policy Statement provides guidance to Companies in proposing rate designs.

As indicated above, the Company's proposed rate design is entirely consistent with multiple Commission policies and should be approved.

2. I&E and OCA's Argument that the Company's Proposed Demand Component does not Send Appropriate Price Signals is Inaccurate

In its Main Brief, OCA claimed that the Company's proposed rate design "prevents the customer from seeing price signals that would otherwise encourage conservation and the efficient use of electricity." OCA Main Brief at 87. Similarly, I&E argues that fixed charges result in customers being sent "an inaccurate message that their usage does not affect distribution system costs." I&E Main Brief at 63. I&E opposes a fixed charge by arguing that a utility's future investment in demand infrastructure is not a fixed cost because there remains some possibility that such capital investment could be avoided if customers reduce consumption and peak demands. I&E Main Brief at 64-65. I&E claims that higher fixed charges do not signal to customers to either to avoid usage at the peak or to conserve energy at all times. I&E Statement No. 3 at 31.

These arguments by I&E and OCA misconstrue the Company's actual proposed rate design. As explained in detail in testimony and in the Company's Main Brief, Wellsboro's proposal is based on an analysis of customers' monthly and yearly demand data and reflects cost of service principles by *calculating the minimum portion of demand costs used by each customer*. *See* Wellsboro Main Brief at 110. All remaining demand costs above the minimum demand threshold – will still be recovered through the volumetric energy charge. Thus, the price signals existing today will be preserved, but with a more accurate connection to cost of service.[17] In fact, the

[17] In the 2012 PPL Order, the Commission stated:

> With regard to the concerns expressed by the opposing Parties that PPL's compromise proposal discourages conservation, we note our agreement with the Company's observation that the distribution charge is relatively small in the context of the energy portion of a customer's bill, which comprises approximately 86% of the charges on the average customer's bill. Therefore, we find that this will provide a more than adequate opportunity for customer savings due to energy conservation.

2012 PPL Order at 131.

Commission should consider that the minimum demand analysis performed by Mr. Gorman indicates that continuing to recover minimum level of demand costs in the volumetric rate is not consistent with cost of service principles. While customers should benefit from conservation to a degree, the minimum costs of operating the Company's system, including minimum demand costs, are not appropriate for recovery through volumetric charges. The Commission should not support positions from I&E and OCA that would unreasonably require the Company to lump all costs that are not included under the customer charge into the volumetric charge.

In contrast to relying on an energy charge to impact demand, the "perfect" solution would be to establish a demand charge that is commensurate with demand costs. While this would address parties' concerns about price signals, the Company did not develop a full-fledged demand charge at this time because it believed such a proposal would require significant customer education. Wellsboro Statement No. 1 at 38, 42; Wellsboro Main Brief at 107. However, the Company is willing to create a residential time-of-use or demand charge at this time if desired by the Commission.

As explained above, I&E and OCA's concerns about cost signals ignore the sound cost basis of the Company's proposed rate design. The Company's proposal preserves price signals while moving the rate design closer to cost of service by more closely aligning Company revenue and customer rates. The Company respectfully requests that the Commission approve its proposed rate design.

3. Contrary to I&E's Analysis, the Company's Proposal Aligns Closely with the Policy Goals in the Commission's Final Policy Statement on Alternative Ratemaking

In 2018, the General Assembly passed Act 58, providing clear legislative authority to approve alternative ratemaking methodologies. *See* Act 58; 66 Pa. C.S. § 1330. Later, the Commission established a Final Policy Statement on alternative ratemaking, where it identified a set of factors the Commission will consider in determining just and reasonable distribution rates that promote certain policy objectives. *See generally Final Policy Statement*, Docket No. M-2015-2518883 (Order entered July 18, 2019).

As explained in the Company's Main Brief, the Company's proposal aligns with the Commission's enumerated policy factors established in its Final Policy Statement. 52 Pa. Code § 69.3302. I&E, however, grounds its opposition to the Company's rate design proposal primarily based on three concerns: efficiency and energy conservation; low-income customers; and cost causation. I&E Main Brief at 65-68. Specifically, I&E argues that the goals of promoting efficient use of energy sources, avoiding unnecessary future capital investments, and reflecting sound application of cost of service principles, and considering customer impacts are discouraged by Company's proposal. *Id.*

Wellsboro has demonstrated that its proposal meets many of the 14 goals. Even if Wellsboro's rate design were found to be inconsistent with one or more of the objectives in the Final Policy Statement, the rate design certainly advances a significant number of these goals. The Policy Statement did not require the proposal to provide energy efficiency and conservation – that is one consideration. By way of contrast, I&E's analysis of each of the 3 highlighted goals is unpersuasive, as explained below.

First, regarding efficiency and energy conservation, I&E's criticisms are unwarranted. As discussed above, the Company's proposal maintains the volumetric charge for *all demand-based costs above the minimum demand.* Put simply, appropriate price signals remain in place as any reduction to the volumetric charges is proportionate to the customer's minimum demand. At most, the proposal could be considered neutral from an energy efficient standpoint, but certainly not "detrimental" to energy efficiency as claimed by I&E. *See* I&E Main Brief at 66.

Second, I&E has not demonstrated that there will be a detrimental impact on low income customers with low usage. By shifting only the *minimum* demand costs to the fixed customer charge, the Company's proposal provides exactly the type of consumer protection deemed absent in I&E's Main Brief. *See* I&E Main Brief at 66.

Third, I&E's contention that the proposed rate design does not align revenues with cost causation principles has been addressed both above and in the Company's Main Brief. *See* Wellsboro Main Brief at 107. I&E again ignores the Company's repeated clarifications that only each customer's minimum demand costs would be rolled into the fixed charge, thus aligning the proposed rate design with cost of service.

The Company's proposal balances many ratemaking goals – cost of service, simplicity, gradualism, reliability, revenue stability for Wellsboro, cost stability for customers, and more. I&E and OCA fail to demonstrate that Wellsboro's proposal conflicts with the Commission's Final Policy Statement.

4. Conclusion

For the foregoing reasons, the company respectfully requests that the Commission deny the adjustments of I&E and OCA and approve the Company's rate design.

D. SCALE BACK

In its Main Brief, the Company recommends a proportionate scale back if the Commission approves a lower-than-requested revenue requirement. Wellsboro Main Brief at 111. I&E recommends a proportionate scale-back of increased customer charges and usage rates based upon the cost of service study. I&E Main Brief at 69. OSBA proposes to exclude Rates RSAE, NRH, and CSH from any scale back. OSBA Main Brief at 12. OCA recommends that the increases proposed for RSAE, NRH, and CSH not be scaled back until the increase for each class reaches 1.5 times the system average increase. OCA Main Brief at 93.

The Company maintains its position that any scale back should include a proportional scale back of all rate increases or decreases. The Company's revenue allocation proposal was designed to reflect cost-causation principles. Wellsboro Main Brief at 112. To preserve these principles, the Company believes a proportionate scale back to all rates is appropriate. *Id.* at 112. Consequently, the Company requests that any scale back of rates should be proportionate based on the allocated cost of service study methodology accepted by the Commission, updated to reflect the revenue requirement authorized by the Commission.

X. MISCELLANEOUS ISSUES

A. REPORTING REQUIREMENTS

In its Main Brief, I&E accepts the Company's plant in service projections for the FTY and FPFTY, but argues that the Company should be ordered by the Commission to submit updates to Schedule C3 by April 1, 2020 (for the year ended December 31, 2019) and by April 1, 2021 (for the year ended December 31, 2020). I&E offers two primary arguments in support of its position. First, I&E states that such reporting requirements have been approved in other proceedings. I&E Main Brief at 71. Second, I&E argues that lack of regulations, if anything, heightens the need for the reporting requirements. I&E Main Brief at 71-72. The Company respectfully requests that the Commission reject I&E's arguments and decline to impose additional reporting requirements, for the following reasons.

The Commission has undertaken to develop FPFTY regulations through the ongoing FPFTY stakeholder process. Presumably, the ongoing FPFTY stakeholder process will result in a clear set of reporting standards to which the Company (and all EDCs) will be subject. As opposed to this individual rate case, the stakeholder process is the ideal location for the Commission to gather input from a variety of stakeholders and issue a broadly applicable order.[18]

Similarly, the Company rejects I&E's argument that a lack of regulation should, in fact, result in additional burdens on Wellsboro. As explained in its Main Brief, the Company submits numerous filings to the Commission each year, including Annual Reports that include detailed plant, expense, and sales data that the Commission and I&E can review. *See* Wellsboro Main Brief at 112 *citing* 52 Pa. Code § 57.47. In addition, Commission regulations require quarterly updates while the rate filing is pending. *Id.* at 117 *citing* 52 Pa. Code § 53.56. Thus, year-end balances will be provided through other means. The Company urges the Commission to mitigate the regulatory burden on small utilities by denying I&E's mandatory reporting request.

[18] *See*, e.g., *Pa. PUC v. Pennsylvania-American Water Co*., Docket No. R-00932670 et al., 1994 Pa. PUC LEXIS 120 at *158 (Final Order entered July 26, 1994) (adopting the ALJ's conclusion that the issues raised by OCA were outside the scope of rate case and would be better addressed in a statewide rulemaking proceeding).

XI. CONCLUSION

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

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By ______________________

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Counsel to Wellsboro Electric Company

Dated: January 22, 2020

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Tanya J. McCloskey, Acting Consumer Advocate, Petitioner	:	
v.	:	No. 1549 C.D. 2018 Argued: December 10, 2019
Pennsylvania Public Utility Commission, Respondent	:	

BEFORE: **HONORABLE RENÉE COHN JUBELIRER,** Judge
HONORABLE PATRICIA A. McCULLOUGH, Judge
HONORABLE ANNE E. COVEY, Judge

OPINION BY
JUDGE COHN JUBELIRER **FILED: January 15, 2020**

Before this Court is the petition for review of Tanya J. McCloskey, Acting Consumer Advocate (Office of Consumer Advocate (OCA)), challenging the October 25, 2018 Order of the Pennsylvania Public Utility Commission (Commission) that approved a general rate increase filed by UGI Utilities, Inc.-Electric Division (UGI), which OCA contends results in utility rates that are not just and reasonable. The Commission ultimately approved an annual revenue increase for UGI of $3.201 million, or 3.6%. Although the underlying general rate proceeding involved the litigation or settlement of numerous issues, the only issues remaining for our consideration are: whether Sections 315, 1301, and 1301.1 of the Public Utility Code (Code), 66 Pa. C.S. §§ 315, 1301, 1301.1, support UGI's calculation of its rate base,[1] rather than OCA's calculation of that rate base, and whether the Commission's acceptance of UGI's calculations is supported by substantial evidence. OCA contends that the approved rates are inconsistent with the Code and the Commission's Decision is not supported by substantial evidence. The Commission, UGI, which has intervened, and the Energy Association of Pennsylvania (EAP), which has filed an *amicus curiae* brief in favor of affirmance, argue the Commission's determinations are supported by the plain language of Sections 315(e) and 1301.1(b) of the Code, the purpose of those statutory provisions, and the record.

I. Background

To better understand the nature of UGI's general rate proceeding, OCA's objections to UGI's proposed rate increase, and the Commission's Decision, we begin with some basic principles of ratemaking, the Commission's role in the ratemaking process, and changes to the ratemaking process made by the General Assembly in 2012 and 2016.

A. Ratemaking Under the Code

1. General Principles

Section 1301(a) of the Code mandates that "[e]very rate made, demanded, or received by any public utility . . . shall be just and reasonable, and in conformity with [the] regulations or orders of the [C]ommission." 66 Pa. C.S. § 1301(a). Pursuant to the just and reasonable standard, a utility may obtain "a rate that allows

[1] A utility's "[r]ate base" is "[t]he value of the whole or any part of the property of a public utility which is used and useful in the public service." Section 102 of the Code, 66 Pa. C.S. § 102.

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. Pub. Util. Comm'n*, 793 A.2d 978, 982 (Pa. Cmwlth. 2002). There is no single way to arrive at just and reasonable rates, and "[t]he [Commission] has broad discretion in determining whether rates are reasonable" and "is vested with discretion to decide what factors it will consider in setting or evaluating a utility's rates." *Popowsky v. Pa. Pub. Util. Comm'n*, 683 A.2d 958, 961 (Pa. Cmwlth. 1996). "Under traditional ratemaking, utilities may not change rates charged to customers outside of a base rate case." *McCloskey v. Pa. Pub. Util. Comm'n*, 127 A.3d 860, 863 n.2 (Pa. Cmwlth. 2015).

At issue here is a general rate filing governed by Section 1308(d) of the Code, which provides the procedures for changing rates, the time limitations for the suspension of the new rates, and the time limitations on the Commission's actions. 66 Pa. C.S. § 1308(d).[2] The Commission is required to investigate all

[2] Section 1308(d) provides:

> **(d) General rate increases**.--Whenever there is filed with the commission by any public utility described in paragraph (1)(i), (ii), (vi) or (vii) of the definition of "public utility" in section 102 (relating to definitions), and such other public utility as the [C]ommission may by rule or regulation direct, any tariff stating a new rate which constitutes a general rate increase, the [C]ommission shall promptly enter into an investigation and analysis of said tariff filing and may by order setting forth its reasons therefor, upon complaint or upon its own motion, upon reasonable notice, enter upon a hearing concerning the lawfulness of such rate, and the [C]ommission may, at any time by vote of a majority of the members of the [C]ommission serving in accordance with law, permit such tariff to become effective, except that absent such order such tariff shall be suspended for a period not to exceed seven months from the time such rate would otherwise become effective. Before the expiration of such seven-month period, a majority of the members of the [C]ommission serving in accordance with law, acting unanimously, shall make a final decision and order, setting forth its reasons

(Footnote continued on next page…)

general rate increase filings. *Popowsky*, 683 A.2d at 961. Section 315(a) of the Code places the burden of proving the reasonableness of a proposed rate on the utility. 66 Pa. C.S. § 315(a). The evidence necessary to meet that burden must be substantial. *Lower Frederick Twp. Water Co. v. Pa. Pub. Util. Comm'n*, 409 A.2d 505, 507 (Pa. Cmwlth. 1980). To meet this burden of proof, a utility uses a test year, which is a snapshot of time that reflects the typical conditions, revenues, expenses, and capital costs of the utility. *See Green v. Pa. Pub. Util. Comm'n*, 473

(continued…)

> therefor, granting or denying, in whole or in part, the general rate increase requested. If, however, such an order has not been made at the expiration of such seven-month period, the proposed general rate increase shall go into effect at the end of such period, but the [C]ommission may by order require the interested public utility to refund, in accordance with section 1312 (relating to refunds), to the persons in whose behalf such amounts were paid, such portion of such increased rates as by its decision shall be found not justified, plus interest, which shall be the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the act of January 30, 1974 (P.L. 13, No. 6), referred to as the Loan Interest and Protection Law, during the period or periods for which the [C]ommission orders refunds. The rate in force when the tariff stating such new rate was filed shall continue in force during the period of suspension unless the [C]ommission shall grant extraordinary rate relief as prescribed in subsection (e). The [C]ommission shall consider the effect of such suspension in finally determining and prescribing the rates to be thereafter charged and collected by such public utility, except that the [C]ommission shall have no authority to prescribe, determine or fix, at any time during the pendency of a general rate increase proceeding or prior to a final determination of a general rate increase request, temporary rates as provided in section 1310, which rates may provide retroactive increases through recoupment. As used in this part general rate increase means a tariff filing which affects more than 5% of the customers and amounts to in excess of 3% of the total gross annual intrastate operating revenues of the public utility. If the public utility furnishes two or more types of service, the foregoing percentages shall be determined only on the basis of the customers receiving, and the revenues derived from, the type of service to which the tariff filing pertains.

66 Pa. C.S. § 1308(d).

A.2d 209, 213-15 (Pa. Cmwlth. 1984) (describing generally items within a test year); *City of Pittsburgh v. Pa. Pub. Util. Comm'n*, 112 A.2d 826, 832 (Pa. Super. 1955) (indicating that a condition to be considered in examining a test year is the weather during that year). A utility could use a historic test year (HTY), the year prior to the filing of the rate case, or a future test year (FTY), the year ending shortly before the date the new rates would go into effect, to determine the amount of the rate base upon which its new rates would be calculated. Historically, in order for certain facility or related costs to be included in a utility's rate base, the facility had to be "used and useful" and "in service to the public" **at the time** the rate base was being calculated. Section 1315 of the Code, 66 Pa. C.S. § 1315.[3] However, the manner in which a utility could meet its burden of proof **changed** in 2012, when the General Assembly enacted a series of amendments to the Code, including to Section 315(e), which addressed the type of test year a utility could use to support its proposed rates.

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[3] Section 1315 provides:

> Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.

66 Pa. C.S. § 1315.

2. <u>Act 11 of 2012 – Section 315(e) of the Code</u>

By the Act of February 14, 2012, P.L. 72, No. 11 (Act 11), the General Assembly amended Section 315(e) to allow a utility to use a "**fully projected future test year**" (FPFTY) to satisfy its burden of proving the reasonableness of its proposed rates. 66 Pa. C.S. § 315(e) (emphasis added). The FPFTY is "the 12-month period beginning with the first month that the new rates will be placed in effect after application of the full suspension period permitted under section 1308(d) [(a period not to exceed seven months)]." *Id.* Section 315(e) requires that:

> Whenever a utility utilizes a [FTY] or a [FPFTY] in any rate proceeding and such [FTY] or a [FPFTY] forms a substantive basis for the final rate determination of the [C]ommission, the utility shall provide, as specified by the [C]ommission in its final order, appropriate data evidencing the accuracy of the estimates contained in the [FTY] or a [FPFTY], and the [C]ommission may after reasonable notice and hearing, in its discretion, adjust the utility's rates on the basis of such data.

Id. As part of the Act 11 amendments to Section 315(e), the General Assembly added the following: "Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the [C]ommission may permit facilities which are projected to be in service during the fully projected future test year to be included in the rate base." *Id.*

In its *Implementation of Act 11 of 2012* Final Order, 299 P.U.R.4th 367 (August 2, 2012), 2012 WL 3249678 (*Final Implementation Order*), issued after holding a working group with stakeholders, the Commission explained the Act 11 amendments were intended "to reduce regulatory lag[4] due to the use of rate case inputs that [were] outdated by the time new base rates bec[a]me effective." *Id.* at 2. The addition of the ability of a utility to use a FPFTY, the Commission indicated, would substantially reduce "the risks associated with regulatory lag" "because the new rates w[ould] be consistent with the test year used to establish those rates for at least the first year." *Id.* at 3. The Commission further noted the exemption to Section 1315's "used and useful" requirement now included in Section 315(e) allowed it discretion in deciding whether to include in a utility's rate base facilities that are not yet used and useful but are projected to be during the FPFTY. *Id.* at 3-4. The Commission indicated that, where a FPFTY is used and a utility is permitted to include a facility that is not yet in service, it "expect[ed] that in subsequent base rate cases, the utility [would] be prepared to address the accuracy of the [FPFTY] projections made in its prior base rate case." *Id.* at 5. OCA "support[ed]" the Commission's interpretation in its comments during the Act 11 implementation process and indicated that the use of the FPFTY could result in fewer rate increases on customers in the future. *Id.* at 4.

The General Assembly did not end its amendments to the ratemaking provisions of the Code in 2012.

3. <u>Act 40 of 2016 – Section 1301.1 of the Code</u>

In 2016, the General Assembly enacted the Act of June 12, 2016, P.L. 332, No. 40 (Act 40), in which it added Section 1301.1 to the Code, 66 Pa. C.S.

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[4] Regulatory lag is "a delay between the imposition of wholesale costs on a utility and state regulatory commission approval of a retail rate increase. Regulatory lag is inherent in many systems of retail rate regulation . . . ." *Kentucky West Virginia Gas Co. v. Pa. Pub. Util. Comm'n*, 862 F.2d 69, 75 (3d Cir. 1988).

§ 1301.1. Act 40 addressed the computation of income tax expenses for ratemaking purposes and eliminated the use of the consolidated tax savings adjustment (CTA). The CTA required a utility to adjust its rate base to account for the amount of tax savings it received by filing its taxes jointly with its parent and/or affiliated entities. In eliminating the use of the CTA, Pennsylvania joined the majority of states, which do not use the CTA. *See* H. 200th Sess., Feb. 8, 2016, at 117.[5] Section 1301.1(a) provides:

> If an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes, the related income tax deductions and credits shall also be included in the computation of current or deferred income tax expense to reduce rates. If an expense or investment is not allowed to be included in a public utility's rates, the related income tax deductions and credits, including tax losses of the public utility's parent or affiliated companies, shall not be included in the computation of income tax expense to reduce rates. The deferred income taxes used to determine the rate base of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity. . . .

66 Pa. C.S. § 1301.1(a). However, recognizing that a differential could result between the ratemaking procedures used prior to the effective date of subsection (a) (applying the CTA), and the computation now in effect (excluding the CTA), the General Assembly mandated in subsection (b) how the revenue from that differential should be used. Per that subsection, "the differential shall be used as follows: (1) fifty percent to support reliability or infrastructure related to the rate-base eligible capital investment as determined by the commission; and (2) fifty

[5] Available at https://www.legis.state.pa.us/WU01/LI/HJ/2016/0/20160208.pdf#page=18 (last visited January 8, 2020).

percent for general corporate purposes." 66 Pa. C.S. § 1301.1(b). The General Assembly's restriction on the use of this revenue applies until December 31, 2025. 66 Pa. C.S. § 1301.1(c)(1).

With these principles and statutory provisions in mind, we turn to the facts of UGI's rate case.

B. UGI's Rate Case

"UGI provides electric distribution services to approximately 61,832 residential, commercial[,] and industrial customers." (Commission Opinion (Op.) at 2.) It maintains over 1200 miles of underground and overhead primary distribution lines, 12 distribution substations, and 49 distribution circuits. Its last base rate case was in 1996. On January 26, 2018, UGI filed a new tariff, which was to become effective on March 27, 2018, that UGI later amended to reflect certain changes in federal tax law. "UGI proposed a rate base change that would have increased its annual revenues by $7.705 million, or 8.6%, based on a . . . FPFTY[] ending September 30, 2019." (*Id.* at 1.) The use of September 30, 2019, as the end of the FPFTY reflects the use of a "year-end rate base methodology" (year-end methodology). (*Id.* at 18.) UGI asserted the proposed rate increase reflected the business environment it currently faced, including the "accelerated investment in the repair, replacement or improvement of an aged and aging distribution system; the modernization of core technology systems . . . ; and modest increases in employee wages and salaries since its last base rate case in 1996." (*Id.* at 1-2.) UGI claimed that it was prevented from earning a fair rate of return on its investment at the present rate levels due to the growth in capital and operating costs, as well as stagnation in customer usage and growth trends. (*Id.*)

UGI further asserted that under Act 40, it was required to compute what the CTA would have been, here, $75,400, and then certify that this amount (Act 40 savings) would be used in accordance with Section 1301.1(b). Pointing out that its capital expenditures for reliability and infrastructure projects for the FPFTY exceeded $11 million, which was far greater than 50% of $75,400, and that its general corporate expenses likewise far exceeded the 50% requirement, UGI contended it complied with Section 1301.1(b)'s requirements.

By operation of law, the tariff was suspended, pursuant to Section 1308(d) of the Code, until October 27, 2018. In accordance with the requirement that all general rate cases be investigated, *Popowsky*, 683 A.2d at 961, the Bureau of Investigation and Enforcement (I&E) began an investigation of the proposed general rate increase.

C. Objections to UGI's Rate Case

OCA, along with others including the Office of Small Business Advocate (OSBA) and two UGI customers, filed complaints against UGI's proposed rate increase. (Commission Op. at 3.) I&E also opposed UGI's proposed rates. OCA, OSBA, and I&E particularly objected to UGI's calculation of its rate base using facilities and costs that were projected to be in effect as of the **end** of the FPFTY. They asserted that using this calculation would allow UGI to **overcollect** because the proposed rates included costs that would not be incurred by UGI on the day the rates went into effect, October 27, 2018, but would be incurred throughout various points within the FPFTY, ending September 30, 2019. Instead, they proposed using an "**average rate base methodology**" that would combine the costs listed for the beginning of the FPFTY and the costs listed at the end of the FPFTY and divide the total by two. (*Id.* at 15.) This methodology, they contended, resulted in a more just and reasonable rate. They also suggested that the same methodology be applied to UGI's depreciation expenses. OCA contended this position was supported by the decision of the Illinois Commerce Commission in *Re North Shore Gas Company*, (Ill. C.C. No. 12-0511/0512, June 18, 2013), 2013 WL 3762292, which rejected the use of year-end methodology in favor of an average rate base methodology.

OCA further sought a downward adjustment to UGI's rate base in the amount of $75,400, UGI's Act 40 savings. OCA contended that UGI did not prove that it would use that $75,400 as required by Section 1301.1(b) because it had not provided an accounting for those funds and, therefore, UGI should not be able to retain those funds. OCA observed that UGI's approach to satisfying this requirement should be rejected as it would not show actual use of the funds for the required purposes.

II. Recommended Decision and the Commission Decision

A. Recommended Decision

Following the receipt of witness testimonies, documentary evidence, other evidentiary filings, and an evidentiary hearing, two Administrative Law Judges (ALJs) issued a Recommended Decision. After providing an overview of the amendments to Section 315(e) of the Code, the ALJs held that, following Act 11, a utility may use the FPFTY in a base rate case to project items such as revenues, operating expenses, and capital expenditures throughout the 12-month period beginning with the first month the rates go into effect. (Recommended Decision (R.D.) at 13.) Noting that while a fundamental principle of regulating utilities is that a public utility be permitted to include projects in a rate base and earn a reasonable return on its investments **only** when the project becomes used and useful, the ALJs concluded that Act 11 **altered** this principle by allowing the use of the FPFTY to address the risks associated with regulatory lag. Citing the plain language of Section 315(e) and the policy behind its enactment, the ALJs accepted the use of the year-end methodology proposed by UGI. The ALJs were particularly persuaded by the exemption from Section 1315's "used and useful" requirement given to utilities that sought to meet their burden of proof using a FPFTY. (R.D. at 18-19.) However, the ALJs did not approve all of UGI's projected facilities. They rejected UGI's proposed "Electrical Engineering and Operations Center" (Operations Center), which added $17.3 million to UGI's FPFTY, as being in its preliminary planning stages and because there was no "reasonable certainty that it [would] be in operation in the FPFTY." (*Id.* at 22-24.) The ALJs rejected, as not persuasive, the Illinois Commerce Commission's decision in *North Shore Gas Company*, observing that decisions of other jurisdictions were not relevant to Pennsylvania rate cases due to, among other reasons, differences in statutory language and ratemaking principles. (R.D. at 21.) The ALJs acknowledged OCA's concern regarding the possibility of a utility overcollecting based on overstated projections, but indicated such issues could be addressed through protections the Commission could invoke, including verifications in subsequent rate filings or the imposition of an audit. (*Id.* at 22.)

The ALJs likewise agreed that UGI satisfied the requirements of Act 40, the language of which the ALJs found to be clear and unambiguous. (*Id.* at 110.) Reasoning that Act 40 does not state within Section 1301.1(b) any specific requirements for demonstrating the use of funds, the ALJs held that UGI was not required to show exactly where the Act 40 savings would be spent. (*Id.*) The ALJs found that the testimony of UGI's witness explaining how UGI's capital and general corporate purpose expenditures far exceeded the 50% threshold found in Section 1301.1(b) supported UGI's ability to retain the full $75,400. (*Id.* at 111.) Finding OCA's contrary argument to be unpersuasive and without support in the Code, the ALJs recommended the Commission approve UGI's retention of the full $75,400 to be used in accordance with Act 40.

B. Exceptions and Replies

OCA filed exceptions to the ALJs' acceptance of UGI's proposed rate base calculated using the year-end methodology. OCA contended that because the plain language of Act 11 did not specifically address the type of methodology to be used in conjunction with a FPFTY, the average rate base methodology must be used to ensure the proposed rates would be just and reasonable as required by Section 1301. UGI responded that the use of the year-end methodology was consistent with the plain language of Act 11, the purpose of Act 11 to reduce regulatory lag, and the prior use of that methodology in ratemaking under the FTY process.

OCA also filed an exception to the ALJs' recommendation that the Commission adopt UGI's Act 40 proposal. OCA argued that Section 1301.1(b) requires a utility to provide an accounting for how these funds are being used to benefit ratepayers when rates are being set, at least until December 31, 2025, and the ALJs' interpretation of that provision rendered Section 1301.1(b) meaningless. According to OCA, UGI failed to establish its proper use of these funds and those amounts should be used to offset the rate base in this case. UGI responded that it complied with Act 40's directives and, therefore, the exception should be denied. UGI contended Section 1301.1(b) does not contain any requirement that an accounting be given in order for a utility to retain those amounts.

C. The Commission Decision

Upon its review, the Commission agreed with and adopted the ALJs' recommendation and rationale that UGI be permitted to utilize a year-end methodology for calculating its rate base. Pointing to the purposes of Act 11 to address regulatory lag and to encourage plant investment to counter aging utility infrastructure, the Commission explained these purposes are addressed by allowing the use of the FPFTY. Reviewing the statutory language of Section 315(e), and its exemption from Section 1315 for utilities using the FPFTY, the Commission held that the "used and useful" language in Section 1315 is not a bar to including plants added during the FPFTY. (Commission Op. at 23-24.) According to the Commission, the use of the FPFTY, as authorized by Section 315(e), allows a utility to project revenue requirements and ratemaking components throughout the 12-month period beginning with the first month the new rates would begin and to recover those amounts as part of the rate base. Further, in reviewing the rate base approved by the ALJs, the Commission affirmed their exclusion of the $17.3 million Operations Center from UGI's rate base, agreeing there was insufficient evidence to establish it would be in service during the FPFTY. (*Id.* at 31.)

The Commission found no error in the ALJs' rejection of the Illinois Commerce Commission's decision in *North Shore Gas Company*. The Commission observed, among other things, that it was not bound by such decision and "it would be inappropriate to consider another jurisdiction's statute where there was no indication that the General Assembly based Pennsylvania legislation on [the] legislation adopted in other jurisdictions." (Commission Op. at 25 (citing *Elder v. Orlucky*, 515 A.2d 517, 522 (Pa. 1986)).)

Finally, in response to OCA's concerns that UGI may have overstated its projections, the Commission agreed with the ALJs that this issue is addressed through other available protections. In addition to requiring verification through a subsequent rate filing, Section 315(e) specifically authorizes the Commission to **audit** a utility that uses a FPFTY to determine whether such projections are accurate and to **adjust** the utility's "rates to reflect material differences." (*Id.* at 26.) For these reasons, the Commission denied OCA's exception to the use of the year-end methodology.

Next, after reviewing the language of Section 1301.1 and the purpose of Act 40, which "was to move away from Pennsylvania's past practice of requiring a CTA to a public utility's tax expenses when setting rates in a base rate proceeding," the Commission agreed with the ALJs that this language was clear and unambiguous and supported UGI's position. (*Id.* at 152.) The Commission explained:

> Section 1301.1(a) specifies how income tax expense is to be computed for ratemaking purposes in base rate cases, while Section 1301.1(b) specifies how utility operating income generated by the operation of Section 1301.1(a) must be used by the affected public utilities until December 31, 2025. Based on a plain reading of the statute, Section 1301.1(b) requires that 50% of the Act 40 savings be used for reliability or infrastructure purposes, and the other 50% of the Act 40 savings be used for general corporate purposes. The statute does not require public utilities to provide specific information concerning how the amounts would be used.

(*Id.*) The Commission found that UGI had presented substantial evidence to show its compliance with Act 40's requirements. This evidence, the testimony of its witness, was that UGI's *pro forma* capital additions for reliability or infrastructure for its FPFTY were over $11 million, far greater than 50% of $75,400, and that

UGI's general corporate purpose expenses also far exceeded that threshold. (*Id.*) The Commission accepted that evidence and approved UGI's retention of the $75,400 for the purposes UGI stated they would be used. Thus, the Commission denied OCA's exception.

OCA now petitions this Court for review.

III. OCA's Appeal

OCA is challenging the Commission's interpretation of the Code and acceptance of UGI's calculations and retention of the Act 40 savings. The Commission argues its determinations are supported by the Code and the record and should be affirmed. UGI has intervened in OCA's appeal, providing argument in support of affirming the Commission's Order.[6] EAP filed an *amicus curiae* brief also providing argument in support of affirming. Before setting forth and addressing these arguments, we lay out the standards by which this Court reviews Commission decisions generally, as well as Commission decisions related to ratemaking. Further, as this matter involves statutory construction, we set forth those standards of review as well.

A. Standards for Reviewing Commission Decisions and Engaging in Statutory Construction

Our standard of review of a Commission decision is limited to determining whether substantial evidence[7] supports the findings of fact, whether the Commission committed an error of law, and whether constitutional rights were

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[6] The OSBA participated in the proceedings before the ALJs and the Commission and filed a notice of intervention in OCA's petition for review. However, due to its failure to file a timely brief, OSBA was precluded from further participation.

[7] "Substantial evidence is such evidence that a reasonable mind might accept as adequate to support a conclusion." *McCloskey,* 127 A.3d at 866 n.16.

violated. *McCloskey*, 127 A.3d at 866 n.16. We defer to the Commission's interpretation of the Code and its own regulations unless the Commission's interpretations are clearly erroneous. *Coal. for Affordable Util. Servs. & Energy Efficiency in Pa. v. Pa. Pub. Util. Comm'n*, 120 A.3d 1087, 1095 (Pa. Cmwlth. 2015). We are not to substitute our judgment for that of the Commission "when substantial evidence supports the [Commission's] decision on a matter within the [C]ommission's expertise." *Id.* (internal quotation marks and citation omitted). Such "deference is even more necessary when the statutory scheme is technically complex." *Id*. (internal quotation marks and citation omitted). However, on issues of law, "our standard of review is de novo and our scope of review is plenary." *Id*.

"The [Commission] has broad discretion in determining whether rates are reasonable" and "is vested with discretion to decide what factors it will consider in setting or evaluating a utility's rates." *Popowsky*, 683 A.2d at 961. We are not to "indulge in the processes of weighing evidence and resolving conflicting testimony." *Popowsky v. Pa. Pub. Util. Comm'n*, 706 A.2d 1197, 1201 (Pa. 1997) (citations omitted). Where "[t]he decision at issue[] involve[s] complex financial determinations and weighing and interpreting statistical and economic evidence, [it] is within the [Commission's] area of expertise." *Id.* Further, "[a]s long as there is a rational basis for the [Commission's] methodology [in establishing the rate structure], such decisions are left entirely up to the discretion of the" Commission, "which, using its expertise, is the only one which can properly determine which method is most accurate given the particular circumstances of the case and economic climate." *Id.* (third alteration in the original) (citations omitted). "[T]he establishment of a rate structure . . . is an administrative function peculiarly within the expertise of the [Commission]." *Id.* (citation omitted).

Finally, because this matter involves statutory construction, we are guided by the principles of Section 1921 of the Statutory Construction Act of 1972, which dictate that the object of statutory construction is to ascertain and effectuate legislative intent. 1 Pa. C.S. § 1921(a). Thus, "[w]hen the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa. C.S. § 1921(b). "The best indication of legislative intent is the plain language of the statute." *Slippery Rock Area Sch. Dist. v. Pa. Cyber Charter Sch.*, 31 A.3d 657, 663 (Pa. 2011). We are to construe the statutory language, if possible, to give effect to all of its provisions. 1 Pa. C.S. § 1921(a). It is "[o]nly when the words of the statute are not explicit" that the court should resort to statutory construction to ascertain the legislature's intent. 1 Pa. C.S. § 1921(c).

B. Use of the Year-End Methodology – Section 315(e) of the Code

1. The Parties' Arguments

a. OCA's Arguments

OCA argues the Commission erred in calculating UGI's rate base using the FPFTY that included any facility that was **projected** to be in service by the end of that year for the following reasons. Section 315(e), which does not expressly set forth what methodology may be used to calculate a utility's rate base when a FPFTY is utilized, must be read consistently with Section 1301(a) of the Code, which requires that all rates be just and reasonable. OCA does not dispute that when Sections 315(e) and 1315 are read together, the use of a FPFTY permits an electric utility "to include in its rate base projected plant[s] and investments that are not used and useful on the day that rates go into effect." (OCA Brief (Br.) at 32.) But, allowing the use of the year-end methodology, rather than the average rate base methodology, permits a utility to collect rates for facilities or costs **before** the facilities are operational or the costs incurred and creates a rate that is not just or reasonable in contravention of Section 1301. OCA's witnesses, along with the witnesses of I&E, explained why the year-end methodology was not an appropriate form of ratemaking because it allowed for overcollection by a utility, for which OCA contends the utility will not be held to account. This conclusion is supported by the Illinois Commerce Commission's decision in *North Shore Gas Company*, which the Commission erred in not considering. Further, while the year-end methodology was used in conjunction with a FTY, such did not result in overcollection because the FTY ended at approximately the same time the new rates became effective. Thus, the facilities projected to be in service by the end of the FTY would be in service (used and useful) when the ratepayers began to pay the new rates.

OCA further argues the Commission's decision is not based on substantial evidence, citing evidence in the record that supports the use of the average rate base methodology rather than the year-end methodology. In contrast, UGI presented no evidence to demonstrate that Act 11 and the use of the FPFTY authorized the use of the year-end methodology.

b. The Commission's Arguments

The Commission responds that its interpretation of Section 315(e) is entitled to deference, particularly given the complexity of the Code, and should not be reversed because that interpretation is not clearly erroneous for the following reasons. The Commission's approval of the year-end methodology is supported by the plain language of Section 315(e) and the purpose of the Act 11 amendments, which was intended to encourage plant investment by mitigating, among other things, the risks associated with regulatory lag. OCA's use of the average rate base methodology results in a utility being unable to recover costs for all facilities projected to be in service during the FPFTY, which is contrary to the plain language of Section 315(e). The plain language of Section 315(e) likewise does not support OCA's argument that the only way the rates calculated using the FPFTY can be just and reasonable as required by Section 1301 is to use the average rate base methodology. The General Assembly was aware of Section 1301's just and reasonable requirements when it amended Section 315(e) to allow usage of the FPFTY without the restrictions of the used and useful requirements of Section 1315 in a general rate case. Thus, including in a rate base facilities not yet in service but projected to be during the relevant time period is permitted and does not result in an unjust and unreasonable rate. As for *North Shore Gas Company*, that decision may have supported OCA's position on its face, but the Commission examined that decision and found it not to be persuasive, as is its prerogative.

In response to OCA's concerns about a utility not being accountable for its projections or collections, the Commission asserts every utility has the burden of presenting an evidentiary record that supports the additions to its rate base and why such additions are needed to provide service to its customers. The Commission does have the authority, pursuant to Section 315(e), to make after-the-fact adjustments and to require a utility to support its prior projections in a subsequent rate case. Thus, contrary to OCA's contentions, there are safeguards that the Commission may use to hold a utility to account if the use of the year-end methodology results in overearning.

c. UGI's and EAP's Arguments

UGI and EAP both argue, like the Commission, that the use of the year-end methodology is supported by substantial evidence and the plain language and purpose of the Act 11 amendments to Section 315(e). They contend OCA's evidentiary arguments are not relevant because this issue involves a legal question and, if relevant, are merely a request for the Court to reweigh the evidence. UGI presented substantial evidence to support that its proposed rate was just and reasonable and that OCA's proposed methodology was flawed, which the Commission accepted. That evidentiary determination is not subject to appellate review.

As for OCA's legal arguments, UGI and EAP assert as follows. OCA's arguments are inconsistent with the statutory language as amended by the General Assembly via Act 11, and the Commission's interpretation of those provisions, as well as its setting of UGI's rate, are entitled to deference. The Act 11 amendments reflect the General Assembly's intent to reduce regulatory lag and support the need to replace Pennsylvania's aging utility infrastructure. By permitting a utility to use a FPFTY to meet its burden of proof in a rate case, the General Assembly authorized utilities to include, without limitation, all facilities projected to be in service **during** the FPFTY in its rate base. The use of the term "during" supports the use of the year-end methodology approved by the Commission in this matter, as does the use of that methodology to calculate a utility's rate base prior to the Act 11 amendments. OCA's average rate base methodology also allows a utility to earn returns on facilities not yet in service, but only for a portion of the FPFTY, a position not supported by Section 315(e)'s language. Although OCA raises concerns about utilities overearning through the use of the year-end methodology, utilities are not overearning when they comply with the plain language of Section

315(e), which authorized the use of the FPFTY and projected costs that would be incurred during that test year.

UGI, individually, argues the following. Section 315(e) does **not** speak in terms of partially projected future test years or of averaging the costs of plants projected to be in service in the test year for inclusion in the rate base, which is what OCA proposes. This methodology also eviscerates the concept of prospective rate making by designing a rate year that will recover only one-half of the total costs a utility will incur in a prospective test year. Using year-end methodology is appropriate because rates are established on an annual basis, are prospective in nature, and will be in effect for more than a year. The use of the FPFTY coupled with year-end methodology has the effect of not only reducing regulatory lag more than the average rate base methodology proposed by OCA but also reducing how frequently a utility must return to the Commission to seek an increase in its rates. OCA's arguments reflect its position that the used and useful requirement of Section 1315 should continue to be utilized, at least in part, in calculating UGI's rate base. However, the General Assembly was aware of this requirement and **exempted FPFTYs** from Section 1315, thereby choosing to **allow** rates based on facilities not yet in service but projected to be sometime during that test year. OCA's argument that rates proven under Section 315(e)'s FPFTY process are not permissible because they do not meet Section 1301's general just and reasonable requirement is not supported by the principles of statutory construction. According to UGI, OCA seeks to impose a general statutory provision (Section 1301) on a specific statutory provision (Section 315(e)), which is also the later enacted provision. Rather, Section 315(e) should be read as a refinement of Section 1301's general just and reasonable requirement. In short, if a rate base is calculated using the FPFTY and year-end procedures authorized by the General Assembly in Section 315(e), the corresponding rate is just and reasonable.

EAP argues, individually, as follows. There is no single way to arrive at a just and reasonable rate and the methodology used by the Commission in determining a utility's rate base is a sub-determination within ratemaking that falls distinctly in the Commission's expertise. The use of the year-end methodology provides the most current and foreseeable financial information for the purpose of setting a utility's rates. According to EAP, as long as there is evidence to support the numbers used by the Commission to set a utility's rate, the Commission did not err or abuse its discretion. Using any point earlier than the end of the FPFTY would result in an understated rate base, and OCA's average rate base methodology effectively eliminates one-half of the benefits of using the FPFTY. In reviewing UGI's proposed rate base, the Commission excluded certain claimed facilities UGI projected to be in service during the FPFTY, demonstrating the Commission's exercise of its expertise in ratemaking.

d. OCA's Reply

In its reply brief, OCA reiterates many of the arguments made in its initial brief, including that the plain language of Section 315(e) does not support the Commission's determination and that the use of its proposed average rate base methodology is the only way to ensure just and reasonable rates when a FPFTY is used. OCA contends the Commission's interpretation of Section 315(e) as allowing the use of year-end methodology is clearly erroneous and not entitled to deference because it does not give effect to Section 1301's requirement that rates must be just and reasonable. These two provisions must be read together and using

OCA's average rate base methodology harmonizes the two. Neither the mere existence of the FPFTY, nor the use of the word "during" in Section 315(e), implies the General Assembly intended that a rate base be calculated using the year-end methodology. Finally, OCA asserts that using the average rate base methodology also addresses regulatory lag when compared to the use of the HTY or FTY to set new rates.

2. Discussion

Due to the high level of deference this Court gives to the Commission, particularly in rate making decisions, in order to reverse the Commission's Order in this case, the Court would have to conclude that the Commission's interpretation of Section 315(e) of the Code is **clearly erroneous** and that there is **no rational basis for the Commission's methodology** in approving UGI's rate structure. *Popowsky*, 706 A.2d at 1203. Although OCA asserts the Commission's decision is not supported by substantial evidence, the question before the Court on this issue is one of law – whether the statutory language supports the use of a year-end methodology when a utility chooses to utilize a FPFTY to calculate its rate base. Reviewing the statutory language of Section 315(e), we cannot say the Commission's interpretation of that provision in this rate case is clearly erroneous. Nor can we say there is no rational basis for the Commission's approval of that methodology under the plain language of Section 315(e) and the purposes of Act 11.

Section 315(e) of the Code states, in relevant part:

> In discharging its burden of proof the utility may utilize a future test year or a **[FPFTY], which shall be the 12-month period beginning with the first month that the new rates will be placed in effect after application of the full suspension period permitted under**

> **section 1308(d) (relating to voluntary changes in rates).** . . . Whenever a utility utilizes a future test year or a [FPFTY] in any rate proceeding and such [FTY] or a [FPFTY] forms a substantive basis for the final rate determination of the [C]ommission, the utility shall provide, as specified by the [C]ommission in its final order, appropriate data evidencing the accuracy of the estimates contained in the [FTY] or a [FPFTY], and the [C]ommission may after reasonable notice and hearing, in its discretion, adjust the utility's rates on the basis of such data. **Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the [C]ommission may permit facilities which are projected to be in service during the [FPFTY] to be included in the rate base.**

66 Pa. C.S. § 315(e) (emphasis added).

By its terms, Section 315(e) authorizes a utility to meet its burden of proof in a general rate case by using a FPFTY, which is "the 12-month period **beginning with the first month** that the new rates will be placed in effect." *Id.* (emphasis added). While ordinarily a facility must be in service to the public, or used and useful, for its associated costs to be included in a utility's rate base and the rates charged by the utility, 66 Pa. C.S. § 1315, the General Assembly granted the Commission the discretion **not to impose** this requirement for those utilities seeking to meet their burden of proof using the FPFTY. It did so by allowing a utility to include in its **rate base**, upon which customer rates are calculated, "facilities which are **projected** to be in service **during** the" FPFTY "[n]otwithstanding [S]ection 1315." 66 Pa. C.S. § 315(e) (emphasis added). Thus, under Section 315(e)'s plain language, a utility can include in its rate base, if permitted by the Commission, the costs of facilities that are not yet in service, but that are projected to be in service **during the 12-month period beginning with the first month** the new rates will be in effect. Section 315(e) does not speak in terms of averages or partially projected test years – it says facilities that are projected to be in service during the 12-month period that is statutorily defined as the FPFTY can be included in the rate base. This 12-month period includes day 1, as well as day 365.

In ascertaining and effectuating the General Assembly's intent, we are mindful that "when the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa. C.S. § 1921(b). OCA's arguments appear to urge the Court to disregard the letter of Section 315(e), which, it acknowledges, when read with Section 1315 permits a utility "to include in its rate base projected plant[s] and investments that are not used and useful on the day the rates go into effect." (OCA's Br. at 32.) However, it is OCA's preferred methodology that does not give effect to the plain language of Section 315(e) because it essentially redefines the key term "FPFTY" and limits the language excluding FPFTYs from Section 1315's used and useful requirement. We may not disregard the General Assembly's intent when it is clearly stated within the statutory language in question. 1 Pa. C.S. § 1921(b). The Commission reviewed this language and concluded, within its particular expertise in the complex statutory scheme that is the Code, *Coalition for Affordable Utility Service*, 120 A.3d at 1094, that a year-end methodology could be applied to the FPFTY for UGI's rate case. This interpretation is supported not only by Section 315(e)'s plain language, but also by the purposes of Act 11, which were to mitigate the risks of regulatory lag and to aid in the resolution of the aged and aging nature of Pennsylvania's utility infrastructure. (Commission Decision at 23); *Final Implementation Order* at 1-3; *see also* H. 195th Sess., Oct. 4, 2011, at 1954-56; S. 196th Sess., Jan. 25, 2012, at 71-72; H. 196th Sess., Feb. 7, 2012, at 156-57.[8]

[8] These materials are available, respectively, at https://www.legis.state.pa.us/WU01/LI/HJ/2011/0/20111004.pdf#page=10; https://legis.state.pa.us/WU01/LI/SJ/2012/0/Sj20120125.
(Footnote continued on next page…)

OCA once recognized that a benefit of using this methodology was the reduction in the need for future rate increases as reflected in its comments set forth in the *Final Implementation Order*, but now OCA seeks to reduce the benefit of using the FPFTY by one half, which would, ironically, require the need for future rate increases sooner. *Id.* at 3. That the Illinois Commerce Commission came to a different result in *North Shore Gas Company* under that state's statutory and ratemaking scheme does not mean the Commission erred in its interpretation of the Code's language.

We are also mindful that there is **no single way** to arrive at just and reasonable rates and that the Commission enjoys "**broad discretion** in determining whether rates are reasonable." *Popowsky*, 683 A.2d at 961 (emphasis added). While OCA claims the Commission's interpretation does not give effect to Section 1301 and results in a rate that is not just and reasonable, that provision does not require a different result. When enacting Act 11 and amending Section 315(e), the General Assembly was aware of the requirement that all rates must be just and reasonable. *Marcellus Shale Coal. v. Dep't of Envtl. Prot.*, 216 A.3d 448, 501 (Pa. Cmwlth. 2019) ("[W]hen the General Assembly enacts a statute, it is presumed to know the current state of the law."). Exercising its legislative and policy making authority, the General Assembly chose to allow, under certain circumstances, a utility to include in its rate base the costs associated with not-yet-in-service facilities, and authorized the Commission, within its discretion, to calculate the utility's rate so as to include such as-of-yet incurred costs. In allowing such costs

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to be included in the rate base, the General Assembly authorized a utility to include those costs in what it charges its customers for their utility service. Accordingly, we agree with UGI that Section 315(e) is a refinement of Section 1301 and that a rate approved by the Commission in accordance with Section 315(e) is one that is just and reasonable under both provisions.

However, both the General Assembly and the Commission were cognizant of the potential of a utility to overproject its rate base when using a FTY or FPFTY, one of OCA's main concerns in this matter.[9] Notably, all parties agree that the year-end methodology was used in the FTY process. Given the potential for overprojection, the General Assembly incorporated certain protections in Section 315(e) by authorizing the Commission to require a utility to provide the Commission with "appropriate data evidencing the accuracy of the estimates" used to calculate the rate base via either the FTY or the FPFTY and to adjust a "utility's rates on the basis of such data" after reasonable notice and a hearing. 66 Pa. C.S. § 315(e). Similarly, in its *Final Implementation Order*, the Commission advised that it "expect[ed] that in subsequent base rate cases, the utility" using the FPFTY would "be prepared to address the accuracy of the [FPFTY] projections made in its prior base rate case." *Id.* at 3. Thus, while OCA's concerns are not lightly taken, there is recourse if a utility does overproject and overcollect because there are means by which the Commission can address a utility's overprojections and any

[9] Moreover, while OCA's arguments could be viewed as suggesting that the Commission did not fully review UGI's projected facilities to determine whether they should be included in the rate base, which allows for improper overcollection, it is apparent the Commission reviewed the evidence to determine what facilities should be included in the FPFTY. For example, the Commission specifically excluded the proposed Operations Center from the rate base on the basis that there was insufficient evidence to support that it would be in service during the FPFTY. This exclusion reduced the rate base by over $17.3 million.

related overcollection that could occur as a result of the use of the FPFTY and year-end methodology.

For all these reasons, we cannot say that the Commission's interpretation of Section 315(e) is clearly erroneous or that its ratemaking decision lacks a rational basis such that the Commission's determinations are not entitled to deference from this Court.

C. *Use of the Act 40 Savings – Section 1301.1(b) of the Code*

1. The Parties' Arguments

a. OCA's Arguments

OCA argues the Commission erred in allowing UGI to retain the Act 40 savings because UGI failed to establish that the $75,400 was actually used or will be used in accordance with Section 1301.1(b). Beyond relying on its *pro forma* calculations, UGI presented no evidence specifically showing how or for what these funds were used: on reliability or infrastructure-related projects or general corporate purposes. Further, the Commission's interpretation of Section 1301.1(b) as not requiring a specific accounting of where or how the Act 40 savings are used does not give effect to the statutory language and renders both that subsection and subsection (c), requiring that restricted use of those savings until December 31, 2025, inoperative. For these same reasons, OCA asserts that the Commission's determination is not supported by substantial evidence. Because UGI did not meet its burden of proof under Section 1301.1(b) with substantial evidence, UGI's rate base should be reduced by $75,400.

b. The Commission's Arguments

The Commission argues its interpretation of Section 1301.1(b) is entitled to deference as it is supported by the section's plain language and the purpose of Act 40 and, therefore, is not clearly erroneous. OCA's assertion that the Act 40 savings should be used to reduce the rate base is contrary to Section 1301.1(a)'s language and purpose, which was to eliminate the use of the CTA such that any savings a utility obtains by filing its taxes with a parent and/or affiliated companies are not used in calculating the utility's rate base. 66 Pa. C.S. § 1301.1(a). Section 1301.1(b) clearly and unambiguously sets out how a utility is to use the Act 40 savings, 50% toward capital investments relating to reliability or infrastructure and 50% toward general corporate purposes, but does not require that a utility provide specific or detailed information as to how those amounts are used. All the utility has to do is show that it is using or expending the threshold amounts in the required category, and UGI presented such evidence by establishing that its capital expenditures for reliability and infrastructure and general corporate expenditures for the FPFTY each far exceeded 50% of $75,400 UGI had in Act 40 savings. The Commission accepted this evidence as showing compliance with Section 1301.1(b), and this determination should be upheld.

c. UGI's and EAP's Arguments

UGI and EAP argue that the Commission's interpretation of Section 1301.1(b) is supported by the plain language of that provision and the purpose of the Act 40 amendment. Act 40 was enacted to end the use of the CTA in Pennsylvania, consistent with a majority of other states, and OCA's arguments disregard the plain language of the statute and seek, essentially, to reinstate the CTA by requiring a reduction of UGI's rate base by $75,400. There is no requirement in Section 1301.1(b) that UGI specifically identify or state with particularity where the Act 40 savings are used. Rather, UGI was required to, and did, establish that the Act 40 savings will be used for the designated statutory purposes.

d. OCA's Reply

In its reply brief, OCA acknowledges Act 40 abolished the use of the CTA in ratemaking, but argues that the Commission's interpretation does not require a utility to prove that the Act 40 savings are actually used in accordance with Section 1301.1(b). OCA asserts the Commission's interpretation does not give effect to the term "use" in that section and, therefore, is not entitled to deference. Moreover, the Commission's acceptance of the *pro forma* evidence does not show how UGI used or will use the $75,400 as required by Section 1301.1(b).

2. Discussion

On this issue the Court is reviewing both the Commission's interpretation of Section 1301.1(b) and the Commission's determination that UGI's evidence established that its use of the Act 40 savings was or would be in accordance with Section 1301.1(b). OCA does not dispute that the General Assembly's intent in enacting Act 40 and adding Section 1301.1 to the Code was to eliminate the use of the CTA in the ratemaking process. Nor does OCA dispute that the Act 40 savings at issue are $75,400, 50% of which is $37,700. Instead, OCA challenges the Commission's reading of Section 1301.1(b) as not requiring UGI to present specific evidence of exactly how UGI actually used or will use the Act 40 savings. OCA further contends the evidence UGI presented did not show the actual use of those savings for the requisite purposes.

Section 1301.1(a) sets forth the treatment of certain income tax deductions and credits a public utility may have for ratemaking purposes. As acknowledged by OCA, this section eliminates the use of the CTA for ratemaking purposes and, therefore, only "the tax deductions and credits received by the public utility" and not the "deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity" shall be included in the utility's rate base. 66 Pa. C.S. § 1301.1(a). Because the change in treatment of tax deductions and credits would result in a utility accruing additional revenues, the General Assembly placed restrictions on the use of that additional revenue until December 31, 2025. 66 Pa. C.S. § 1301.1(b), (c). That restriction requires a utility to use its Act 40 savings as follows: "(1) fifty percent to support reliability or infrastructure related to the rate-base eligible capital investment as determined by the commission; and (2) fifty percent for general corporate purposes." 66 Pa. C.S. § 1301.1(b).

In its Decision, the Commission held that the plain language of Section 1301.1(b) "**does not require** public utilities to provide **specific information** concerning how the amounts would be used." (Commission Decision at 152 (emphasis added).) While OCA contends this interpretation is inconsistent with that provision's language, reviewing the language supplied by the General Assembly, we cannot say the Commission's interpretation is clearly erroneous. Section 1301.1(b) sets forth the categories to which the Act 40 savings must be applied, but the General Assembly **did not expressly** impose any particular manner in which a utility had to establish its compliance. Instead, the General Assembly indicated that those savings had to be used to support reliability or infrastructure capital investment and general corporate purposes, but does not require an accounting of those funds. "When the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa. C.S. § 1921(b). Even if this provision was ambiguous as to what a utility had to do to establish its compliance, because the Commission's interpretation is not clearly erroneous, it is entitled to deference. *Popowsky*, 706 A.2d at 1203.

Finally, we turn to OCA's substantial evidence challenge. The Commission is the fact finder in these matters, and we may not "indulge in the process of weighing evidence and resolving conflicting testimony." *Id.* at 1201. In performing a substantial evidence review, we must consider the record in the light most favorable to the party that prevailed before the Commission, giving that party the benefit of all inferences that can be logically drawn from the evidence. *United Transp. Union, Pa. State Legislative Bd. v. Pa. Pub. Util. Comm'n*, 68 A.3d 1026, 1032 (Pa. Cmwlth. 2013).

Here, UGI's witness Stephen F. Anzaldo testified regarding UGI's Act 40 savings and Section 1301.1(b). When asked whether UGI's rate case supported the conclusion that UGI was "using at least 50 percent of [Section 1301.1(b)'s] revenue requirement . . . to support reliability or infrastructure related to capital investment," Anzaldo stated yes, it did, because UGI's "*pro forma* capital additions for reliability or infrastructure for projects for the . . . FPFTY is $11.770 million," which was "greater than 50% of the amount of what would have been consolidated tax savings adjustment under the prior ratemaking principles." (Reproduced Record at 23a.) When asked the same question regarding the use of the Act 40 savings to support general corporate purposes, Anzaldo explained that UGI "anticipated an operating expense budget of more than $81 million" and that "50[%]of the consolidated tax adjustment revenue requirement would equate to only $37,700." (*Id.* at 23a-24a.) Anzaldo further acknowledged that he understood Section 1301.1(b)'s requirement that the $75,400 in Act 40 savings had to be used by UGI as set forth in that provision. (*Id.* at 23a.)

Considering this testimony, accepted by the Commission, and all inferences logically drawn therefrom in favor of UGI, we cannot say that a reasonable mind would not accept it as adequate to support the conclusion that UGI's use of the Act 40 savings was or would be in accordance with Section 1301.1(b). It is a reasonable inference that UGI will use the $75,400 in Act 40 savings as mandated by Section 1301.1(b) because it is aware of that requirement and it is otherwise expending more than $11 million in capital additions related to reliability and infrastructure and has an $81 million budget for its operating expenses. Thus, there is substantial evidence to support the Commission's conclusion that UGI satisfied the requirements of Section 1301.1(b). While OCA cites to evidence disagreeing that UGI's evidence met its burden of proof under Section 1301.1(b) and explaining that UGI had not used the Act 40 savings as required, the fact that there is evidence in the record to support a contrary finding does not matter where the findings made are supported by substantial evidence. *Energy Conservation Council of Pa. v. Pub. Util. Comm'n*, 995 A.2d 465, 486 n.19 (Pa. Cmwlth. 2010).

Because the Commission's interpretation of Section 1301.1(b) is not clearly erroneous and its conclusion that UGI met its burden of proof under that provision is supported by substantial evidence, there is no basis to reverse that decision.[10]

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[10] Moreover, we question whether the relief requested by OCA, the reduction of UGI's **rate base for ratemaking purposes** would be consistent with the plain language of Section 1301.1(a) or the purpose of Act 40. The General Assembly was clear that Act 40 savings, which reflect the former CTA, **are not** to be included in a utility's rate base. 66 Pa. C.S. § 1301.1(a) ("**[T]he rate base** . . . shall be based solely on the tax deductions and credits received by the **(Footnote continued on next page…)**

IV. Conclusion

As the United States Supreme Court has explained, "[t]he economic judgments in rate proceedings are often hopelessly complex and do not admit of a single correct result." *Duquesne Light Company v. Barasch*, 488 U.S. 299, 314 (1989). And, in reviewing these complex matters, the Commission is given broad discretion in interpreting the Code and in setting rates. *Popowsky*, 706 A.2d at 1203. Those determinations will not be overturned unless clearly erroneous or they lack a rational basis. Because the Commission's determinations in this complex matter are consistent with Sections 315(e) and 1301.1 of the Code, and are supported, where required, by the accepted evidence, we cannot say the Commission's Decision was clearly erroneous or lacked a rational basis. Accordingly, we affirm.

RENÉE COHN JUBELIRER, Judge

Judge Fizzano Cannon did not participate in the consideration of this matter.

(continued…)
public utility and **shall not include any deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity**." (emphasis added)).

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Tanya J. McCloskey, Acting Consumer Advocate, Petitioner	:	
v.	:	No. 1549 C.D. 2018
Pennsylvania Public Utility Commission, Respondent	:	

<u>O R D E R</u>

NOW, January 15, 2020, the Order of the Pennsylvania Public Utility Commission, entered in the above-captioned matter, is **AFFIRMED**.

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RENÉE COHN JUBELIRER, Judge