BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	R-2019-3008208
Office of Consumer Advocate	:	C-2019-3011959
Office of Small Business Advocate	:	C-2019-3012589
	:	
v.	:	
	:	
Wellsboro Electric Company	:	

RECOMMENDED DECISION

Before
Steven K. Haas
Benjamin J. Myers
Administrative Law Judges

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I. INTRODUCTION

This Recommended Decision recommends that the proposed tariff supplement filed by Wellsboro Electric Company to increase total recommend operating revenues by $999,967.00, or approximately 19.5%, be denied because the Company has not met its burden of proving by a preponderance of the evidence that justness and reasonableness of every element of its requested increase. Instead, this decision recommends the approval of an increase $954,649.00, or approximately 18.23%. The suspension date is May 1, 2020.

A. Wellsboro Electric Company

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

Wellsboro's service territory is predominantly rural and is surrounded by the service territory of Pennsylvania Electric Company (Penelec) and Tri-County Rural Electric Cooperative. As of December 31, 2018, Wellsboro served 6,337 customers, of which 5,116 were residential, 1,216 were commercial and industrial, 2 were lighting, and 4 were exchange utility.

Wellsboro seeks approval from the Pennsylvania Utility Commission (Commission) for an increase in annual distribution revenues. Its analysis was conducted using 2020 as a Fully Projected Future Test Year (FPFTY), as authorized by the Public Utility Code. The company's original request, Supplement No. 125 to Tariff Electric Pa. P.U.C. No. 8, filed on July 1, 2019, sought an increase in annual distribution rates of approximately $1,419,610.00 or approximately 27.7%. Subsequently, on July 31, 2019, the Company filed replacement base rate schedules and tariff sheets by which it revised its requested increase to $999,967,00 or approximately 19.5%. According to Wellsboro, under current rates, it earned a rate of return on its distribution business in 2018 of only 5.73%, a return that it argues will not support the long-term health of the Company. Wellsboro further argued that, by 2020, its FPFTY, the Company's return is projected to decline substantially to 2.56%. If the full request is granted, the Company believes it will have the opportunity to earn a return of approximately 7.14%.

B. History of the Proceeding

On July 1, 2019, Wellsboro filed Supplement No. 125 to Tariff Electric Pa. P.U.C. No. 8 with the Commission which proposed to increase Wellsboro's total annual operating revenues in excess of $1 million. The Office of Consumer Advocate (OCA) filed a Formal Complaint against Wellsboro's rate increase on August 5, 2019. On July 22, 2019, the Office of Small Business Advocate (OSBA) filed a Notice of Appearance. On July 19, 2019, the Bureau of Investigation and Enforcement (I&E) filed a Notice of Appearance.

Concurrent with this rate case filing, Wellsboro filed a Joint Petition for Waiver (Joint Petition for Waiver) seeking a waiver from informational requirements for general rate increase requests in excess of $1 million as set forth in 52 Pa. Code § 53.53 of the Commission's regulations. Wellsboro withdrew the Joint Petition for Waiver on July 29, 2018. While awaiting a Commission determination, Wellsboro filed replacement base rate schedules and tariff sheets reflecting an increase in distribution revenues of $999,967 or approximately 19.5% on July 31, 2019. On August 8, 2019, by Secretarial Letter, the Commission denied the Joint Petition for Waiver and acknowledged Wellsboro's updated revenue request.

By Order entered on August 29, 2019, the Commission instituted an investigation to determine the lawfulness, justness, and reasonableness of the proposed rate increase and the tariff was suspended until March 30, 2020.

On August 29, 2019, the Office of Small Business Advocate (OSBA) filed a Formal Complaint docketed at C-2019-3012589.

On September 9, 2019, Wellsboro filed a tariff supplement voluntarily extending the suspension period through April 29, 2020. On October 2, 2019, Wellsboro filed an updated tariff supplement voluntarily extending the suspension period until May 1, 2020. The Commission assigned Administrative Law Judges (ALJs) Steven K. Haas and Benjamin J. Myers to preside over this proceeding.

The ALJs held a Prehearing Conference on September 13, 2019, at which time a litigation schedule was developed. The Prehearing Conference was held jointly with rate cases filed by Citizens' and Valley at Docket Nos. R-2019-3008212 and R-2019-3008209, respectively. Prior to the Prehearing Conference, on August 2, 2019, Wellsboro provided the parties with its direct testimony. In accordance with the procedural schedule, direct testimony and associated exhibits were submitted by OCA, I&E, and OSBA on October 15, 2019. On November 14, 2019, the parties submitted rebuttal testimony and associated exhibits. On December 4, 2019, the parties submitted surrebuttal testimony and associated exhibits.

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

Main Briefs were file on January 8, 2020, and Reply Briefs were filed on January 22, 2020. The record closed on January 22, 2020.

C. Burden of Proof

A public utility has the burden of proof to establish the justness and reasonableness of every element of its rate increase request in all proceedings under 66 Pa. C.S. § 1308(d). The standard to be met by the public utility is set forth at 66 Pa. C.S. § 315(a):

> **Reasonableness of rates.** –In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceeding upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. § 315(a)

The Commonwealth Court of Pennsylvania set forth the utility's burden of proof in a rate proceeding pursuant to 66 Pa. C.S. § 315(a) as follows:

> Section 315(a) of the Public Utility Code, 66 Pa. C.S. Section 315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the public utility. <u>It is well-established that the evidence adduced by a utility to meet this burden must be substantial</u>.

Lower Frederick Twp. Water Co. v. Pa. Pub. Util. Comm'n., 48 Pa. Cmwlth. 222, 226-227, 409 A.2d 505, 507 (1980) (emphasis added). *See also*, *Brockway Glass Co. v. Pa. Pub. Util. Comm'n*, 63 Pa. Cmwlth. 238, 437 A.2d 1067 (1981).

In general rate increase proceedings, the burden of proof does not shift to parties challenging a requested rate increase. Rather, the utility's burden of proof to establish the justness and reasonableness of every component of its rate request is an affirmative one and that burden of proof remains with the public utility throughout the course of the rate proceeding. There is no similar burden placed on other parties to justify a proposed adjustment to the public utility's filing. The Pennsylvania Supreme Court has held:

> [T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations, and that is the burden which the utility patently failed to carry.

Berner v. Pa. Pub. Util. Comm'n, 382 Pa. 622, 631, 116 A.2d 738, 744 (1955).

However, a public utility does not need to affirmatively defend every claim it has made in its filing, even those which no other party has questioned, in proving that its proposed rates are just and reasonable. The Pennsylvania Commonwealth Court has held:

> While it is axiomatic that a utility has the burden of proving the justness and reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged.

Allegheny Center Assocs. v. Pa. Pub. Util. Comm'n, 131 Pa. Cmwlth. 352, 359, 570 A.2d 149, 153 (1990) (citation omitted). *See also, Pa. Pub. Util. Comm'n v. Equitable Gas Co*., 73 Pa. PUC 310, 359–60 (1990).

Additionally, 66 Pa.C.S. § 315(a) does not place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose. The burden of proof must be on a party to a general rate increase case who proposes a rate increase beyond that sought by the utility. *Pa. Pub. Util. Comm'n v. Metropolitan Edison Company,* Docket No. R-00061366, 2007 Pa. PUC LEXIS 5 (Order entered January 11, 2007).

II. RATE BASE

The Company states that its claim for a new rate base in this case is based upon data for the FPFTY ending December 31, 2020. Wellsboro Main Brief at 6; Wellsboro Stmt. No. 1 at 2; Wellsboro Stmt. No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R). The Company has provided data for the Historical Test Year (HTY) ending December 31, 2018. Wellsboro Stmt. No. 1 at 9, 10.

According to the Company, its final claimed rate base of $14,614,186 reflects all adjustments adopted by the Company in this proceeding. Wellsboro Main Brief at 17; Wellsboro Stmt. No. 1-R, Exhibit__(HSG-1R), Schedule C1 (R). The claimed rate base consists of:

- the original cost of its utility plant in service as of December 31, 2020

- less: accumulated depreciation; accumulated deferred income taxes ("ADIT"); excess deferred income taxes ("EDIT"); and customer deposits

- plus: CWIP; accrued pension / OBEP liability; materials and supplies; and Cash Working Capital ("CWC")

Wellsboro Main Brief at 17; Wellsboro Stmt. No. 1-R at 6. The Company notes that I&E proposed changes to CWIP and Materials and Supplies but did not dispute any other rate base components, while OCA proposed adjustments to plant in service, CWIP, Materials and Supplies, Customer Deposits, Depreciation Expense, and EDIT. Wellsboro Main Brief at 17. For the reasons explained, the Company asserts that its claimed rate base is reasonable and should be approved.

A. Utility Plant in Service and FPFTY

Positions of the Parties

The Company's claim for original cost utility plant in service of $29,325,470 is based on projected plant in service at the end of the FPFTY. Wellsboro Stmt. No. 1, Exhibit__(HSG-1), Schedules C1-6 (W), C2 (W), E-1A (W). The Company notes that OCA witnesses allege that the Company's plant in service and accumulated depreciation calculations for the FPFTY do not appropriately reflect plant retirements, and that any adjustment to Plant in Service for retirements would require a parallel adjustment to accumulated depreciation. Wellsboro Main Brief at 17; OCA Stmt. No. 2 at 4.

The Company states that its rate claim based on plant projected to be in service at the end of the FPFTY is consistent with direction recently provided by the Commission for calculation of plant in service at the end of the FPFTY. Wellsboro Main Brief at 18 (citing *Pa. Pub. Util. Comm'n v. UGI Utilities, Inc. – Electric Division,* Docket No. R.2017-2640058 (Order Entered October 25, 2018) (*UGI Order*) at 23-26; 66 Pa. C.S. § 315(e); *Pa. Pub. Util. Comm'n v. PPL Electric Utilities Corporation*, Docket No. R-2012-2290597 at 12). The Company contends that, in the *UGI Order*, the Commission rejected arguments from OCA based on Section 1315 of the Code, which requires electric utility projects to be "used and useful" before being included in the rate base, as follows:

> Section 315(e) of the Code specifically exempts application of 66 Pa. C.S. § 1315, which, for electric utilities, requires projects to be "used and useful" before being included in the rate base. The ALJs properly determined that the "used and useful" standard in Section 1315 is not a bar to including all plant added during the FPFTY.

Wellsboro Main Brief at 19, 20 (citing *UGI Order* at 23). The Company also asserts that the Commission stated that by using a FPFTY, "a utility is essentially permitted to require ratepayers to pre-pay a return on its projected investment in future facilities." *Id.* (citing *UGI Order* at 24).

The Company also contends that the language of Act 11 (66 Pa. C.S.A. § 315) fully supports use of end of test year balances, stating that the Act does not contain a separate provision for the FPFTY, but instead adds the FPFTY to the existing statute authorizing use of an FTY. Wellsboro Main Brief at 20. Moreover, according to the Company, the Legislature (1) expressly indicated that the FPFTY may include plant projected to be in service *during* the FPFTY; and (2) specifically noted that Section 1315, which codified the "used and useful" standard, provides no bar to including in rate base all plant added during the FPFTY. Wellsboro Main Brief at 20, 21.

Given the above, the Company contends that OCA's proposal to use an average rate base would dramatically weaken the benefits provided by the legislature in adopting Act 11, because OCA would effectively deny half of the rate recovery by disallowing half of the additions budgeted between the end of the FTY and the end of the FPFTY. Wellsboro Main Brief at 22. Specifically, the Company states that OCA would eliminate half of the benefits of using the FPFTY by only allowing half of Wellsboro's $1,599,100 in plant additions in 2020. *Id.* (citing OCA Stmt. No. 2, Schedule LKM-2; Wellsboro Stmt. No. 1, Exhibit__(HSG-1), Schedule C1-6 (R)). The Company also notes that, under OCA's proposal, at some point during the first-year rates are in effect, rates will become insufficient to cover the used and useful plant placed into service during that year, effectively converting a fully projected future test year to a "partially projected half test year." *Id.*; Wellsboro Stmt. No. 1-R at 12, 13. The Company argues that this approach is inconsistent with the purpose and policy underlying Act 11, and that OCA has provided no factual or legal basis for its average proposal, except that OCA is challenging the Commission's current position. *Id.* Therefore, according to the Company, OCA's position should be rejected. *Id.*

Regarding the Company's proposed use of FPFTY, OCA opposes this methodology, contending that although Section 315 of the Code permits capital investments that are not used and useful on the first day of new rates to be included in an electric utility's rate base during the FPFTY period, Act 11 does not remove the requirement under Section 1301 of the Public Utility Code that rates be just and reasonable under 66 Pa. C.S. § 1301. OCA Main Brief at 11, 12. OCA contends that the use of the FPFTY allows for levels of costs that will be experienced at the end of the rate year rather than the levels of costs incurred during the rate year, and that the use of a year-end rate base would result in Wellsboro earning a 12-month return, beginning on January 1, 2020, on the level of plant that will not be in service until December 31, 2020. OCA Main Brief at 13.

OCA states that the end-of-year method will allow the Company to over-earn on its investment in the FPFTY while annual average method recognizes that capital investments will be made throughout the first year that new rates are in effect. OCA Stmt. No. 1 at 4, 5. OCA submits that the Company has not met its burden to demonstrate that the use of the end of the test year methodology for rate base results in just and reasonable rates. Therefore, according to OCA, the Company's proposed end-of-year method results in rates are unjust and unreasonable. OCA Main Brief at 13, 14. Accordingly, OCA submits that the Commission should utilize the average rate base method for determining its rate base, resulting in a proposed change from the Company's filed end of test year rate base to the OCA's proposed average which would decrease the Company's proposed rate base by $1,469,980 from $29,325,470 to $27,855,490. OCA Stmt. No. 1 at Sch. SLS-3.

OCA also asserted that the Company's proposed retirements and contributions of plant in service in the FTY and FPFTY should be modified. OCA witness Morgan testified:

> As presented on Exhibit (HSG-1) Schedule C3, during the historical periods, the activity for each year includes plant additions and retirements in the determination of the year end balances for the FTY or the FPFTY. The exclusion of retirements causes the year end balances to be overstated. Therefore, I have determined that it is necessary to adjust plant retirements and contributions in 2019 and 2020.

OCA Stmt. No. 2 at 4, Sch. LKM-1. The OCA notes that in rebuttal testimony, OCA witness Gorman did not specifically address Mr. Morgan's recommendations with respect to plant retirements. Wellsboro Stmt. No. 1-R at 11-12.

I&E and OSBA did not specifically address the issue of Wellsboro's use of a FPFTY or OCA's recommendation that the Commission should utilize the average rate base method for determining Wellsboro's rate base. I&E and OSBA also did not specifically address the issue of plant retirements.

Disposition

Regarding the issue of the Company's use of a Fully Projected Future Test Year, we agree with the Company that using the FPFTY is appropriate and is supported by law. The Company correctly cites to the recent Commission decision in the *UGI Order*, wherein the Commission allowed the use of an FPFTY even though some of the utility plant in service might not be operational until the latter part of the FPFTY. We note here that the Commonwealth Court recently upheld the Commission's order on this issue on January 15, 2020. See, *McCloskey v. Pa. Pub. Util. Comm'n.,* 1549 C.D. 2018 (Pa. Cmwlth. Jan. 15, 2020). Accordingly, the parties to this proceeding, and subsequent rate proceedings, are bound by the Commission's holding in the *UGI Order*.

In addition, although OCA contends that the Code Section 1301 (mandating that rates be just and reasonable) should override the Company's rate claims because those claims are unjust and unreasonable, we do not agree. In that regard, assuming that the Commission's *UGI* holding does not otherwise override the provisions of Section 1301, we see no record evidence to show that the proposed rate base or rates are unjust or unreasonable. Most importantly, we note that OCA made no specific factual arguments in support of its contention that use of an FPFTY results in unjust or unreasonable rates; instead, OCA merely sets forth the proposition that, since the Company will be earning interest for the whole FPFTY on an asset that is not put in service until the end of that year, the Company will by definition be "overearning" on its investment. Given the clear holding of the Commission holding in the *UGI Order*, and the Commonwealth Court's decision affirming the Commission, this particular argument has already been considered and rejected by the Commission. We, therefore, also reject this argument.

We also note that none of the other parties to the proceeding have objected to the Company's use of a FPFTY. Given that fact, and the factors discussed above, we conclude that the Company is permitted to use a FPFTY in this proceeding.

B. Accumulated Depreciation

Positions of the Parties

Regarding the issue of accumulated depreciation, the Company's claim for rate base included an accumulated depreciation of $15,178,447 for the FPFTY. Wellsboro Stmt. No. 1, Exhibit__(HSG-1), Schedule C1-6 (W). As described by Wellsboro witness Gorman, accumulated depreciation is calculated by adding annual depreciation expense at each year-end and subtracting retirements to the previous year-end balance. Wellsboro Stmt. No. 1 at 16.

The Company notes that I&E did not oppose the Company's accumulated depreciation claim. Wellsboro Main Brief at 21; I&E Stmt. No. 3, Exhibit No. 3, Schedule 1. The Company also notes that OCA proposed an adjustment to accumulated depreciation based on its arguments that original cost utility plant in service should be based on an average of the beginning-of-year and end-of-year FPFTY plant balances. *Id.*; OCA Stmt. No. 2 at 4. The Company contends that original cost plant in service should be calculated based on the FPFTY year-end balance, consistent with the Commission's holding in the *UGI Order*. Wellsboro Main Brief at 23. Therefore, the Company argues that OCA's position regarding accumulated depreciation should be rejected based on the holding in the *UGI Order*. *Id*.

OSBA took no position on the issue of accumulated depreciation.

Disposition

Regarding the issue of accumulated depreciation, we do not find adequate record evidence to support OCA's recommended downward adjustment. The Company contends that original cost plant in service should be calculated based on the FPFTY year-end balance, consistent with the Commission's holding in the UGI Order. Wellsboro Main Brief at 20–22. Therefore, the Company argues that OCA's position regarding accumulated depreciation should be rejected based on the holding in the *UGI Order*. *Id.* As we have previously agreed with the Company on this point (use of FPFTY), we find for the Company on this particular issue as well. Therefore, we recommend that the Company's claim for accumulated depreciation be approved by the Commission.

C. Materials and Supplies

Positions of the Parties and Disposition

Regarding the issue of materials and supplies, the Company agreed to a Materials and Supplies adjustment proposed by OCA and I&E, reducing its claimed increase by $37,074 from $245,607 to $208,533. Wellsboro Main Brief at 24; Wellsboro Stmt. No. 1-R at 6; OCA Stmt. No. 2, Schedule LKM-4; I&E Stmt. No. 3 at 7; I&E Stmt. No. 3-R at 4. As no other parties raised any objection or counterproposal, we conclude that the small adjustment is reasonable; therefore, we recommend it be approved.

D. Accrued Pension/OPEB Liability

Positions of the Parties and Disposition

Regarding the issue of Accrued Pension / Other Post-Employment Benefits (OPEB) liability, the Company proposed a reduction to rate base for Accrued Pension / OPEB liability. This reduction reflects the excess of amounts charged to expense over amounts paid. Wellsboro Main Brief at 24; Wellsboro Stmt. No. 1, Exhibit_(HSG-1), Schedule C1-6 (W). Neither OCA nor I&E proposed any adjustments to the Company's claim. *Id.* at 25; OCA Stmt. No. 1, Schedule SLS-3; I&E Stmt. No. 3, at 6. As no other parties raised any objection or counterproposal, we conclude that the small adjustment is reasonable; therefore, we recommend that it be approved.

E. Cash Working Capital and Construction Work in Progress

Positions of the Parties

Regarding the issue of Cash Working Capital, the Company claimed an increase of $388,475 to rate base. Wellsboro Stmt. No. 1, Exhibit__(HSG-1) Schedule C1-6 (W). The Company derived the CWC by using the formula of 1/8 of non-fuel cash operating costs. Wellsboro Stmt. No. 1, at 18. The Company notes that I&E and OCA do not oppose the 1/8 method proposed by the Company, but that I&E and OCA each propose to reduce the CWC claim to reflect the respective party's proposed operating and maintenance (O&M) expense adjustments and remove non-cash items (uncollectible expense, taxes other than income, and depreciation) from computation of CWC. Wellsboro Main Brief, at 25; I&E Stmt. No. 1, at 28; OCA Stmt. No. 1, at 9. The Company agrees that CWC should be recalculated if the Commission orders any changes to the Company's claimed O&M expenses. Wellsboro Main Brief, at 25; Wellsboro Stmt. No. 1-R, pat 6, 11. If O&M expenses are adjusted, the Commission should use the same 1/8 method utilized by the Company, with removal of non-cash items as proposed by I&E, and OCA, to adjust CWC. *Id.*

The Company agrees that CWC should be recalculated if the Commission orders any changes to the Company's claimed O&M expenses. I&E noted that the Company's rate base claim includes $59,971 of Construction Work in Progress ("CWIP") based on the December 31, 2018 financial statements and estimated to be the same in the FTY and FPFTY. Wellsboro Exhibit_(HSG-1), Schedule C1-6(W), line 5; Wellsboro Stmt. No. 1, pat 16-17. I&E also noted that, although CWIP allows a utility to recover costs for plant additions that will be completed and in service within six months of the end of the test year, the Company elected to use a FPFTY ending December 31, 2020, which includes projections of plant in service and depreciation that will be recovered in rates during that twelve-month period. Accordingly, I&E stated there is no reason to include a CWIP claim given that the plant should be included in the Company's FPFTY plant claim. The Company accepted I&E's recommended adjustment in rebuttal testimony "because it is using an end-of-year rate base for the FPFTY, and because it did not include specific projects in CWIP"; therefore, the $59,971 CWIP claim should be removed from the FPFTY rate base as originally filed.

I&E also noted that the Company claimed $388,475 for Cash Working Capital ("CWC"), which was later revised to $362,964. Wellsboro Exhibit HSG-1, Schedule C1-6(W); Wellsboro Exhibit HSG-1-R, Schedule C1-6R(W); I&E Stmt. No. 1-SR, at 31. CWC covers the lag between the payment of operating expenses and the receipt of revenues from ratepayers. All cash-based expenses are included in the Company's overall CWC claim; therefore, any adjustments to the Company's O&M expense claims impact the CWC allowance. I&E Main Brief, at 11. I&E recommended that Wellsboro's O&M expense claims be reduced by $135,463, which reduces the Company's CWC allowance by $16,933. I&E Stmt. No. 1-SR, at 32.

Disposition

I&E recommends a deduction from Wellsboro's claimed rate base in its original filing. This deduction to rate base reflects I&E's recommended disallowance of CWIP and a reduction to CWC allowance. I&E notes that the tables attached to I&E's Appendix A only reflect a recommended reduction to rate base of $16,933 for CWC because Wellboro's rebuttal position accepted I&E's CWIP recommendation.

We note OSBA did not take positions on the above issues. OCA asserted 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. According to OCA, the Commission has historically disallowed the inclusion of CWIP in rate base.

We also note that the Company has agreed to I&E and OCA's recommended adjustment regarding CWIP. We also note that all parties have agreed to adjust CWC, using the 1/8 methods, based upon changes to the Company's O&M claims.

F. Customer Deposits

Positions of the Parties and Disposition

Regarding the issue of reductions from rate base, the Company notes that OCA proposed a $5,810 adjustment to Customer Deposits, which the Company accepted. Wellsboro Main Brief, at 25; OCA Stmt. No. 2, p. 7; Wellsboro Stmt. No. 1-Rat 13. As no other parties raised any objection or counterproposal, we conclude that the small adjustment is reasonable; therefore, we recommend that it be approved.

G. ADIT and EDIT

Positions of the Parties

The Company notes that Adjusted Deferred Income Tax (ADIT) addresses the difference between actual tax liability for accumulated depreciation paid by Wellboro and the amount of tax expense for accumulated depreciation paid by ratepayers in the revenue requirement. Wellsboro Stmt. No. 1 at 17. Excess Deferred Income Tax (EDIT), on the other hand, directly addresses the benefit the Company received by taking depreciation expense for tax purposes while the Federal corporate tax rate was 34% and the revaluation of EDIT as of December 31, 2017, when the corporate tax rate changed from 34% to 21%. *Id.* Because the EDIT is due to the one-time change in the tax rate established through the Tax Cuts and Jobs Act of 2017 ("TCJA"), it will not change over time. *Id.*

The Company's claimed rate base includes a reduction for ADIT of $40,701 for the end of the FPFTY. This amount is equal to the difference between accumulated depreciation based on Federal tax expense borne by ratepayers (i.e., based on straight line method) and accumulated depreciation based on Wellsboro's actual tax Federal tax expense (i.e., based on double declining balance method), times the current Federal income tax rate. Wellsboro Stmt. No. 1 at 17; *see also* Wellsboro Stmt. No. 1, Schedule C1-6, lines 27-32 and line 6.

The EDIT is calculated by taking the ADIT at December 31, 2017 (the initial effective date of Federal income tax rates under the TCJA), times the reduction in Federal income rates due to the TCJA. Wellsboro Stmt. No. 1 at 17. The EDIT is computed on Schedule C1-6, lines 34-39 and carried up to Schedule C1-6, line 7. *Id.* The Company is amortizing the balance over the estimated remaining book life of the assets – ten years. *Id.* The EDIT balance included in rate base declines each year during this ten-year period. *Id.* The annual EDIT accretion (Schedule C1-6, line 40) is carried forward to reduce Income tax expense (Schedule C1-4, line 28). *Id.*

No party challenged the Company's calculation of ADIT; however, OCA proposed adjustments to the Company's calculation of EDIT. Wellsboro Main Brief at 27. EDIT is fully addressed in Section VI. Taxes.

H. Summary

In sum, the following adjustments to the Company's claimed rate base have been agreed upon by all parties:

1) A Materials and Supplies adjustment decreasing the Company's claim by $37,074 from $245,607 to $208,533;

2) A deduction of $59,971 from the Company's claimed rate base in its original filing, reflecting the disallowance of CWIP;

3) An increase to rate base for Accrued Pension / OPEB liability. This increase reflects the excess of amounts paid to expense over amounts charged. The additional amount is $29,500;

4) A $5,810 adjustment which increases Customer Deposits and decreases rate base;

5) An EDIT balance reducing rate base by $5,289 (The EDIT is computed on Schedule C1-6, lines 34-39 and carried up to Schedule C1-6, line 7. *Id.* The Company is amortizing the balance over the estimated remaining book life of the assets – ten years. *Id.* The EDIT balance included in rate base declines each year during this ten-year period. *Id.* The annual EDIT accretion (Schedule C1-6, line 40) is carried forward to reduce Income tax expense (Schedule C1-4, line 28)).

6) A reduction to rate base of $40,701 for ADIT for the end of the FPFTY.

Additionally, CWC will be reduced by $5,047 which reflects our adjustment to operating expenses of $40,376, and, an adjustment reducing EDIT by $2,267, which reflects the OCA's flowback of EDIT for 2018; making our total adjustments $7,314.

Given the above adjustments, we conclude that the final rate base that we recommend for Commission approval is $14,606,872.

III. REVENUE

A. Forfeited Discounts

At issue in this proceeding is the appropriate adjustment from projected revenues for Forfeited Discounts (late payment charges). Wellsboro has claimed $35,443 in revenue Forfeited Discounts for 2020. Wellsboro Stmt. No. 1, Ex. (HSG-1), Schedule B6 (W). I&E was the only party to challenge this claim. I&E witness Cline argues that the Company's revenue claim for Forfeited Discounts was the same under both present and proposed rates. I&E Stmt. No. 3 at 18. I&E argues that the Company should include revenue from Forfeited Discounts equal to the percentage of sales the Company is ultimately granted the opportunity to recover through rates by the Commission. I&E recommends that revenue from Forfeited Discounts claimed by Wellsboro be increased by $1,734.00. I&E Stmt. No. 3-SR at 10-11.

In response, Wellsboro agrees with I&E and acknowledges that Forfeited Discounts may, in fact, increase with higher revenue, but argues that Uncollectible Accounts expense is also likely to increase in a corresponding amount. Wellsboro Stmt. No. 1-R at 7. Wellsboro recommends that, because the difference between the two changes will likely be immaterial, I&E's recommended adjustment should be rejected. Wellsboro Stmt. No. 1-R at 7. In the alternative, Wellsboro argues that, if I&E's adjustment for Forfeited Discounts is accepted by the Commission, a corresponding expense increase for Uncollectible Accounts should also be approved.

We recommend approval of I&E's recommended upward adjustment in the amount of $1,734.00 to revenue from Forfeited Discounts claimed by Wellsboro. As noted, Wellsboro witness Gorman acknowledged in rebuttal testimony that Forfeited Discounts will likely increase with higher revenue. Wellsboro Stmt. No. 1-R at 7. Accordingly, Wellsboro is generally in agreement with I&E on this issue. We will reject Wellsboro's request that its Uncollectible Accounts expense amount be increased by a corresponding amount. While Wellsboro did project increases in its Uncollectible Accounts in its filing, it did not request an adjustment associated with Forfeited Discounts, with associated supporting documentation and analysis. We will not do so here based on the record in this proceeding.

In consideration of the various adjustments adopted in this RD, we recommend an overall revenue requirement in this proceeding of $6,190,882.00.

IV. EXPENSES

As a matter of law, a utility is entitled to recover in its rates all legitimate expenses incurred in the rendition of its public utility service. *UGI Corp. v. Pa. Pub. Util. Comm'n,* 410 A.2d 923, 932 (Pa. Cmwlth. 1980). Thus, the general rule is that utilities are permitted to set rates which will recover those operating expenses reasonably necessary to provide service to customers, while earning a fair rate of return on the investment in plant used and useful in providing adequate utility service. *Western Pa. Water Company v. Pa. Pub. Util. Comm'n*, 422 A.2d 906 (Pa. Cmwlth. 1980). The objective evaluation of reasonableness is whether the record provides sufficient detail to objectively determine whether the expense is prudently incurred. *Popowsky v. Pa. Pub. Util. Comm'n*, 674 A.2d 1149, 1153-54 (Pa. Cmwlth. 1996). With respect to operating and maintenance expenses, those expenses, if properly incurred, are allowed as part of the overall rate computation. To the extent that expenses are not incurred, imprudently incurred, or abnormally overstated during the test year, they should be disallowed and found not recoverable through rates.

A. Inflation Adjustment

In developing its expense claims, the Company analyzed HTY actual costs and the FTY budget and developed projected costs for the FPFTY. The Company additionally added a 3% wage, salary, and benefit inflation adjustment and other known adjustments to the O&M accounts in its FTY budget. Wellsboro Main Brief at 37. I&E does not object to the inflation adjustment; however, OCA strongly objects to the inflation adjustment. The respective parties' positions will be analyzed below.

Position of the Parties

Wellsboro contends that the Company's use of an inflation adjustment is a realistic approach to projecting expenses for the FPFTY. Witness Gorman testified that growth in costs cannot be "known with certainty but can be reasonably estimated." Wellsboro Stmt. No. 1-R at 10. To that extent, the Company contends that actual historic O&M expenses show an increase of over 18% from 2015 to 2018 and 24% from 2012 to 2018. Wellsboro Main Brief at 36. On an overall basis, Wellsboro expects expenses to increase by over 3% from 2019 to 2020, with significantly higher increases in some areas (e.g. health insurance costs) being offset by management's efforts to manage costs. Wellsboro Stmt. No. 6-R at 5. In summary, the Company contends that it is clear that a 3% inflation adjustment is a reasonable and conservative projection of the Company's FPFTY increase in O&M costs. Wellsboro Main Brief at 36.

The Company used the Producer Price Index (PPI) as a guideline in forming its 3% inflation projection. The Company argues that using the PPI as the basis for the proposed

3% inflation adjustment is reasonable because the Company's historical year-to-year O&M expense escalations, projected expense increases, and budgeted 2020 expenses indicate that overall O&M expenses will increase by at least 3%. Wellsboro Main Brief at 35-40.

Wellsboro cites to *Pa. Pub. Util. Comm'n v. Pennsylvania-American Water Co.*, Docket No. R-00038304 (Order entered Jan. 29, 2004) and *Pa. Pub. Util. Conmm'n v. Pennsylvania-American Water Co.,* Docket No. R-880916 (Order entered Oct. 21, 1988), for the proposition that the Commission has recognized the use of inflation factors in projecting costs. Wellsboro also contends that its use of a 3% inflation rate aligns with the Commission's purposes as set forth in Act 11 in establishing the FPFTY as a ratemaking tool. Wellsboro argues that to accept OCA's position and removing the inflation adjustment would be to assume no cost increases from the FTY to the FPFTY. Wellsboro Main Brief at 38-40.

OCA strongly objects to the use of a 3% inflation adjustment. OCA submits that the proposed 3% inflation factor applied to all expenses is not known and measurable or consistent with the law. OCA Main Brief at 21. OCA argues that inflationary adjustments are not actually known and measurable because they do not reflect the true cost of expenses in that inflation adjustments are typically blanket adjustments or increases which do not directly relate to actual costs expected to be incurred by the Company in the period in which rates are set. OCA Stmt. No. 2 at 7-8.

OCA cites to a number of cases for the proposition that across-the-board inflation factors, or attrition adjustments, should not be used to establish rates because they are speculative in nature. *See*, *Pa. Pub. Util. Comm'n v. Philadelphia Gas Works*, 2007 Pa. PUC LEXIS 45 (Sept. 28, 2007); *Pa. Pub. Util. Comm'n v. Philadelphia Electric Co.*, 1990 Pa. PUC LEXIS 155 (May 16, 1990); *Pa. Pub. Util. Comm'n v. Philadelphia Electric Co.*, 58 Pa. PUC 7, 11-12 (1983). OCA also argues that a utility cannot meet its burden of proof, per 66 Pa. C.S. § 315(a), by applying the inflation to all its costs because there is no way to assess the reasonableness of the FPFTY expenses relative to HTY or the FTY expenses. OCA states that when utilities file a FPFTY, the utilities demonstrate and explain reasons for FPFTY cost changes based upon specific causes such as unit price increases, planned activities, and abnormal activity in the HTY.

OCA argues that no such detail or causes can be provided by Wellsboro because the only explanation is the choice of the inflation escalation rate. OCA Main Brief at 22-23.

OCA additionally opposes the use of the PPI in forming the inflation adjustment and argues that a better measure of inflation for ratemaking purposes would be the forecasted Gross Domestic Product-Price Index (GDP-PI). Witness Morgan argued that if the Commission allows the use of an inflation adjustment, it should be based on the GDP-PI at 2.1%[1], instead of the PPI the Company used. Witness Morgan testified that use of projected GDP-PI is more reasonable for three reasons: (1) past history is not a good predictor of future inflation; therefore, relying on past inflation is not reasonable, (2) the 3% used by the Company was judgmental and did not rely upon an objective quantitative approach for determination, (3) it is a misuse of the PPI to forecast operating costs, especially for projecting expenses for ratemaking purposes. OCA Stmt. No. 2 at 9-10. OCA notes that the PPI is a family of indexes that measures the average change over time in the selling prices received by domestic producers of goods and services, and claims that the cost changes that the Company is attempting to project are not its price changes but rather the cost changes are those Wellsboro is projecting for prices or costs it will pay in obtaining goods and services. Thus, OCA believes that the PPI is not an appropriate tool to measure the change in costs. *Id.*

Disposition

We agree with OCA on this issue. Based on the arguments presented above, we find it improper to use an inflation escalation in projecting FPFTY expenses.

Both parties have cited to cases to support their positions concerning the inflation adjustment; however, the cases that the parties have cited were decided prior to Act 11, which authorized electric distribution companies to use a FPFTY in their Section 1308(d) base rate proceedings. Although Act 11 allowed for utilities to use the FPFTY to project expenses for the

[1] The forecasted GDP-PI of 2.1 percent for calendar year 2020 was obtained from the August 2019, Volume 44, No. 8 *Blue Chip Financial Forecast.*

FPFTY, it did not eliminate the “known and measurable” standard. We believe that if a company claims that an expense will increase in the FPFTY, then such a claim must be supported through some known and measurable change in the FPFTY, in order for the company to meet its burden of proof under 66 Pa. C.S. § 315(a).

To that extent, we agree with OCA’s argument that inflation adjustments are not actually known and measurable because they do not reflect the true cost of expenses in that the adjustments are blanket adjustments which do not directly relate to the actual costs expected to be incurred. As discussed more below, we reject the Company’s position that the Commission should accept the Company’s total expense claim without consideration of individual expense adjustments. The assumption that all expenses will increase by 3% is not supported in the record. Given the Company’s burden of proof in this proceeding, if the Company alleges that an individual expense will increase in the FPFTY, then such a claim must be supported in the record. Claiming that an individual expense will increase by a blanket percentage does not meet the requisite burden of proof pursuant to 66 Pa. C.S. § 315(a).

Accepting OCA’s position is not assuming that there are no cost increases from the FTY to the FPFTY. As indicated in the individual adjustments to the expense sections below, we recommend that the Commission accept FPFTY projections consisting of cost increases from the FTY to the FPFTY that the Company can demonstrate and explain in the record.

Furthermore, we accept OCA’s argument that an inflation adjustment of 3% was based on judgment and no real quantitative approach. Wellsboro argues that a 3% inflation adjustment is appropriate due to historical O&M expense increases of greater than 3%; however, as noted, we do recommend the Company’s FPFTY projections that the Company has sufficiency proven in the record. It is not known how the Company specifically came to its 3% inflation adjustment figure. It is a speculative figure that should not be used to set rates.

Therefore, we recommend Wellsboro not be permitted to apply a blanket 3% inflation adjustment to all of its O&M accounts in its FTY budget to reach its FPFTY projections.

B. Resolved Expense Issues

In rebuttal testimony, Wellsboro raised two expense adjustments that were accepted by OCA and not challenged by I&E. The two expense adjustments are adjustments relating to tree trimming costs and direct labor costs.

First, the Company forecasts an additional $60,000 in tree trimming costs in 2020. OCA Stmt. No. 1-SR (Revised) at 3. Wellsboro witness Farnsworth testified that the increase is due to accelerated efforts to address outages on the Middlebury circuit and the confirmation of the costs associated with the 115 KV transmission line associated with the Mid-Atlantic Interstate Transmission (MAIT) project. OCA Stmt. No. 1-SR (Revised) at 3-4. OCA accepts the proposed additional expense but does not agree that the costs are likely to continue. OCA recommends that this expense be normalized rather than considered an increase to FTY expenses. OCA Stmt. No. 1-SR (Revised) at 4.

Second, the Company also explained that its direct labor costs for 2019 were lower than anticipated due to an employee being on short-term disability. OCA Stmt. No. 1-SR (Revised) at 4. Wellsboro witnesses Gorman and Farnsworth indicated that the adjustment should be $21,000 for labor; however, OCA witness Campbell indicated that the employee's absence lowered Wellsboro's expenses by $14,934.16 during the three months of disability. *Id.* OCA does not oppose the inclusion of the direct labor costs in the annualized FTY but suggests a more conservative adjustment of $14,934. OCA Stmt. No. 1-SR (Revised) at 5.

As these two expense adjustments have been accepted by the parties, we recommend that the Commission accept the expense adjustments. The adjustment to tree trimming costs will be factored into account 593 (maintenance of overhead lines / vegetation management). The adjustment to direct labor costs will be factored into account 588 (miscellaneous distribution expense).

C. Individual Adjustments

I&E and OCA have proposed individual adjustments to Wellsboro's expense claims, an approach that Wellsboro takes exception. Wellsboro argues that the Commission should deny I&E's and OCA's individual expense adjustments and approve the Company's full expense claim as filed. Wellsboro claims that making adjustments to individual expense accounts presents unique challenges for a smaller utility such as Wellsboro, that moves expense amounts between General Ledger accounts based on the operational needs of the Company. Wellsboro Main Brief at 32-35.

However, Wellsboro does propose to accept an across-the-board adjustment to expenses based on the annualized FTY expense as of September 30, 2019, plus the 3% inflation adjustment.

Wellsboro's argument here will be rejected. A public utility has the burden of proof to establish the justness and reasonableness of every element of its rate increase request in all proceedings under 66 Pa. C.S. § 1308(d). The standard to be met is set forth at 66 Pa.C.S.A. § 315(a), which states "In any proceeding upon the motion of the commission, involving any proposed or existing rate of any public utility, or in any proceedings upon complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility." 66 Pa.C.S.A. § 315(a). As a result, individual expense claim will be analyzed below, to determine the justness and reasonableness of each claim.

1. Maintenance of Overhead Lines / Vegetation Management (Account 593)

Position of the Parties

Wellsboro made an original claim of $669,615 for Maintenance of Overhead Lines for the FPFTY. Nine-month data for the FTY (as of September 30, 2019), provided by the Company, shows a FTY amount of $422,595. The FTY data annualized shows an amount of $563,460. Applying a 3% inflation adjustment to the FTY annualized amount would show an amount of $580,364 for the FPFTY. Wellsboro Stmt. No. 1-R at 4

Account 593 includes expenses for Wellsboro's right of way inspections, tree trimming, and other vegetation management. Wellsboro cites maintenance and repairs due to tree damage from the Emerald Ash Borer as the reason for why its costs in this account have increased. Wellsboro Stmt. No. 6 at 7-8. The Emerald Ash Borer is an insect that causes death and damage to trees in Wellsboro's service territory. Damaged trees pose a risk to the reliability of the Company's distribution system. Wellsboro expects tree contractor costs to increase in 2020 compared with 2019 to combat the Emerald Ash Borer. Wellsboro Stmt. No. 6-R at 7. The Company alleges that, due to the small sizes of Wellsboro's contracts, it faces the challenge of limited qualified vegetation contractor interest. Wellsboro Stmt. No. 6 at 8. The Company asserts that the bids received from the Company for 2020 contractors show higher costs than its 2019 bids. Wellsboro Main Brief at 42-43.

Initially, in its direct testimony, I&E recommended a reduction of $20,535 to Wellsboro's claim. The reduction was based on an average of the last three years' labor cost - maintenance lines - storm expense (Sub-Account 593.51) because the Company experienced a wide fluctuation in this expense category during 2016 through 2018 and in the first six months of 2019. I&E Stmt. No. 1 at 24-25. Wellsboro accepted I&E's proposed adjustment for a claim of $649,081, noting that the Company's FTY budget included $20,600 of duplicative costs. Wellsboro Stmt. No. 6-R at 6.

However, I&E now recommends adjusting Wellsboro's claim to $580,364 based on the annualized YTD FTY expense as of September 30, 2019 plus the 3% inflation adjustment for the FPFTY. I&E Main Brief at 23.

OCA recommends an adjustment to Wellsboro's claim to $563,460 based on the annualized YTD number as of September 30, 2019, without a 3% inflation adjustment for the FPFTY. OCA Main Brief at 28.

Wellsboro argues that the annualized FTY expense as of September 2019 does not accurately reflect Wellsboro's FTY costs for the Account. Wellsboro asserts that its 2019 FTY expense was negatively impacted by employee absences in November and December that are not expected to recur. I&E Main Brief at 23. Wellsboro states that the 9-month data would not reflect actual year-end costs for Account 593 due to tree-trimming costs to be incurred in the 4th quarter. Wellsboro claims that $65,000 of additional funds have been budgeted for 2019 and are expected to be spent at the end of the year, which would increase the FTY projection above the annualized amount. Wellsboro Stmt. No. 6-R at 7.

In response to an on-the-record data request, Wellsboro witness Farnsworth stated that its expenses for the Account were $515,199.33 through November 30, 2019, and projected $81,320 in additional expenses through December 2019, for total actual-estimated Account 593 expenses of $596,519.33 for 2019. Escalating the Account by a 3% inflation factor would produce a FPFTY claim of $614,415 ($596,519.33 x 1.03 = $614,414.57). I&E Reply Brief at 22-23.

<u>Disposition</u>

We agree with Wellsboro on this issue. We find that Wellsboro provided sufficient evidence to show that the proposed increase in vegetation management expenses is due to a known and measurable change, in particular, the impact that the Borer will have on the Account.

I&E's initial adjustment to the expense was based on the average of the last three years' labor cost - maintenance lines - storm expense. I&E now recommends that Wellsboro's claim be adjusted to $580,364, which is the annualized YTD FTY of the expense as of September 30, 2019 plus the 3% inflation adjustment. OCA recommends that Wellsboro's claim be adjusted to $563,460, which is the annualized YTD FTY of the expense as of September 30, 2019 minus the 3% inflation adjustment.

We are persuaded by Wellsboro's evidence that the annualized FTY expense as of September 2019 does not properly reflect end-of-year costs give employee absences and tree-trimming costs that the Company projects to incur in the 4th quarter. The Company notes that the bids received from the Company for 2020 contractors show higher costs than its 2019 bids, because of the Borer and the challenge Wellsboro faces of limited qualified vegetation contractor interest.

Thus, ultimately, accepting either the I&E's or OCA's positions on this issue runs the risk of under collection of this expense. Under collection of this expense could affect the Company's ability to provide safe and reasonable service to its customers. *See* 66 Pa. C.S. § 1501. Wellsboro needs to have the necessary funds to be able to correct damaged trees to prevent service interruptions in its service territory.

To the concern that annualized YTD data as of September 2019 does not reflect end-of-year costs, Wellsboro has provided updated information concerning the expenses for this Account through November 30, 2019, along with the projected expenses through December 2019. As a result, we believe that Wellsboro's claim should be adjusted based on the most recent information available, that is, the expenses provided for Account 593 of $515,199.33 through November 30, 2019, plus the projected $81,320 in additional expenses through December 2019, for total actual-estimated Account 593 expenses of $596,519.33 for 2019.

Furthermore, as noted in Section B above, titled "Resolved Expense Issues," the Company forecasts an additional $60,000 in tree trimming costs in 2020 due to accelerated efforts to address outages on the Middlebury circuit and the confirmation of the costs associated with the 115 KV transmission line associated with the Mid-Atlantic Interstate Transmission (MAIT) project. OCA Stmt. No. 1-SR (Revised) at 3-4. The parties agree to let Wellsboro recover these additional costs; however, OCA posits that these tree trimming costs should be normalized, stating that costs are not likely to continue past 2020. *Id.* Wellsboro did not present any evidence to counter OCA's assertion. Normalization is a ratemaking concept that transforms an operating expense that recurs at irregular intervals into a "normal' annual test year expense allowance. The normalization concept prevents over recovery of an expense that might recur sporadically. Thus, we recommend that the $60,000 in additional tree trimming costs be normalized over three years ($20,000).

Therefore, we recommend that the Commission approve a total claim of $616,519.33 ($596,519.33 + $20,000) for maintenance of overhead lines / vegetation management expense.

2. <u>Operations Supervision & Maintenance Expense (Account 580)</u>

<u>Position of the Parties</u>

Wellsboro made an original claim of $106,704 for Operations Supervision and Maintenance Expense for the FPFTY. Wellsboro's claim for this expense was based on its FTY estimation. I&E Stmt. No. 1 at 10-11. Nine-month data for the FTY (as of September 30, 2019), provided by the Company shows a FTY amount of $63,103. The FTY data annualized shows an amount of $84,137. Applying a 3% inflation adjustment to the FTY annualized amount would show an amount of $86,662 for the FPFTY. Wellsboro Stmt. No. 1-R at 4.

Initially, I&E recommended a $27,724 adjustment to Wellsboro's claim. The recommendation was based on six months of annualized actual FTY expenses plus a 3% increase for employee payroll and benefits expense. I&E Stmt. No. 1 at 10-11. However, given Wellsboro's updated 9-month FTY data, I&E accepts a claim for account 580 of $86,662.

Wellsboro requests, however, that the Commission approve the Company's original expense claim of $106,704, asserting that the expense for the account varies due to the projects, maintenance, and repairs occurring from year to year. I&E Stmt. No. 1, Exhibit No. 1, Schedule 2. The Company argues it has detailed significant ongoing and escalating operational activities, including accelerating tree-trimming cycles from the current 7 to 8-year cycle to a 5 to 6-year cycle. Wellsboro Stmt. No. 6 at 8.

Additionally, Wellsboro notes that 2019 (the FTY) was the first full year of employment for the new VP of Engineering & Operations/COO position. I&E Exhibit No. 1, Schedule 2. Wellsboro asserts that the VP of Operations & Engineering/COO served as a witness in the rate case but will resume normal operational duties in the FPFTY. Wellsboro Stmt. No. 6 at 1.

<u>Disposition</u>

We agree with Wellsboro on this issue. Although Wellsboro provided YTD FTY data as of September 30, 2019, showing a FPFTY claim of $86,662 as compared to its original claim of $106,704 for the FPFTY, Wellsboro still contends that its original claim should be accepted. We find that the Company's original projected expenses for the FPFTY to be reasonable given the escalating operational activities that the Company has undertaken and that are still ongoing, including accelerating tree-trimming cycles. Our discussion of account 593 detailed the various circumstances that have led to the increase in tree-trimming activities by Wellsboro.

We recommend that the Commission approve Wellsboro's original FPFTY expense claim for operations supervision & maintenance expense, subtracting the 3% inflation factor, for an allowance of $103,596 ($106,704 / 1.03) for this account. As this recommendation recommends approval of estimated projected expenses that will be included in the Company's base rates, we also believe that it would be in the public interest that the Company's future actual expenditures related to the allowed expense be monitored to ensure the accuracy of projected expenses. *See* 66 Pa. C.S. § 315(e).

3. Miscellaneous Distribution Expense (Account 588)

Position of the Parties

Wellsboro made an original claim of $219,007 for Miscellaneous Distribution Expense for the FPFTY. Nine-month data for the FTY (as of September 30, 2019), provided by the Company shows a FTY amount of $169,106. The FTY data annualized shows an amount of $225,474. Applying a 3% inflation adjustment to the FTY annualized amount would show an amount of $232,239 for the FPFTY. Wellsboro Stmt. No. 1-R at 4.

Wellsboro notes that, based on the YTD data from September 30, 2019, the Company's expenses are running ahead for this Account. Wellsboro notes that Account 588 is running ahead of projections in almost the same amount as Account 590 is running behind projections, due to a Company employee who recorded more time on Account 588 activities than anticipated during the first three quarters of 2019. Wellsboro Stmt. No. 6-R at 9.

The Company cites new employee training and a limited overall work force as the reason for the increased cost in this Account. Wellsboro claims that approximately 50% of its workforce has the potential of retiring within ten years. Wellsboro Main Brief at 45. Wellsboro argues that the anticipated turnover in the next few years, plus the need to train new employees, indicates that training expenses of this nature are likely to recur often. *Id.*

I&E recommended an adjustment of $29,016 to the Company's claim. I&E's recommendation is based on an average of most recent three historic years' "other" expense (one of the expense categories included in the miscellaneous distribution expense)[2] because the Company's significantly increased its FPFTY "other" expense claim (+137.73%) over the HTY expense and this increase was not supported by the fluctuating other expense trend experienced in the last three years. The historical and projected "other" expense is as follows:

2 The "other" expense subcategory is for training new employees. I&E Reply Brief at 10.

2016	2017	2018	FTY	FPFTY
$12,581	$9,562	$17,807	$41,100	$42,333

I&E Stmt. No. 1 at 15; I&E Exhibit No. 1, Schedule 5 at 1-2.

Additionally, I&E claims that the Company's claim was based on the speculative assumption about recurrence of training expenses for new employees at an elevated pace in the FPFTY. I&E Stmt. No.1 at 15-16. I&E notes that the Company did not specify the number of new employees expected to be trained, duration of the training, and the basis for projected training expense to be incurred in the FTY. I&E argues that the Company projects the FPFTY "other" expense claim to increase at an elevated level on the speculative assumption that the training expense will recur at the same pace for new employees in the FPFTY, when there is no certainty about future additions of new employees to characterize this expense as a normal, recurring annual expense. *Id.* Additionally, I&E claims that Wellsboro did not provide any evidence in rejoinder that it is experiencing or will experience employee turnover or specific impact to the "other" expense subcategory that it has not experienced historically. OCA Reply Brief at 12.

OCA recommends an adjustment of $88,447 to the Company's claim. This recommendation is based on a three-year average (2015-2017) expense for the Account, due to the variance of expenses in the Account over the years. OCA states that, although the Company cites to new employee training and a limited overall work force as the reason for the increased cost for this Account, beyond the retirement of an employee of an employee in 2018, there appears to be no change in employees for 2019 and 2020. Furthermore, OCA notes that the new employee training costs are unlikely to continue in future years unless the Company plans to hire additional employees. OCA Stmt. No. 1 at 6.

<u>Disposition</u>

We agree with I&E on this issue. Wellsboro cites new employee training and a limited overall work force as the reason for the increased costs in this account. We agree with

I&E that the Company's presumption that its training expenses for training new employees will increase at an elevated pace is speculative in nature. Wellsboro claims that approximately 50% of its workforce has the "potential" of retiring within ten years. This is a speculative assumption that, if Wellsboro's original claim is accepted, could result in over recovery if the employees that Wellsboro believes may retire do not in fact retire. Wellsboro did not provide sufficient evidence to show that it would be experiencing employee turnover at a recurring, accelerated rate. Thus, we do not believe that the expenses relating to training new employees will be a normally occurring, prudent expense. Expenses that are not normal should not be allowed as part of the overall rate computation. *See*, *Pa. Pub. Util. Comm'n v. Philadelphia Gas Works*, 2007 Pa. PUC LEXIS 45, *26-27. ("The object of using a test year is to reflect typical conditions."). To the extent that expenses are not incurred, imprudently incurred, or abnormally overstated during the test year, they should be disallowed and found not recoverable through rates.

We recommend that the Commission approve I&E's FPFTY expense claim adjustment for miscellaneous distribution expense.

Furthermore, as noted in Section B above, titled "Resolved Expense Issues," the Company forecasts an additional $21,000 in direct labor costs, because its direct labor costs for 2019 were lower than anticipated due to an employee being on short-term disability. OCA Stmt. No. 1-SR (Revised) at 4. OCA witness Campbell indicated that the employee's absence lowered Wellsboro's expenses by $14,934.16 during the three months of disability. *Id.* OCA does not oppose the inclusion of the direct labor costs in the annualized FTY but suggests a more conservative adjustment of $14,934. OCA Stmt. No. 1-SR (Revised) at 5. Wellsboro did not contradict OCA's testimony that the employee's absence lowed the Company's expenses by $14,934.16. Thus, we will also recommend that Wellsboro be permitted to recover the amount of $14,934.16 in its claim for miscellaneous distribution expense.

In summary, we recommend that the Commission approve a total claim of $204,925 ($189,991 + $14,934) for miscellaneous distribution expense.

4. Maintenance Supervision and Engineering (Account 590)

Position of the Parties

Wellsboro made an original claim of $80,232 for Maintenance Supervision and Engineering in the FPFTY. Nine-month data for the FTY (as of September 30, 2019), provided by the Company, shows a FTY amount of $47,530. The FTY data annualized shows an amount of $63,373. Applying a 3% inflation adjustment to the FTY annualized amount would show an amount of $65,275 for the FPFTY. Wellsboro Stmt. No. 1-R at 4

This expense increased from the HTY to the FTY. Wellsboro notes that the expense increase from the HTY to the FTY was largely based on filling the vacant position of VP Engineering & Operations/COO. I&E Stmt. No. 1 at 13; Exhibit No. 1, Schedule 4 at 1-2. Wellsboro states that the shortfall in Account 590 is related to an employee who spent additional time on an Account 588 task. Wellsboro Stmt. No. 6 at 9. In other words, Wellsboro claims that the record reflects that the $14,957 expense shortfall in Account No. 590 directly caused the $13,232 expense overage in Account No. 588. Wellsboro states that approving I&E's adjustments to both accounts would double count the expense reduction.

Initially, I&E recommended an adjustment of $19,571 ($60,661) to Wellsboro’s claim, based on six months of annualized actual FTY expenses ($58,894) plus a 3% increase for employee payroll and benefits expense. I&E Stmt. No. 1 at 13. I&E now recommends an adjustment of $14,957 ($65,275) based on a 9-month annualization of the FTY expense. I&E Stmt. No. 1-SR at 19.

Concerning the employee who spent additional time on an account 588 task, I&E argues that if Wellsboro’s claim for $80,232 was approved, a single expense would be double counted in the FPFTY, in both account 588 and account 590. I&E notes that the Company admitted that this expense has only been booked to account 588 (Wellsboro Main Brief at 46) and, therefore, has provided no evidence that the expense in dispute for this particular employee, which exists only in account 588 in the FTY, will exist in both accounts in the FPFTY. I&E

further notes that its recommendation for account 588 was based on the "other" expense subcategory (the subcategory for training new employees), not a specific employee's expense being booked to one account or the other. I&E Main Brief at 10.

Disposition

We agree with I&E on this issue. Wellsboro has provided no justification for its original claim of $80,232 for maintenance supervision and engineering in the FPFTY. We accept I&E's explanation concerning the employee who spent additional time on an account 588 task, in that there is no evidence provided that the issue concerning this particular employee will exist in both accounts in the FPFTY. Given the lack of justification for the claim, it is more appropriate to use the annualized figure based off the most recent information provided by the Company, that is, the 9-month YTD data provided by Wellsboro for its claim in the FPFTY. The 9-month data annualized supports a FPFTY claim of $63,373, with no inflation adjustment added.

Therefore, we recommend that the Commission approve a claim of $63,373 for maintenance supervision and engineering.

5. Safety and Communication (Account 908-913)

Position of the Parties

Wellsboro made an original claim of $19,197 for Safety and Communication in the FPFTY. This amount includes $4,777 for Customer Assistance, $10,815 for Customer Service, and $3,605 for Advertising. I&E Exhibit No. 1, Schedule 3 at 2.

Nine-month data for the FTY (as of September 30, 2019), provided by the Company, shows a FTY amount of $3,651. The FTY data annualized shows an amount of $4,867. Applying a 3% inflation adjustment to the FTY annualized amount would show an amount of $5,013 for the FPFTY. Wellsboro Stmt. No. 1-R at 4.

Wellsboro claims that, although FTY costs are below projections, the shortfall is due in part to reduced demand for energy audits and includes costs for customer service. I&E Stmt. No. 1, Exhibit No. 1, Schedule 7. The Company's claim for the FPFTY reflected projected amounts for customer assistance and advertising following a rate increase.

Accordingly, Wellsboro states that the only adjustment the Commission should accept is to normalize the Company's tri-annual Eligible Customer List expense and reduce that customer service component of the Account claim by $6,497 from $10,815 to $4,138. I&E Stmt. No. 1 at 20-22. The Company asserts that its FPFTY claim for the remaining components, advertising, and customer assistance, should be accepted without modification. I&E Stmt. No. 1 at 20. This ultimately results in a FPFTY expense of $12,694 for Safety and Communication.

I&E initially recommended an adjustment of $10,282 based on normalization of the Company's tri-annual Eligible Customer List expense of $10,815 over three years and eliminating expenses for advertising of $3,605. I&E Stmt. No. 1 at 21-22. Given the FPFTY projection based on the YTD data through September 30, 2019, I&E now recommends a FPFTY claim of $5,013.

OCA recommended a reduction of $9,941 based on normalization of the tri-annual Eligible Customer List expense but allowed the HTY advertising and customer assistance expense. OCA Stmt. No. 1 at 9.

Disposition

We agree with I&E, in part, on this issue. All the parties agreed to normalization of Wellsboro’s tri-annual Eligible Customer List expense of $10,815 over three years, reducing the Customer Service category of the Safety and Communication claim to $4,138.

We agree with I&E in that Wellsboro should not be permitted to recover expenses related to advertising. A utility may only recover those operating expenses reasonably necessary to provide service to customers. *Western Pennsylvania Water Company v. Pa. Pub. Util. Comm'n*, 422 A.2d 906 (Pa. Cmwlth. 1980); *Butler Township Water Co. v. Pa. Pub. Util. Comm'n,* 81 Pa. Cmwlth. 40, 43-44, 473 A.2d 219, 221 (1984). Wellsboro has not provided sufficient evidence that would lead to a finding that expenses relating to advertising would be necessary in providing electric service to its customers.

We find that Wellsboro should be permitted to recover expenses relating to customer assistance. We are convinced by Wellsboro's projection that its customer assistance expenses will increase following a rate increase. We find it reasonable that customers of Wellsboro will need greater assistance from Wellsboro once their rates increase following the conclusion of this proceeding.

Therefore, we recommend that the Commission approve a $8,915 FPFTY expense claim for safety and communication expense. This figure is based on normalization of the Company's tri-annual Eligible Customer List expense of $10,815 over three years and elimination of the expenses for Advertising of $3,605.

6. Office Supplies (Account 921)

Position of the Parties

Wellsboro made an original claim of $140,595 for Office Supplies in the FPFTY.

Nine-month data for the FTY (as of September 30, 2019), provided by the Company shows a FTY amount of $46,869. The FTY data annualized shows an amount of $62,492. Applying a 3% inflation adjustment to the FTY annualized amount would show an amount of $64,367 for the FPFTY. Wellsboro Stmt. No. 1-R at 4

Despite the fact that costs in the FTY are tracking below budget as of September 30, 2019, the Company states that its budgeted costs do not always track in accordance with the budget on a month to month basis. Wellsboro Stmt. No. 6-R at 4.

Wellsboro notes that, 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 Stmt. No. 1, Exhibit No. 1, Schedule 9 at 8, 10 (showing increased phone/internet and miscellaneous expense for November 2018 and December 2018). Consequently, Wellsboro claims that annualized YTD data may not accurately reflect total FTY expenses for this account. Wellsboro notes that the Office Supplies expense from 2012 to 2018 has always significantly exceeded $64,367. Wellsboro Stmt. No. 1, Exhibit__(HSG-1), Schedule C1-1 (W) at 2. The HTY expense for this account was $125,467.

Initially, I&E recommended a reduction of $11,364 ($129,231) to Wellsboro's claim. I&E's recommendation was based on the HTY expense of $125,467 plus a 3% increase for determining the FPFTY expense allowance of $129,231 to remove the impact of certain non-recoverable expense items claimed in the FPFTY. I&E Stmt. No. 1 at 26-27. The costs that I&E defines as "non-recoverable" include 2018 expenses for 3000 AD POP Lollipops of $797, Player's/Hole sponsorship of $650, 2019 calendars of $305, pocket calendars of $426, team registration of $400, Pro-AM Golf sponsorship of $800, picnic expenses of $332, Christmas gift cards of $374, and Christmas parties/banquet of $5,107. I&E Stmt. No. 1 at 27.

Wellsboro objects to I&E's characterization of these expenses, claiming the Commission allows expenses for employee recognition events. Wellsboro Main Brief at 48.

Given the Company's YTD data results in a FPFTY projection of $64,637, I&E now recommends an adjustment for office supplies to $64,637. Wellsboro maintains its FPFTY claim for $140,595.

Disposition

We agree with Wellsboro on this issue. Wellsboro's argument that the its YTD annualized data does not accurately reflect total FTY for this account, given that the Company's HTY expense showed increased costs in November and December, and the fact that historically the expenses for this account always significantly exceeded the YTD annualized amount.

However, we agree with I&E in disallowing the expenses that I&E deemed to be non-recoverable, listed above. Said costs are not reasonable and necessary in the provision of utility service to customers.

In *Pa. Pub. Util. Comm'n. v. Citizens Utilities Water Co. of Pa.,* Docket No. Docket No. R-00953300C0001-0072 (Opinion and Order entered March 29, 1996), the utility sought to recover expenses relating to flowers, gifts to employees, in-house lunches and horticultural service. The Commission in that case determined that such expenses were not necessary for the provision of utility service and disallowed said expenses.

In *Pa. Pub. Util. Comm'n v. York Water Co*., Docket Nos. R–850268, R–850268C001 (Opinion and Order entered November 25, 1986) (*York*), the Commission granted the utility's expense claim for a company banquet but did not grant the utility's expense claim for a company picnic. The ALJ in *York* referred to a 1972 case at Docket No. C–19466, in which the Commission stated that, "We are of the opinion that respondent's annual dinner, at which service pins are awarded, provide respondent the opportunity to give recognition to its employees for service to the Company and its customers. These annual award dinners should prove a real value in fostering improved employee/management relations and result in a more satisfied and effective work force." Thus, the ALJ came to the conclusion that the Commission accepts expenses relating to employee recognition. The ALJ then makes a distinction between the company picnic and the company banquet, stating that the company picnic does not stand on the same footing as the company banquet, since it involves no element of employee recognition. The Commission accepted this distinction.

In *Pa. Pub. Util. Comm'n. v. The Columbia Water Company*, Docket No. R-2013-2360798 (Opinion and Order entered January 23, 2014), the ALJ disallowed employee recognition expenses in the form of a Hershey Park outing and a year-end banquet. In disallowing expenses for the banquet, the ALJ stated that the utility did not provide specific information about the year-end banquet to demonstrate that it qualifies as an "employee recognition" dinner. This implies that had the utility provided specific information about the banquet so that it qualified as an "employee recognition" dinner, that the ALJ would have allowed the banquet expenses.

In summary, employee activity costs clearly identified as employee recognition costs can be claimed as an expense. *See also Pa. Pub. Util. v. UGI Utilities, Inc. – Electric Division,* R-2017-2640058 (Order enered October 25, 2018) *(citing Pa. Pub. Util. Comm'n v. York Water Co.,* 62 Pa. P.U.C. 459 (1986) and *Pa. Pub. Util. Comm'n v. Columbia Water Company,* Docket No. R-2013-2360798 (Order entered January 23, 2014)). Although Wellsboro claims that the costs that I&E highlighted were expenses connected to employee recognition events, Wellsboro did not provide substantial evidence providing as such. Wellsboro did not meet its burden of proving that said costs are connected to employee recognition events. I&E's initial recommendation was $129,231, which was based on the HTY expense to remove these above costs, plus a 3% inflation factor. Thus, we believe that an allowance of $125,467, which is the Company's HTY expense, removes the costs not necessary in the provision of Wellsboro's service to its customers, and factors in Wellsboro's argument that its YTD annualized data does not accurately reflect total FTY expenses for the account.

Therefore, we recommend that the Commission approve a claim of $125,467 for office supplies expense.

7. Regulatory Commission Expense (Account 928)

Position of the Parties

Wellsboro made an original claim of $107,341 for Regulatory Commission Expense in the FPFTY. The claim includes amortization of the 2016 rate case expense of $68,710.

I&E recommends a reduction of $68,710 ($38,631) to Wellsboro's claim. I&E's recommendation is based on removal of the 2016 rate case expense amortization of $68,710 from the FPFTY Regulatory Commission Expense claim, alleging that only the current allowable rate case expenses should be normalized in the FPFTY. I&E Stmt. No. 1-SR at 23.

Wellsboro agrees to I&E's proposal and accepts an allowance of $38,631. Wellsboro Main Brief at 15.

Disposition

Given that Wellsboro agrees to I&E's proposal and accepts their recommendation of $38,631 for Regulatory Commission Expense, we agree with I&E on this issue. No party has challenged this figure.

Therefore, we recommend that the Commission adopt I&E's allowance of $38,631 for regulatory commission expense.

8. Maintenance of General Property (Account 932)

Position of the Parties

Wellsboro made an original claim of $90,199 for Maintenance of General Property in the FPFTY.

Nine-month data for the FTY (as of September 30, 2019), provided by the Company, shows a FTY amount of $51,409. The FTY data annualized shows an amount of $68,546. Applying a 3% inflation adjustment to the FTY annualized amount would show an amount of $70,602 for the FPFTY. Wellsboro Stmt. No. 1-R at 4

OCA recommended an adjustment of $43,242 to Wellsboro's claim. OCA alleges that the Company's claim is based on its proposal to increase the "other" subcategory of this expense by 30% from HTY to FTY, with no explanation other than stating that projects will vary year to year. Thus, OCA alleges that the Company does not justify why the increase in the FTY would continue to the FPFTY. OCA's reduction is based on the three-year average of the 2016-2018 "other" subcategory plus the remaining FTY subcategory expenses, not including an inflation adjustment. OCA Stmt. No. 1 at 10.

Wellsboro alleges that OCA's recommended FPFTY allowance of $46,957 would not even cover the Company's actual $51,409 expense incurred for Account 932 as of September 30, 2019. Wellsboro states that OCA's method of adjusting the total Account 932 costs because a single component of the total Account 932 is lower than historic levels is illogical. The Company represents that maintenance activities recorded under Account 932 vary from year to year thus it is prudent to rely on the Company's budgeted experience. Wellsboro Reply Brief at 19.

Disposition

We agree with Wellsboro on this issue. Given that use of the FPFTY is based on projected expenses and given Wellsboro's testimony that maintenance activities recorded under this Account vary from year to year, we agree that it is prudent to rely on the Company's budgeted experience in projecting this account for the FPFTY. It is also acknowledged that OCA's adjustment would not cover the actual $51,409 expense incurred for the Account as of September 30, 2019.

The most recent up to date data shows that Wellsboro will incur $68,546 of costs in this account by the end of the 2019 year.

Therefore, we recommend that the Commission approve an allowance of $68,546 for maintenance of general property.

9. Rate Case Expense

Position of the Parties

Wellsboro proposed a total rate case expense claim of $326,000 and proposed to normalize this amount over three years consistent with the anticipated frequency of base rate proceedings going forward.

Wellsboro acknowledges that the filing intervals for its last three rate cases have been 37 months, 75 months and 34 months, which averages out to 48 months but claims that the more typical filing interval is about 36 months. Wellsboro claims that it would be penalized for being able to forego a rate case for 3.25 additional years (75 months -36 months) if I&E's or OCA's positions are accepted. Wellsboro states that accepting the other parties' positions runs the risk of under-recovery. Additionally, in support of its three-year normalization request, Wellsboro claims that the industry is changing rapidly, and having 36 months between rate cases is much more likely to be the case than 48 months. Wellsboro Stmt. No. 1-R at 5-6. More specifically, Wellsboro's witness claims the following:

> The electric industry is in a period of transition as distributed generation resources become more economical for customers. Similar to the projects underway in the Citizens' Electric Company of Lewisburg, PA ("Citizens'") service territory, Wellsboro expects its customers to install solar and combined heat & power ("CHP") resources in the years following this rate case. As I discuss further below, Wellsboro very recently received an interconnection application from a large industrial customer proposing to install solar generation. The expectation of revenue loss due to a heightened pace of solar and CHP projects supports a shorter 36-month normalization period for rate case expense.

Wellsboro Stmt. No. 6-R at 6.

In summary, Wellsboro cites to limited prospects for load growth; increase in solar and combined heat and power ("CHP"); change in industry generally; continuing tree trimming, capital replacements, and other reliability enhancing projects; and significance of the time period since the last rate filing for justification for a three year normalization period. Wellsboro Stmt. No. 1-R at 5-6; Wellsboro Stmt. No. 6-R at 5-6.

Wellsboro cited to cases for the proposition that, while historic filing frequency is a factor considered in determining the normalization for rate case normalization, it is not the only factor the Commission considers, including *Butler Township Water Co. v. Pa. Pub. Util. Comm'n,* 473 A.2d 219 (Pa. Cmwlth. 1984) and *Pa. Pub. Util. Comm'n v. UGI Utilities, Inc. – Electric Division*, R-2017-2640058 (Order entered October 25, 2018).

I&E proposed a normalization period of 48 months based on the average of the Company's last three base rate case filings. I&E alleges that a 36-month normalization period is not supported by the Company's historic filing frequency. I&E Stmt. No. 1 at 7. I&E submitted that the factors that Wellsboro cited in support of a 36-month normalization period do not merit deviation from the Commission's endorsed practice of reviewing historical filing frequency. I&E alleged that tree trimming and normal capital replacements are routine operational costs, and the cost of such activities are normally forecast in the annual budget. I&E Statement No. 1-SR at 12. I&E alleged that the Company's expectation about customers' installation of solar and CHP projects and consequent revenue losses in the years following the rate case are speculative in nature. I&E Statement No. 1-SR at 13. Lastly, I&E alleged that Wellsboro's claims of limited prospects for load growth and change in industry generally are conclusory statements that lack sufficient support. I&E Main brief at 27.

OCA proposed a normalization period of 45 months based on the average time between the Company's last four rate case filings, including the present case. OCA Stmt. No. 1 at 10. OCA's witness claimed the following:

> There is Commission precedent to utilize the average period between rate cases to determine the normalization of the rate case expense, as I have done to calculate the normalization period in this case. This method is not to penalize or discourage the Company from filing a rate case as needed, rather it is a way to match the expense recovery over the average period of time of when cases are filed. While there are factors that have been identified in rebuttal testimony that could impact the Company's decision to file sooner, the actual amount of time between this rate case and the next is unknown. Therefore, I maintain my recommendation to utilize a 45 month normalization period. Additionally, as with the Company's concern regarding under-recovery, there is concern for over-recovery of rate case expense if the Company does not file within the time period.

OCA Stmt. No. 1-SR (Revised) at 11.

Disposition

We agree with Wellsboro on this issue. The total rate case expense claim of $326,000 is not disputed between the parties. At issue is the length of the normalization period for recovery of the rate case expense. Wellsboro requested a 36-month normalization period, I&E requested a 48-month normalization period, and OCA requested a 45-month normalization period.

It is the Commission's practice to recognize all prudently incurred rate case expense and set a normalization period based upon historic filing frequency. *City of Lancaster v. Pa. Pub. Util. Comm'n*, 793 A.2d 978 (Pa. Cmwlth. 2002). However, the Commission has also recognized that there are exceptions to the general principle that the history of rate filings represents the best evidence for normalization of rate case expense. In *Pa. Pub. Util. Comm'n v. PPL Electric Utilities Corporation,* Docket No. R-2012-2290597 (Order entered December 28, 2012), PPL's request for a two-year period for normalization of rate case expense was granted despite PPL's historic filing frequency of three years. The Commission was persuaded that PPL's major capital improvement program addressing aging infrastructure warranted an accelerated normalization period for the rate case expense. In *Pa. Pub. Util. Comm'n. v. UGI Utilities, Inc. – Electric Division*, R-2017-2640058 (Order entered October 25, 2018), UGI's request for a three-year period for normalization of rate case expense was granted despite UGI not having filed for a base rate increase for 22 years. The Commission was persuaded that UGI's ongoing capital improvement costs warranted establishing an amortization period without regard to historic frequency of the Company's base rate filings.

We find that the record supports deviation from the general principle that history of rate filings represents the best evidence for normalization of rate case expense. The record supports a finding that the Company's proposed use of a three-year normalization period for rate case expense is appropriate and that a longer period between rate proceedings is unlikely. Wellsboro cited to limited prospects for load growth; increase in solar and combined heat and power (CHP); change in industry generally; continuing tree trimming, capital replacements, and other reliability enhancing projects; and significance of the time period since the last rate filing as justification for its normalization period. As the Commission noted in the *UGI Order*, the normalization period for rate case expense is an expense that can be based on future expectations. *UGI Order* at 60. It is accepted that Wellsboro will be likely to file its next rate case with three years as compared to a longer period. The historic filing frequency is inflated by Wellsboro forgoing a rate case filing for an additional 3.25 year-period, as noted above. It is also agreed that accepting either I&E or OCA's proposal would likely result in an under collection in the likely event that Wellsboro files a rate case within the next three years.

Therefore, we recommend that the Commission accept the $326,000 expense claim for Rate Case Expense, to be normalized over three years ($108,667).

10. <u>Cash Working Capital</u>

As noted previously in this Decision, Wellsboro's CWC claim is based on one-eighth (12.5%) of its O&M expenses. Thus, the adjustment to cash working capital will be made in accordance with the total O&M adjustments adopted in this proceeding.

Based on the total O&M expense adjustments ($40,736), CWC will be adjusted downwards by $5,092 ($40,736 * 12.5%).

11. <u>Depreciation Expense</u>

<u>Position of the Parties</u>

As a result of Wellsboro's use of the end of test year rate base, Wellsboro has based its test year depreciation expense on the projected balance of plant in service as of the end of the FPFTY. OCA Stmt. No. 2 at 7; OCA Main Brief at 32.

OCA recommends an adjustment to the depreciation expense in order reflect OCA's proposed use of an average test year rate base instead of the Company's proposed end of test year rate base. OCA submits that the Company should base its depreciation expense on average plant in service in the FPFTY. Thus, OCA recommends that the Company use an average test year rate base, and therefore, claims the accumulated depreciation expense should be reduced by $21,292. OCA Stmt. No. 2 at 8; OCA Stmt. No. 1, Sch. SLS-3.

Disposition

We agree with Wellsboro on this issue. A utility seeking to recover a depreciation deficiency from rates has the burden of proving that the deficiency is genuine. *Pa. Power & Light Co. v. Pa. Pub. Util. Comm'n*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973). The genuineness of a deficiency is proved by the utility's demonstrating that it has not received revenues sufficient to pay all of its operating expenses together with a fair return on its rate base during the years when the deficiency was created. See generally*, U.S. Steel Corp. v. Pa. Pub. Util. Comm'n, supra.; Pa. Power & Light Co*., *supra.* The issue between Wellsboro and OCA with respect to depreciation expense is the question of which methodology should be used to base the depreciation expense. Wellsboro proposed an end-of-year methodology while OCA proposed an average rate base methodology.

In the *UGI Order* the Commission permitted UGI Electric to use the end-of-year methodology in its FPFTY, so that its depreciation expense claims reflected end-of-the year conditions. *UGI Order* at 74-76. We note that the Commission's order on this issue was upheld by the Pennsylvania Commonwealth Court on January 15, 2020. See, *McCloskey v. Pa. Pub. Util. Comm'n.,* 1549 C.D. 2018 (Pa. Cmwlth. Jan. 15, 2020). As to remain consistent with the Commission's decision in the *UGI Order,* Wellsboro should be permitted to utilize end-of-year methodology in the FPFTY. Thus, it is proper for Wellsboro to base its test year depreciation expense on the projected balance of plant in service as of the end of the FPFTY.

Therefore, we recommend that the Commission reject OCA's recommendation to reduce the accumulated depreciation expense.

D. Conclusion

Consistent with the above discussion, we recommend an adjustment of total claimed expenses for the FPFTY in the amount of $40,376. The total expense number of O&M is $2,942,934. We have accepted Wellsboro's end-of-year methodology for calculating the FPFTY in this proceeding, so no reductions were made based on the use of an average rate-based methodology.

V. FAIR RATE OF RETURN

Wellsboro is seeking in this proceeding an overall rate of return of 7.64%, including a cost of long-term debt of 4.98% and a cost of common equity of 10.30%. Wellsboro Main Brief at 100. As more fully explained below, we recommend an overall rate of return of 7.14%, including a cost of long-term debt of 4.86% and a return on common equity of 9.31%.

A. Legal Standards

A public utility seeking a general rate increase is entitled to an opportunity to earn a fair rate of return on the value of the property dedicated to public service. *Pa. Gas and Water Co. v. Pa. Pub. Util. Comm'n*, 341 A.2d 239 (Pa. Cmwlth. 1975) In determining what constitutes a fair rate of return, the Commission is guided by the criteria set forth in *Bluefield Water Works and Improvement Co. v. Pub. Service Comm'n of West Virginia*, 262 U.S. 679 (1923) and *Federal Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591 (1944). In *Bluefield* the United States Supreme Court stated:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management,

> to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia, 262 U.S. 679, 692-23 (1923).

The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties (262 U.S. at 693). These principles have been adopted and applied by the Appellate Courts of Pennsylvania in numerous cases. *Riverton Consolidated Water Co. v. Pa. Pub. Util. Comm'n*, 140 A.2d 114 (Pa. Super. 1958); *Pittsburgh v. Pa. Pub. Util. Comm'n*, 126 A.2d 777 (Pa. Super. 1956); *Lower Paxton Twp. v. Pa. Pub. Util. Comm'n*, 317 A.2d 917 (Pa. Cmwlth. 1974).

The return allowed to investors must be commensurate with the risk assumed, as the Supreme Court has stated in three landmark opinions. *Bluefield*, *supra*, requires that the rate of return reflect:

> [a] return on the value of the [utility's] property which it employs for the convenience of the public equal to that generally being made at the same time on investments in other business undertakings which are attended by corresponding risks and uncertainties. . . .

262 U.S. at 692.

The Supreme Court reiterated that standard in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), as follows:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be

> commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Id. at 603.

Later, in reaffirming *Hope*, the Supreme Court, in *Duquesne Light Co. v. Barasch*, 388 U.S. 299, 314 (1989) observed that "[o]ne of the elements always relevant to setting the rate under *Hope* is the return investors expect given the risk of the enterprise." *Id.*

The determination of a fair rate of return thus requires the review of many factors, including: (1) the earnings which are necessary to assure confidence in the financial integrity of the company and to maintain its credit standing; (2) the need to pay dividends and interest; and (3) the amount of the investment, the size and nature of the utility, its business and financial risks, and the circumstances attending its origin, development and operation. *Pa. Pub. Util. Comm'n. v. Pa. Gas and Water Co. - Water Division*, 341 A.2d 239 (Pa. Cmwlth. 1975); *Lower Paxton Twp.*, *supra.* Moreover, the Commission's findings must be based upon substantial and competent evidence on the record before it, not upon speculation or hypothesis. *Ohio Bell Telephone Co. v. Pub. Util. Comm'n of Ohio*, 301 U.S. 292 (1937); *United States Steel Corp. v. Pa. Pub. Util. Comm'n*, 390 A.2d 849 (Pa. Cmwlth. 1978); *Octoraro Water Co. v. Pa. Pub. Util. Comm'n*, 391 A.2d 1129 (Pa. Cmwlth. 1978).

In analyzing a proposed general rate increase, the Commission determines a rate of return to be applied to a rate base measured by the aggregate value of all the utility's property used and useful in the public service. In determining a proper rate of return, the Commission calculates the utility's capital structure and the cost of the different types of capital during the period in issue. The Commission has wide discretion, because of its administrative expertise, in determining the cost of capital. *Equitable Gas Co. v. Pa. Pub. Util. Comm'n*, 405 A.2d 1055 (Pa. Cmwlth. 1979).

B. Capital Structure

Wellsboro' is proposing in this proceeding a capital structure of 49.33% debt, 50.05% common equity and 0.62 preferred equity. Wellsboro Joint Stmt. No. 2 at 13-14. No parties dispute Wellsboro proposal. OCA Stmt. No. 3 at 3; I&E Stmt. No. 2 at 16. We recommend adoption of Wellsboro's proposed capital structure.

C. Cost of Long-Term Debt

Wellsboro is proposing in this proceeding a cost of long-term debt rate of 4.98%. No parties dispute Wellsboro proposal. OCA Stmt. No. 3 at 3; I&E Stmt. No. 2 at 17. We recommend adoption of Wellsboro's proposed cost of long-term debt rate.

D. Cost of Common Equity

Wellsboro seeks a 10.30% return on common equity, which results in an 7.64% overall rate of return. OCA Main Brief at 33. This is based on its proposed capital structure of 49.33% long-term debt, 50.05% common equity, and 0.62% preferred equity.

Description	**Capitalization Ratio**	**Embedded Cost**	**Return-%**
Long-Term Debt	49.33%	4.98%	2.46%
Common Equity	50.05%	10.30%	5.16%
Preferred Equity	0.62%	4.00%	0.02%
Total	100.00%		7.64%

OCA states that the company's request for a return on equity of 10.30% is well in excess of an objective assessment of investor market requirements in the current economic environment and should be rejected. OCA Main Brief at 35. OCA recommends a fair overall rate of return of 6.68%, including a cost of common equity of 8.38%. OCA Main Brief at 35.

Description	Capitalization Ratio	Embedded Cost	Return-%
Long-Term Debt	49.33%	4.98%	2.46%
Common Equity	50.05%	8.38	4.20%
Preferred Equity	0.62%	4.00%	0.02%
Total	100.00%		6.68%

I&E used the DCF model and the CAPM as a comparison to the DCF results. I&E recommends a 6.53% overall rate of return and an 8.10% return on equity. I&E Main Brief at 29-30.

Description	Capitalization Ratio	Embedded Cost	Return-%
Long-Term Debt	49.33%	4.98%	2.46%
Common Equity	50.05%	8.10%	4.05%
Preferred Equity	0.62%	4.00%	0.02%
Total	100.00%		6.53%

Wellsboro witness D'Ascendis conducted a thorough analysis of multiple ROE models to develop a ROE, based on his proxy group, of 9.05%. Mr. D'Ascendis then adjusts the proxy group's ROE upward by 1.00% for the Company's smaller relative size to the proxy group and 0.25% to reflect management performance. As a result of his adjustments to the proxy group's ROE to reflect the unique risk of the Company, Mr. D'Ascendis recommends a 10.30% ROE. *See* Joint Statement No. 2-R, Exhibit __(DWD-1R), Sch. 1R at2; Wellsboro Main Brief at 55-56.

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

> My recommendation results from applying several cost of common equity models, specifically the Discounted Cash Flow Model ("DCF model"), the Risk Premium Model ("RPM"), and the Capital Asset Pricing Model

("CAPM"), to the market data of the Electric and Gas Utility Proxy Group whose selection criteria will be discussed below. In addition, I applied the DCF model, RPM, and CAPM to proxy groups of domestic, non-price regulated companies comparable in total risk to the Electric and Gas Utility Proxy Groups ("Non-Price Regulated Proxy Groups").

Wellsboro Joint Stmt. No. 2 at 4-5; Wellsboro Main Brief at 58.

The results derived from each are as follows:

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

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

Wellsboro Joint Stmt. No. 2-R, Exhibit __(DWD-1R), Sch. 1R at 2.

As indicated in the above table, the Rebuttal update reduced the recommended ROE for Wellsboro from 11.15% to 10.30%. Wellsboro Main Brief, Table 2 at 59.

As noted, both I&E and OCA recommend using the DCF method as the primary method to determine the cost of common equity, with the results of the CAPM used as a comparison to the DCF results.

In addressing this issue, the Commission has stated:

> Although there are various models used to estimate the cost of equity, the Discounted Cash Flow (DCF) method applied to a barometer group of similar utilities, has historically been the primary determinant by the Commission. *Pa. PUC v. City of Lancaster – Water Bureau,* Docket No. R-2010-2179103, at 56 (Order entered July 14, 2011); *Pa. PUC v. PPL electric Utilities, Corp.,* Docket No. R-00049255, at 59 (Order entered December 22, 2004). The DCF model assumes that the market price of a stock is the present value of the future benefits of holding the stock. These benefits are the future cash flows of holding the stock, *i.e.*, the dividends paid and the proceeds from the ultimate sale of the stock. Because dollars received in the future are worth less than dollars received today, the cash flow must be "discounted" back to the present value at the investor's rate of return.

2012 PPL Order at 69-70.

More recently, the Commission affirmed reliance primarily on the DCF and rejected giving equal weight to the other methodologies. In *City of Dubois – Bureau of Water*, the Commission stated:

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

Pa. Pub. Util. Comm'n v. City of DuBois -- Bureau of Water, Docket No. R-2016-2554150, pp. 96-96 (Order entered March 28, 2017).

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

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

Pa. Pub. Util. Comm'n v. UGI Utilities, Inc. – Electric Division, Docket No. R-2017-2640058 at 103-06 (Order entered October 25, 2018).

We agree with I&E and OCA in the use of the DCF and CAPM models as the preferred methods to determine an appropriate cost of common equity and see no reason to deviate from these preferred methods in this proceeding.

1. Barometer Groups

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

Mr. D'Ascendis initially proposed an electrical proxy group of 19 companies. The criteria for his proxy companies were:

1. They were included in the Electric Utility Eastern. Western, or Central of Value Line's Standard Edition (February 15.2019; January 25. 2019; March 15,2019);

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

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

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

5. They have Value Line and Bloomberg Professional Services ("Bloomberg") adjusted betas;

6. They have positive Value Line five-year dividends per share ("DPS") growth rate projections; and

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

Wellsboro Stmt. No. 2 at 12.

Mr. Spadaccio applied the following criteria to Value Line's East, Central, and West Electric Utility groups:

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

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

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

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

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

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

I&E Stmt. No. 2 at 10-11.

OCA witness 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, Mr. D'Ascendis eliminated both of these companies from his proxy group in his rebuttal testimony. *See* Wellsboro Joint Stmt. No. 2-R at4; Wellsboro Reply Brief at 22.

I&E's selection criteria differed from Mr. D'Ascendis' in two material respects. The first is that I&E's proxy group includes only companies operating in states with deregulated electric utility markets. I&E Stmt. 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.[3] 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 regulated distribution utility operations.

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[3] 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* Wellsboro Joint Stmt. 2-R at 4.

Proxy Groups of the Parties

Citizens	OCA	BIE
ALLETE, Inc.	ALLETE, Inc.	Ameren Corp
Alliant Energy Corporation	Alliant Energy Corporation	American Electric Power Co., Inc
American Electric Power Co., Inc.	Ameren Corporation	CMS Energy Corp
Avista Corporation	American Electric Power Co., Inc.	Consolidated Edison Inc
Duke Energy Corporation	Avista Corporation	Duke Energy Corp New
Edison International	Dominion Energy, Inc.	Entergy Corp
Eversource Energy	Duke Energy Corporation	Eversource Energy
Entergy Corporation	Edison International	FirstEnergy Corp
FirstEnergy Corporation	Eversource Energy	IDACORP Inc
IDACORP, Inc.	IDACORP, Inc.	NorthWestern Corporation
NorthWestern Corporation	NorthWestern Corporation	PNM Resources Inc
OGE Energy Corporation	OGE Energy Corporation	Portland General Electric Company
Otter Tail Corporation	Otter Tail Corporation	PPL Corporation
Pinnacle West Capital Corporation	Pinnacle West Capital Corporation	Xcel Energy Inc
PNM Resources, Inc.	PNM Resources, Inc.	
Portland General Electric Co.	Portland General Electric Co.	
Xcel Energy, Inc.	Xcel Energy, Inc.	

Ultimately, Mr. D'Ascendis' proxy group, as amended, removes two companies that OCA and I&E both opposed. Mr. D'Ascendis also states that the utility proxy group was updated by re-running the criteria described in his direct testimony with updated data. (Wellsboro Stmt. No. 2-R at 3). As previously referenced, the main difference between Wellsboro and I&E's proxy group comes down to D'Ascendis' requirement that 70% of revenue and assets are derived from regulated electric operation, versus Spadaccio's claim that more than 50% of revenue must come from regulated electrical activities and the company must operate in a deregulated state. Mr. Spaddacio states that the sixth criterion ensures that each company in the proxy group operates in a similar deregulated market. (I&E Stmt. No. 2 at 14). There is minimal discussion regarding proxy group criteria; however, Mr. D'Ascendis' standard appears to be slightly more stringent than Mr. Spadaccio's. We will accept Mr. D'Ascendis' proxy group.

2. Discounted Cash Flow (DCF)

Wellsboro witness D'Ascendis used four methods to determine the cost of equity: Discounted Cash Flow (DCF), Risk Premium (RP), Capital Asset Pricing Model (CAPM), and Comparable Earnings (CE). As discussed above, the Commission has traditionally utilized the DCF method, with use of the CAPM method as a check. Accordingly, we will focus on those methods here.

I&E witness Spaddacio explains the constant growth discounted cash flow model in his testimony as follows:

> The DCF is appealing to investors since it is based upon the concept that the receipt of dividends in addition to expected appreciation is the total return requirement determined by the market. The use of a growth rate and expected dividend yield are also strengths of the DCF, as this recognizes the time value of money and is forward-looking. Using the utilities' own, or in this case, the proxy group's stock prices and growth rates directly in the calculation also causes the DCF to be industry and company specific. The DCF method is the superior method for determining the rate of return for the current economic market because it measures the cost of equity directly. I&E Stmt. No. 2 at 20.
>
> My analysis employs the constant growth DCF model as portrayed in the following formula:
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> $K = D_1/P_0 + g$
>
> Where:
>
> K = Cost of equity
>
> D_1 = Dividend expected during the year
>
> P_0 = Current price of the stock
>
> g = Expected growth rate

I&E Stmt. No. 2 at 20.

The following table summarizes the parties' findings based on the DCF methodology and the parties' subsequent ROE recommendations:

Party	DCF Results	Recommended ROE
Wellsboro	8.27%	10.30 %[4]
OCA	8.16-8.51%	8.38%[5]
BIE	8.10%	8.10%

We note that the OCA's recommended 8.38% ROE is based upon the median of two types of DCF calculations: a constant growth DCF and the FERC 2-Step DCF. As discussed herein, we will utilize the constant growth DCF model, which all three parties have utilized.

As explained in Wellsboro Main Brief:

> Mr. D'Ascendis uses a single-state constant growth DCF model. The DCF model relies on the theory that the "present value of an expected future stream on net cash flows during the investment holding period can be determined by discounting those cash flows at the cost of capital, or the investors' capitalization rate." Joint Statement No. 2 at 16. The capitalization rate is the anticipated common equity return rate and consists of the dividend yield on market price plus a growth rate. *Id.* at 16-17. The calculation of Mr. D'Ascendis' dividend yield and growth rate are detailed below.
>
> i. <u>Dividend Yield</u>
>
> To derive the dividend yield for his DCF model, Mr. D'Ascendis calculated each proxy company's dividends as of September 30, 2019, and divided by the average closing market price for the 60 trading days ending September 30, 2019. *See* Statement No. 2 at 17; *see also* Statement No. 2-R, Exhibit __ (DWD-1R), Schedule 1R at 3, fn. 1 (showing updated dividend yield reflecting data available as of September 30, 2019). Mr. D'Ascendis applied a conservative adjustment to reflect prospective increases to the dividend yield, in accordance with the Gordon Periodic version of the DCF model. Mr. D'Ascendis describes the necessary adjustment in his direct testimony as follows:
>
> > Because the companies in the Electric and Gas Utility Proxy Groups increase their quarterly dividends at various times

[4] Wellsboro witness D'Ascendis averaged multiple ROE methods to determine a 9.05% cost of equity plus an additional 1.25% to reflect and size adjustment and management efficiency.

[5] OCA's recommended ROE is the median value of all cost rates of the constant growth DCF and the FERC-two-step, an alternative model.

during the year, a reasonable assumption is to reflect one-half the annual dividend growth rate in the dividend yield component, or $D_{1/2}$.. Because the dividend should be representative of the next twelve-month period, this achievement is a conservative approach that does not overstate the dividend yield.

Wellsboro Joint Stmt. 2, p. 18. Both the unadjusted dividend yields and the adjusted dividend yields are reflected in columns 1 and 6, respectively, of page 3 to Mr. D'Ascendis' Exhibit __ (DWD-1R), Schedule DWD-1R.

ii. Growth Rate

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

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

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

Wellsboro Main Brief at 60-61.

Mr. D'Ascendis DCF results utilized the average of the mean and median of his results. The following table summarizes Wellsboro DCF results by Company:

Wellsboro			
Company	Adj Div Yield	Average Growth Rate	DCF
ALLETE, Inc.	2.82	6.40	9.22
Alliant Energy Corporation	2.84	5.68	8.52
American Electric Power Co., Inc.	3.03	5.27	8.30
Avista Corporation	3.39	3.40	6.79
Duke Energy Corporation	4.25	4.99	9.24
Edison International	3.47	4.60	8.07
Eversource Energy	3.38	3.75	7.13
Entergy Corporation	2.77	5.58	8.35
FirstEnergy Corporation	3.47	7.00	10.47
IDACORP, Inc.	2.55	3.23	5.78
NorthWestern Corporation	3.24	2.95	6.19
OGE Energy Corporation	3.67	4.80	8.47
Otter Tail Corporation	2.77	7.00	9.77
Pinnacle West Capital Corporation	3.22	5.55	8.77
PNM Resources, Inc.	2.37	6.23	8.60
Portland General Electric Co.	2.82	4.70	7.52
Xcel Energy, Inc.	2.66	5.40	8.06
Mean (1)	8.19		
Median (2)	8.35		
Avg. (1+2)	8.27		

OCA states in its Main Brief:

> [T]he DCF equation calls for a company's growth rate and annual dividend yield to produce its result. Wellsboro is not a publically traded company with a dividend yield and therefore, lacks the necessary data to run a unique DCF analysis. Because the DCF cannot be applied directly to Wellsboro, OCA witness Dr. Habr instead conducted multiple DCF analyses for each company within his electric proxy group. <u>See</u> OCA St. 3 at 21-22. Specifically, Dr. Habr calculated 3 constant growth DCFs for each of the 17 companies in his proxy group. OCA St. 3 at 21-22. Dr. Habr calculated 3 separate constant growth DCFs for each company because he used three separate growth rates, one DCF calculation for each source,

> Yahoo!, Value Line, and Zack's. OCA St. 3 at 21. Calculating a DCF for each company in the proxy group provided for more accurate results as Dr. Habr was able to utilize each company's actual dividend yield and growth rate in his calculation. OCA St. 3 at 21.

OCA Main Brief at 46-47.

Dr. Habr utilized multiple DCF models. The following chart summarizes OCA's DCF result by company using a constant growth DCF model only:

OCA			
Company	Yahoo! Growth Rates	Zacks Growth Rates	*Value Line* Growth Rates
ALLETE, Inc.	8.90%	9.91%	8.90%
Alliant Energy Corporation	7.62%	8.51%	9.52%
Ameren Corporation	7.52%	9.14%	9.14%
American Electric Power	9.28%	8.87%	7.15%
Avista Corporation	7.05%	6.95%	7.15%
Dominion Energy, Inc.	9.55%	9.73%	11.48%
Duke Energy	9.00%	9.20%	10.33%
Edison International	7.64%	9.37%	
Eversource Energy	8.60%	8.57%	8.47%
IDACORP, Inc.	4.90%	6.32%	6.02%
NorthWestern Corporation	6.53%	5.88%	6.29%
OGE Energy Corp.	6.58%	7.90%	10.04%
Otter Tail Corporation	11.86%	9.84%	7.81%
Pinnacle West Capital Corp.	8.25%	9.31%	8.70%
PNM Resources, Inc.	8.66%	7.97%	9.49%
Portland General Electric Co.	7.72%	7.72%	7.42%
Xcel Energy, Inc.	8.65%	7.74%	8.35%
Mean (1)	**8.35%**		
Median (2)	**8.54%**		
Avg. (1+2)	**8.45%**		

As explained in I&E's Main Brief:

> I&E witness Spadaccio recommends a cost of common equity of 8.10%. This recommendation includes a dividend yield of 3.41% and a recommended growth rate of 4.69%.[6] I&E witness Spadaccio's analysis uses a spot dividend yield, a 52-week dividend yield, and earnings growth forecasts. I&E witness Spadaccio employs the standard DCF model formula, $K = D_1/P_0 + g$, where K = the cost of equity, D_1 = the dividend expected during the year; P_0 = the current price of the stock; and g = the expected growth rate. When a forecast of D_1 is not available, D_0 (the current dividend) must be adjusted by ½ the expected growth rate in order to account for changes in the dividend paid in period 1.[7]
>
> a) Dividend yields
>
> A representative yield must be calculated over a time frame sufficient to avoid short-term anomalies and stale data. I&E witness Spadaccio's dividend yield calculation places equal emphasis on the most recent spot (3.24%) and 52-week average (3.57%) dividend yields resulting in an average dividend yield of 3.41%.[8]
>
> b) Growth rates
>
> I&E witness Spadaccio used earnings growth forecasts to calculate his expected growth rate. His earnings forecasts are developed from projected growth rates using 5-year estimates from established forecasting entities for his proxy group of companies, yielding an average 5-year growth forecast of 4.69%.[9]

I&E Main Brief at 33-34.

Mr. Spadaccio recommended an 8.10% ROE calculated from a constant growth DCF model. The recommendation was calculated by adding the average dividend yield of 3.41% and an average growth rate of 4.69%. The following chart summarizes I&E's DCF result by company as well as a mean, median, and average of the two:

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6 I&E Stmt. No. 2 at 27.
7 I&E Stmt. No. 2 at 25.
8 I&E Stmt. No. 2 at 26.
9 I&E Stmt. No. 2 at 26-27.

BIE			
Company	Average Dividend	Average Adjusted Growth	DCF
Ameren Corp	2.82	5.80	8.62
American Electric Power Co., Inc	3.39	5.45	8.84
CMS Energy Corp	2.84	6.89	9.73
Consolidated Edison Inc	3.62	3.81	7.43
Duke Energy Corp New	4.38	5.18	9.56
Entergy Corp	3.69	3.75	7.44
Eversource Energy	3.06	5.81	8.87
FirstEnergy Corp	3.78	5.40	9.18
IDACORP Inc	2.63	3.68	6.31
NorthWestern Corporation	3.52	2.95	6.47
PNM Resources Inc	2.05	5.97	8.02
Portland General Electric Company	3.00	4.38	7.38
PPL Corporation	3.13	1.05	4.18
Xcel Energy Inc	5.78	5.50	11.28
Mean(1)	**8.09**		
Median(2)	**8.32**		
Avg.(1+2)	**8.21**		

We note that the parties' average of the mean and median for each party's constant growth DCF model produces fairly similar results. We choose to average the mean and median for comparison's sake as two of the parties utilized this method for their DCF recommendation. Each party's Mean and Median DCF result was within 20 basis points of each other, so both methodologies produced fairly similar results. Additionally, the lowest average for I&E was within 24 basis points of the highest average of the OCA. As all parties' DCF results were fairly similar and thus appear reasonable, we have selected Wellsboro's DCF model on the slight strength of the proxy group.

3. <u>Capital Asset Pricing Model (CAPM)</u>

The traditional CAPM "is applied by adding a risk-free rate of return to a market risk premium, which is adjusted proportionately to reflect the systemic risk of the individual security relative to the total market as measured by the beta coefficient." Wellsboro Main Brief at 63. The traditional CAPM is portrayed in the following formula:

$$K = R_f + \beta(R_m - R_f)$$

Where:

K	=	Cost of equity
R_f	=	Risk-free rate of return
R_m	=	Expected rate of return on the overall stock market
β	=	Beta measures the systematic risk of an asset

The three witnesses utilized the CAPM with various inputs and even some variation of the model. The validity or accuracy of the CAPM is not determined here. As noted above, the Commission has traditionally utilized the CAPM model as a check on DCF results. Accordingly, we will not determine the reasonableness of CAPM results. Instead, we will merely use the results to determine the reasonableness of each parties' DCF calculation.

I&E witness Spadaccio gave no specific weight to his CAPM results because of his concerns that, unlike the DCF, which measures the cost of equity directly by measuring the discounted present value of future cash flows, the CAPM measures the cost of equity indirectly and can be manipulated by the time period used.[10] However, I&E submits that for purposes of providing another point of comparison, the 7.59% CAPM analysis confirms the reasonableness of I&E witness Spadaccio's 8.10% return under his DCF calculation.[11] I&E Main Brief at 35)

OCA witness Habr calculates his CAPM analysis by using a time frame that includes the time frame he used in his DCF analysis. OCA Stmt. No. 3 at 16. Dr. Habr calculates bond betas for the electric Proxy Group companies based on the New York Stock Exchange Index using weekly holding period returns for the period September 1, 2014 through August 31, 2019. *Id.* The calculated betas were then adjusted using *Value Lines* adjusted formula. OCA

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10 I&E Stmt. No. 2 at 32. I&E witness Spadaccio's presentation of a CAPM analysis serves as a check on his DCF analysis. For the reasons set forth in I&E witness Spadaccio's direct testimony, the DCF model should be used as the primary method in determining a fair return on equity.

11 In rebuttal testimony, Wellsboro witness D'Ascendis provided analysis disputing various data sources relied upon by I&E witness Spadaccio in his CAPM analysis. Wellsboro Statement No. 2-R at 26-27. As I&E Witness Spadaccio explains, even if Wellsboro witness D'Ascendis' recommended return on the overall market rate was accepted by I&E, the CAPM result would only adjust from 7.59% to 8.09%, validating I&E's DCF result of 8.10%. I&E Stmt. No. 2-SR at 16.

Stmt. No. 3 at 16; OCA Main Brief at 51-52. The OCA submits that Dr. Habr's CAPM/Risk Premium median 8.76% and 8.92% confirms the validity of his DCF results because they provide upper limits not to be exceeded. OCA Main Brief at 53.

Mr. D'Ascendis also conducts a CAPM ROE analysis. The traditional CAPM "is applied by adding a risk-free rate of return to a market risk premium, which is adjusted proportionately to reflect the systemic risk of the individual security relative to the total market as measured by the beta coefficient." Wellsboro Main Brief at 63.

For the CAPM risk-free rate, Mr. D'Ascendis used the yield on 30-year U.S. Treasury bonds as set forth on page 42 of Exhibit __ (DWD-1R). Joint Statement No 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 42, fn. 2. As explained in his direct testimony, Mr. D'Ascendis selected the 30-year U.S. Treasury bond yields for the risk-free rate because "[t]he yield on long-term U.S. Treasury bonds is almost risk-free and its term is consistent with the long-term cost of capital to public utilities measured by the yield's on Moody's A-rate public utility bonds; the long-term investment horizon inherent in utilities' common stocks; and the long-term life of the jurisdictional rate base to which the allowed fair rate of return (i.e., cost of capital) will be applied." Joint Stmt. No. 2 at 33-34. Mr. D'Ascendis' rebuttal testimony presents the results of the analysis supporting the risk-free rate of 2.64%.[12] Wellsboro Main Brief at 63-64.

To develop the CAPM market risk premium, Mr. D'Ascendis calculated "an average of three historical data-based market risk premiums, two Value Line data-based market risk premiums, and one Bloomberg data-based market risk premium." Wellsboro Joint Stmt. No. 2 at 34; Wellsboro Main Brief at 63. A detailed description of each of the six data-based market risk premiums is presented in Mr. D'Ascendis' direct testimony. Joint Stmt. No. 2 at 34; *see also,* Wellsboro Joint Stmt. No. 2-R, Ex. __ (DWD-1R), Sch. DWD-1R at 42. Mr. D'Ascendis'

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

Exhibit __ (DWD-1R) shows the derivation of his 10.05% market risk premium based on the updated average of the aforementioned six data-based market risk premiums. As reflected on page 41 of Mr. D'Ascendis' Exhibit __ (DWD-1R), applying the above-referenced risk-free rate and market risk premium to the traditional CAPM and the ECAPM for the Electric Utility Proxy Group results in a CAPM equity cost rate of 8.27% and an ECAPM equity cost rate of 9.38%. Wellsboro Joint Stmt. No. 2-R, Ex. __ (DWD-1R), Sch. DWD-1R at 41. Mr. D'Ascendis then averages these outputs to arrive at a CAPM/ECAPM equity cost rate of 8.82%. Wellsboro Main Brief at 64. We note the standalone CAPM ROE and DCF ROE were both 8.27%, thus making Mr. D'Acendis' DCF analysis appears reasonable.

4. Size Adjustment

Wellsboro has proposed a 100-basis point size adjustment to account for the additional risks associated with smaller public utilities. The size risk has been recognized in financial literature and further demonstrated by empirical analysis conducted by Company witness Mr. D'Ascendis. Wellsboro argues that Mr. D'Ascendis demonstrated that a 470-basis point adjustment could be justified for the company, but he recommends a more modest 100 basis point adjustment. Joint Stmt. No. 2 at 45.

Wellsboro position is explained in its Main Brief as follows:

> The reality that investors demand greater returns to account for size risk is further evidenced through review of the relevant financial literature. In his direct testimony, Mr. D'Ascendis references a Duff & Phelps 2019 Valuation Handbook Guide to Cost of Capital - Market Results through 2018 ("D&P - 2019"), which discusses the nature of the small-size phenomenon in detail as follows:
>
> > The size effect is based on the empirical observation that companies of smaller size are associated with greater risk and, therefore, have greater cost of capital [sic]. The "size" of a company is one of the most important risk elements to consider when developing cost of equity capital estimates for use in valuing a business simply because size has been shown to be a *predictor* of equity returns. In other words, there is a significant (negative) relationship between size and historical equity returns - as size

> *decreases*, returns tend to *increase*, and vice versa. (emphasis in original)

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

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

Joint Statement No. 2 at 42. Finally, Mr. D'Ascendis references noted scholar Eugene Brigham's research identifying the "small-firm effect" as a hindrance to small firm operations:

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

Joint Statement No. 2 at 43. Mr. D'Ascendis' review of financial literature establishes the inverse relationship between Company size and risk. The question relevant to whether a size adjustment is necessary to appropriately reflect Wellsboro risk factors turns to whether Wellsboro is considerably smaller than the companies in the Electric Utility Proxy Group.

To determine whether a size adjustment should be incorporated, Mr. D'Ascendis conducted a market capitalization analysis to quantify the relative size risk. Joint Statement No. 2 at 44. Mr. D'Ascendis' study observed that, as of March 29, 2019, Wellsboro had a market capitalization of $6.358 million compared with an average company market capitalization of $16,675.447 million for the Electric Utility Proxy Group. *Id* at 45. This amounts to a size difference of 2,662.8x.[13] *Id.*

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

In order to quantify the appropriate size adjustment, Mr. D'Ascendis relied on "size premiums for portfolios of New York Stock Exchange, American Stock Exchange, and NASDAQ listed companies ranked by deciles for the 1926 to 2018 period." Joint Statement No. 2 at 45. The Electric Utility Proxy Group $16.7 billion market capitalization ranked in the 2nd decile, while Wellsboro $6.358 million market capitalization ranked in the 10th decile, resulting in a size premium spread of 4.70%. Joint Statement No.2 at 45. Following review of the proxy groups compiled by I&E and OCA, Mr. D'Ascendis refined this market capitalization analysis to include the average market capitalizations of the I&E and OCA proxy groups and finds similar results. *See* Joint Statement No. 2-R at 32; *see also Id.,* Exhibit No.__ (DWD-1R), Schedule DWD-5R. Accordingly, although his analysis supports a 470 basis point adjustment, Mr. D'Ascendis recommends a conservative size adjustment of 1.00% or 100 basis points to the Company's ROE. Joint Statement No. 2 at 45.

Wellsboro Main Brief at 89-91.

OCA's position is explained in its Reply Brief as follows:

OCA witness Dr. Habr testifes that an additional 100-basis point adjustment to ROE would be unduly burdensome for ratepayers. OCA St. 3 at 29-30. After review of all Company testimony as it related to the size adjustment, Dr. Habr found that the economic literature would, in fact, support a downward adjustment if any. As Dr. Habr explained:

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

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

	Market Capitalization ($Mil)			
Decile	Low	High	Size Premium	OLS Beta
1	$24,361.659	$609,163.498	-0.35%	0.92
2	$10,784.101	$24,233.747	0.61%	1.04
3	$5,683.991	$10,711.194	0.89%	1.11
4	$3,520.556	$5,676.716	0.98%	1.13
5	$2,392.689	$3,512.913	1.51%	1.17
6	$1,571.193	$2,390.899	1.66%	1.17
7	$1,033.341	$1,569.984	1.72%	1.25

8	$569.279	$1,030.426	2.08%	1.30
9	$263.715	$567.843	2.68%	1.34
10	$2.516	$262.891	5.59%	1.39

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

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

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

OCA St. 3 at 29-30. (Footnote omitted). Accordingly, the OCA submits that the evidence of record, taken as a whole, does not support the Company's request for a 100-basis point ROE adder.

OCA Reply Brief at 31-32.

OCA also explained its position in its Main Brief by pointing to the testimony of Dr. Habr.

Dr. Habr further commented on the proposed size adjustment as follows:

Yes. Utility customers should not be required to pay higher costs associated with inefficient utility operations. If a utility company chooses to operate at such a small scale that its cost of common equity is truly increased, there is no reason for the utility's captive customers to pay any increased costs resulting from the utility's inefficient size.

OCA Main Brief at 59.

Wellsboro further disputes OCA's position as follows:

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

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

Wellsboro Main Brief at 93-94.

I&E explains its opposition to Wellsboro claims in its Main Brief as follows:

I&E witness Spadaccio rebutted Wellsboro witness D'Ascendis's claims by citing the variance year-to-year of returns for large- and small-capitalization stocks listed on the NYSE, AMEX, and NASDAQ.[14] I&E witness Spadaccio also opines Wellsboro witness D'Ascendis's size adjustment is unnecessary because none of the technical literature he cites supporting investment adjustments related to the size of a company is specific to the utility industry; therefore, such an adjustment is not appropriate.

[14] I&E Statement No. 2-SR at 23-24 (citing Ibbotson *Stocks, Bonds, Bills & Inflation: 2015 Yearbook*, pp. 100, 109, 112 ("While the largest stocks actually declined in 2001, the smallest stocks rose more than 30%. A more extreme case occurred in the depression-recovery year of 1933, when the difference between the first and 10th decile returns was far more substantial. The divergence in the performance of small- and large- cap stocks is evident. In 30 of the 89 years since 1926, the difference between the total returns of the largest stocks (decile 1) and the smallest stocks (decile 10) has been greater than 25 percentage points…. In four of the last 10 years, large-capitalization stocks (deciles 1-2 of NYSE/AMEX/NASDAQ) have outperformed small-capitalization stocks (deciles 9-10). This has led some market observers to speculate that there is no size premium. But statistical evidence suggests that periods of underperformance should be expected…. Because investors cannot predict when small-cap returns will be higher than large-cap returns, it has been argued that they do not expect higher rates of return for small stocks."))

Specific to the utility industry, I&E witness Spadaccio cites an article stating a size adjustment for risk is not applicable to utility companies.[15] In the article "Utility Stocks and the Size Effect: An Empirical Analysis," Dr. Annie Wong concludes:

> The objective of this study is to examine if the size effect exists in the utility industry. After controlling for equity values, there is some weak evidence that firm size is a missing factor from the CAPM for the industrial but not for utility stocks. This implies that although the size phenomenon has been strongly documented for the industrials, the findings suggest that there is no need to adjust for the firm size in utility rate regulation.[16]

I&E Main Brief at 50-51.

Wellsboro responds to I&E's arguments on pages 91-92 of its Main Brief:

> In opposing the Company's proposed size adjustment, I&E places exclusive weight on a single study by Dr. Annie Wong concluding that there is "no need to adjust for the firm size in utility rate regulation." *See* I&E Stmt. 2, p. 42. In response, Mr. D'Ascendis notes that Dr. Wong's study erroneously equates "a change in size to beta coefficients, which accounts for only a small percentage of diversifiable company-specific risk." Joint Statement No. 2-R at 33. By analyzing only the risk captured in beta, Dr. Wong understates the total impact of size risk. Joint Statement No. 2-R at 33.
>
> In addition to critiquing Dr. Wong's methods, Mr. D'Ascendis cited to a more recent article by Thomas M. Zepp which also criticized Dr. Wong's study and observed "[t]wo other studies discussed here support a conclusion that smaller water utility stocks are more risky than larger ones. To the extent that water utilities are representative of all utilities, there is support for smaller utilities being more risky than larger ones." Joint Statement No. 2-R at 34.

Wellsboro Main Brief at 91-92.

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15 I&E Statement No. 2 at 41-42.

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

I&E responds to Wellsboro's argument on pages 51-52 of its Main Brief:

> As explained by I&E witness Spadaccio, Dr. Zepp's article does not contain credible enough evidence to refute Dr. Wong's findings. First, it simply speculates on other possible reasons for her results and references the results of two other studies. The first study, completed by California Public Utilities Commission Staff in 1991, is not included in the article, and, therefore, Dr. Zepp's opinions cannot be properly evaluated. Dr. Zepp also draws his conclusions about an entire industry based on the second study, which examines the effects of size on only four water utility companies.[17] Additionally, Dr. Zepp admitted the limited relevance of the two studies, stating "*to the extent that water utilities are representative of all utilities*, there is support for smaller utilities being more risky than larger ones".[18]

I&E Main Brief at 51-52.

Wellsboro argues as follows:

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

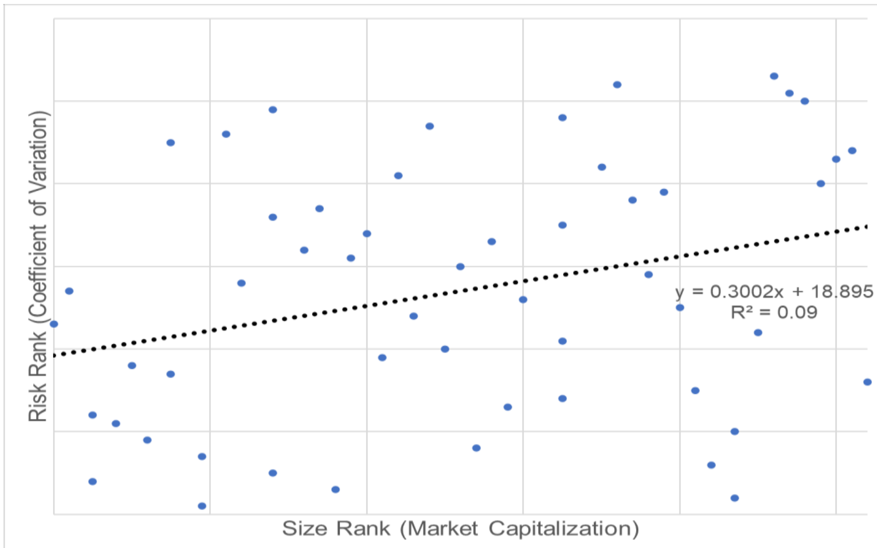
---

[17] I&E Statement No. 2-SR at 22.

[18] Wellsboro Statement No. 2-R at 33-34 (emphasis added, citing Zepp, Thomas M. "Utility Stocks and the Size Effect --- Revisited", *The Quarterly Review of Economics and Finance*, 43 (2003) at 578-582).

Main Brief Table 6

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



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

Wellsboro Main Brief at 92-93.

We are persuaded that there is a general inverse relationship between size and risk generally; however, we are asked to consider whether utilities may be immune to this risk. I&E presents a singular study that suggests size may not be a factor in determining rates for utility stocks. Mr. D'Ascendis points out that the Wong study only describes risk captured in beta and cites a study by Thomas Zepp that criticizes the Wong Study, as well as indicating size may be a risk factor for water utilities. Mr. Spadaccio refutes these claims by noting that Zepp's research is limited to only a few water companies and is unable to be properly evaluated. Similairly, the study Mr. D'Ascendis performed, which shows weak correlation, does not seem to be significant enough to prove that size is a risk for utilities. Thus, we are unable to conclude whether size is or is not a risk for utilities although, generally, size does seem to be a risk factor for companies. Ultimately, we must conclude that smaller companies face size risk and Wellsboro is a smaller company.

Wellsboro addresses this issue on pages 88-89 of its Main Brief:

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

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

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

> weather patterns. Finally, at times, the costs of complying with regulatory requirements can have greater impact on Wellsboro than it would larger EDCs.

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

Wellsboro Main Brief at 88-89.

We believe it is reasonable to conclude that a smaller company would be impacted to a greater degree by such factors as storms, the loss of a large customers, or events impacting the sale of electricity. Wellsboro is significantly smaller than the Proxy Group companies and it is reasonable to conclude that it would face proportionally greater financial and business risk than much larger utilities. While we decline to quantify a specific amount, we recommend that the Company's ROE be based upon the higher end of the DCF range. This ensures that we utilize a market-based result while acknowledging the risk of a smaller utility.

We recommend use of a one standard deviation range of 7.05% to 9.49% based on the average of Wellsboro mean and median constant growth DCF results. We note that the top of Wellsboro range falls below the top of the range for both I&E and OCA. Accordingly, we shall utilize a 9.49% to represent our DCF results. The charts below summarize the results of the DCF range.

Wellsboro			
STD	1.22	Range	
DCF Results		Upper	Lower
Mean (1)	8.19	9.41	6.97
Median (2)	8.35	9.57	7.13
Avg. (1+2)	8.27	**9.49**	**7.05**

OCA			
STD	1.39	Range	
DCF Results		Upper	Lower
Mean (1)	8.35	9.74	6.96
Median (2)	8.54	9.93	7.15
Avg. (1+2)	8.45	**9.84**	**7.05**

BIE			
STD	1.76	Range	
DCF Results		Upper	Lower
Mean (1)	8.09	9.85	6.34
Median (2)	8.32	10.08	6.56
Avg. (1+2)	8.21	**9.96**	**6.45**

5. Management Effectiveness Adjustment

Under the Public Utility Code, the Commission is required to consider management performance and effectiveness when setting rates: Section 523 states:

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

66 Pa. C.S. § 523(a).

In past decisions, the Commission has included upward adjustments to the cost of common equity to reflect solid management effectiveness. *See, e.g. 2012 PPL Order* at 98-99; *Pa. Pub. Util. Comm'n. v. Aqua PA., Inc.*, Docket No. R-00072711, 2008 Pa. PUC LEXIS 50 (Order dated July 17, 2008); *Pa. Pub. Util. Comm'n v. West Penn Power Co.*, Docket No. R-00942986, 1994 Pa. PUC LEXIS 144 (Order dated 12/29/1994). In order to be rewarded with a rate of return premium, the utility must provide specific evidence to support the adjustment. *Pa. Pub. Util. Comm'n v. Columbia Water Co.,* 2013 Pa. PUC Lexis 763, *82.

Wellsboro requests in this proceeding that it be given a 25-basis point addition to the cost of common equity due to its management effectiveness. Both I&E and OCA oppose the award of any allowance for management effectiveness.

Wellsboro summarized various initiatives and accomplishments in its Main brief as follows:

> In managing operations and costs, Wellsboro has gone beyond what it is required to do by improving the quality of public utility service for customers in multiple respects. As Company Chief Executive Officer John Kelchner described in his direct testimony, Wellsboro has accomplished the following: (1) low number of customer complaints; (2) favorable customer feedback; (3) high responsiveness to customer support calls and in energizing new service locations; (4) excellent reliability metrics; (5) no reportable injuries; (6) technological improvements in customer service by offering Smarthub use to customers and providing line crews with tablets; (7) increased pole attachment billing; (8) recognition as a "Tree Line USA" utility; (9) replacement of forty percent of all the streetlights in its service area with LED lights; and (10) continued significant capital investment of approximately $1.4 million per annum. Wellsboro Statement No. 4 at 9-12.
>
> In order to highlight the gravity of the accomplishments Wellsboro has made, a few of these achievements will be explained in more detail. With respect to Wellsboro low number of customer complaints, for the years of 2016 to 2018, Wellsboro received 13 informal complaints but no formal complaints. *Id.* at 9. Further, each informal complaint was either resolved within nineteen days or dismissed by the Commission. *See Id. at* Exhibit__(JK-1). Wellsboro high responsiveness in customer support calls is reflected in Exhibit__(JK-3) attached to Mr. Kelchner's direct testimony, which shows that, on average, Wellsboro responds to 97% of customer phone calls within thirty seconds. *See Id. at* Exhibit__(JK-3). The Company has also sustained excellent reliability metrics in 2018 by meeting, and in some cases, out-performing, all applicable Commission reliability objectives. *Id.* at 10. Through Wellsboro completion of an electronic attachment mapping and audit project the Company was able to realize a 9.2% increase in pole attachment billing from 2018 to 2019. *Id.* at 11. The revenues from pole attachment billing aided Wellsboro in offsetting the increased distribution system expenses and reducing the revenue requirement to be recovered from ratepayers. Further, Wellsboro has continued to invest approximately $1.4 million per annum in system replacements and improvements which ultimately help the Company to continue providing excellent and reliable service to its customers. *Id.* at 12. Notably, Wellsboro implemented these system improvements through

> effective management of base rate revenues, without employing a DSIC. *Id.*

Both OCA and I&E challenge Wellsboro request that it be given an upward performance adjustment for management effectiveness, generally on the basis that the company should not be rewarded for merely doing what it is required to do under the Public Utility Code. OCA witness Habr testified:

> I found descriptions of management doing the job they are expected to do. That is, they are taking actions any successful company has to take to efficiently maintain its operations and provide satisfactory customer service. Regulated utilities are expected to operate efficiently and should not be given a reward for doing what is expected.

OCA Stmt. No. 3 at 31.

I&E witness Spadaccio testified:

> Ultimately, for any company, true management effectiveness is earning a higher return through its efficient use of resources and cost cutting measures. The greater net income resulting from growth, cost savings, and true efficiency in management and operations is available to be passed on to shareholders. I do not believe that Wellsboro or Wellsboro should be granted additional basis points for doing what they are required to do in order to provide adequate, efficient, safe and reasonable service.

I&E Stmt. No. 2 at 43.

We agree with Wellsboro and recommend that its request for a 25-basis point upward adjustment for management effectiveness be granted. Section 523(a) merely requires that the Commission consider a utility's efficiency, effectiveness and adequacy of service in determining just and reasonable rates. This section does not state that any particularly remarkable or extraordinary level of efficiency, effectiveness or customer service is required in order for the Commission to award an adjustment for management effectiveness, and we do not so interpret this section here. We believe that the undisputed record evidence noted above demonstrates that, in fact, Wellsboro is operated in a very efficient and effective manner and provides very good customer service. There simply is no record evidence that suggests or proves otherwise. We also note here that, other than OCA, I&E and OSBA, no other parties or customers of the company intervened in or filed complaints against the company's rate increase request. Accordingly, there is no record evidence in this proceeding demonstrating that the company is operated in an inefficient or ineffective manner, or that it does not provide very good service to its customers. For these reasons, we recommend that Wellsboro request that it be given a 25-basis point upward adjustment for management effectiveness be approved.

E. Summary of Wellsboro Return on Common Equity

Wellsboro presented four methods for determining the cost of equity: Discounted Cash Flow (DCF), Risk Premium (RP), Capital Asset Pricing Model (CAPM), and Comparable Earnings (CE).

I&E recommended using the Discounted Cash Flow (DCF) method as the primary method to determine the cost of common equity. I&E Stmt. No. 2 at 16; I&E Stmt. No. 2-SR at 6. Further, I&E recommended using the results of the Capital Asset Pricing Model (CAPM) as a comparison to the DCF results. *Id.* Further, in the recent case of *Pa. Pub. Util. Comm'n v. City of DuBois-Bureau of Water*, Docket No. R-2016-2554150 (Opinion and Order entered March 28, 2017), the Commission reaffirmed its support for I&E's methodology of basing its recommended cost of common equity on a DCF method analysis with a CAPM analysis solely as a check. The Commission stated, "although there are various models used to estimate the cost of equity, the DCF method applied to a barometer group of similar utilities, has historically been the primary determinant utilized by the Commission." *Id. at* 88.

Accordingly, we did not utilize the Comparable Earnings Method or the Risk Premium Method. We utilized the DCF Method with the CAPM as a check.

For the DCF calculation, we find the top of Wellsboro's DCF range of 9.49% reflects Wellsboro's status as a company many magnitudes smaller than the companies in the proxy group.

Additionally, we would grant Wellsboro the additional 25% management effectiveness adjustment for a ROE of 9.74%. However, Wellsboro's Exhibit (HSG-1R) Schedule C1R only allowed for a 7.14% rate of return on rate base to limit the revenue increase to $999,999.00. As such, the associated return on equity would be 9.31%. Accordingly, we shall only grant Wellsboro the requested 9.31% return on equity.

F. Overall Rate of Return

The parties do not dispute a capital structure consisting of 49.33% debt, 50.05% common equity, and 0.62% preferred equity. Nor, do they disagree to a cost of debt of 4.98%. Although agreement could not be reached regarding the cost of equity, we have examined the testimony and determined a 9.31% cost rate of common equity is appropriate. Based on the evidence presented, the appropriate overall rate of return that will result in just and reasonable rates is 7.14%.

Description	**Capitalization Ratio**	**Embedded Cost**	**Return-%**
Long-Term Debt	49.33%	4.98%	2.46%
Common Equity	50.05%	9.31%	4.66%
Total	100.00%		7.14%

VI. TAXES

A. Excess Accumulated Deferred Income Taxes

On December 31, 2017, Federal Income Tax rates for corporations changed from 35% to 21% due to the passage of the Tax Cuts and Job Act of 2017 (TCJA). The reduction in the Federal Income Tax rate created excess deferred income taxes (EDIT). While the parties agree in general to a flowback of the EDIT to Wellsboro's customers, there is disagreement as to the appropriate commencement date of the flowback.

Wellsboro's Position

Wellsboro has argued that it is flowing back to customers the benefit of the tax reduction by amortizing the EDIT balance over the estimated remaining book life of the assets – ten years. Wellsboro Stmt. No. 1 at17. The EDIT balance included in rate base declines each year during this ten-year period. The annual EDIT accretion (Schedule C1-6 (W), line 40) is carried forward to reduce Income tax expense (Schedule C1-4 (W), line 28). Wellsboro Stmt. No. 1, Exhibit__(HSG-1), Schedules C1-4 (W), C1-6 (W). *Id.*

OCA did not oppose the flowback of the EDIT, generally, but disagreed that 2018 was the appropriate commencement date of the flowback, arguing that rates were not changed in 2018 to reflect the flowback of the EDIT. OCA Stmt. No. 2 at 10. Wellsboro's witness refuted OCA's argument stating "rates were changed in 2018 to reflect the Tax Cut and Jobs Act, which gave rise to the EDIT. This proposed adjustment should be rejected by the Commission." Wellsboro Stmt. No. 1-R. p. 13. Wellsboro, therefore, argues that the Commission should deny OCA's proposed adjustment and accept its EDIT claim for 2018.

OCA's Position

OCA argues that the balance presented by Wellsboro for the FPFTY assumes the flow back of EDIT began in 2018. OCA asserts that this assumption is incorrect. OCA's witness testified that "rates were not changed in 2018 to reflect the flowback of the EDIT. Instead, rates were changed to reflect the reduction of the current Federal Income Tax expense included in rates." OCA Stmt. No. 2 at 10. OCA recommends that since rates were not changed to reflect the flowback of the EDIT, there should be an adjustment to reverse the flowback of EDIT that is reflected in Wellsboro's filing. OCA Stmt. No. 2 at 10-11, Sch. LKM-6.

In response to Wellsboro's assertion that rates were changed in 2018 to reflect the TCJA, which gave rise to the EDIT, OCA argues that Wellsboro did not provide any documentation to support this claim. OCA Stmt. No. 2-SR at 8. OCA specifically denied that Appendix A, Attachment C, Page 2 of Wellsboro's filing identifies any flowback of the EDIT in the determination of the Company's rate reduction or otherwise demonstrate how the EDIT was returned to customers during that period. OCA Stmt. No. 2-SR at 10. Referring to Appendix A, OCA's witness testified that according to Wellsboro, in Docket No. R-2018-3000562, the Commission reduced Wellsboro's rates by -0.6637 % to reflect the decrease in the Federal income tax rate and that in Attachment C there is no recognition of the flowback of the EDIT in the determination of the -0.6637 % rate reduction. OCA Stmt. No. 2-SR at 8-9.

Since the rates do not appear to have been changed to flow back the EDIT, OCA recommended an adjustment on Schedule LKM-6 to reverse the flowback of EDIT reflected in the Company's filing. This adjustment increases the EDIT balance by $2267 and reduces rate base by the same amount. OCA Stmt. No. 2 at 10-11, Sch. LKM-6; *see*, OCA witness Sherwood's flow-through of Mr. Morgan's adjustment at OCA Stmt. No. 1 at 3, Sch. SLS-3; OCA Stmt. No. 1-SR(Revised) at Sch. SLS-1SR (Revised). App. A, Table II.

<u>I&E's Position</u>

I&E indicated that its various recommendations have a flow-through impact on Wellsboro's taxes for the FPFTY as depicted in Table I which was submitted with its Main Brief.

<u>OSBA's Position</u>

The OSBA indicated that it did not have a position on the tax issue.

<u>Disposition</u>

We agree with OCA regarding the flowback of the EDIT. Based on the testimony and evidence provided, it appears that rates were not changed in 2018 to reflect the flowback of the EDIT but rather to reflect the reduction of the current federal income tax expense included in the rates. OCA Stmt. No. 2 at 10. Looking at Docket No. R-2018-3000562, the Commission reduced Wellsboro's rates by -0.6637 % to reflect the decrease in the federal income tax rate and that in Appendix A, Attachment C, Page 2, there is no recognition of the flowback of the EDIT in the determination of the -0.6637 % rate reduction. OCA Stmt. No. 2-SR at 8-9.

Wellsboro has failed to provide any evidence that the 2018 rates have been changed to flow back the EDIT. Therefore, we recommend an adjustment on Schedule LKM-6 to reverse the flowback of the EDIT reflected in the Company's filing. This adjustment increases the EDIT balance by $2267 and reduces rate base by the same amount. OCA Stmt. No. 2 at 10-11, Sch. LKM-6; *see*, OCA witness Sherwood's flow-through of Mr. Morgan's adjustment at OCA Stmt. No. 1 at 3, Sch. SLS-3; OCA Stmt. No. 1-SR(Revised) at Sch. SLS-1SR (Revised). App. A, Table II.

B. Deferred Regulatory Liability

In Docket No. M-2108-2641242, the Commission ordered each utility to create a deferred regulatory liability account to record the tax savings associated with the TCJA for the January 1, 2018 through June 30, 2018 time period. *Tax Cuts and Jobs Act of 2017*, Docket No. M-2018-261242 (Order entered May 17, 2018). After communication with Commission staff and approval by the Commission, Wellsboro implemented a voluntary surcharge (TCJA Voluntary Surcharge) that served as a sur-credit to flow back benefits to customers. Joint Stmt. No. 4 at 13. Wellsboro chose to decrease its distribution rates to reflect the sur-credit rather than implementing a surcharge line item on its bills. On November 8, 2018, the Commission approved a petition by Citizens' and Wellsboro to maintain the regular reconciliation process for the TCJA Voluntary Surcharge until the Companies submit rate cases. Joint Stmt. No. 4 at 13. Subsequently, Wellsboro submitted a reconciliation statement in May 2019, but proposed to keep the distribution rates at the current levels pending resolution of this rate case.

Upon filing rate cases, Wellsboro proposed to maintain the current distribution rates reflecting the TCJA Voluntary Surcharges during the pendency of this base rate case, after which a final reconciliation for the TCJA Voluntary Surcharge will be calculated. Wellsboro requested to provide a final reconciliation of the TCJA Voluntary Surcharges within 120 days after new rates take effect. Joint Stmt. No. 4 at 13. OCA does not agree with this proposal.

Wellsboro's Position

Wellsboro supports its proposal by arguing that it will not have the 2019 tax data to perform the reconciliation until March or April of 2020. Wellsboro will attempt to accelerate the filing of the final reconciliation of the TCJA Voluntary Surcharges; however, if it does not have accurate 2019 tax data, Wellsboro cautions that this may not be possible. Joint Stmt. No. 3-R – Rebuttal Testimony of Melissa Sullivan (Joint Statement No. 3-R) at 2. Therefore, based on the availability of final 2019 tax data, Wellsboro requests Commission approval to provide a final reconciliation of the TCJA Voluntary Surcharge within 120 days after new rates take effect.

OCA's Position

OCA argues that Wellsboro's proposal should not be adopted because it is not consistent with the Commission's Order at Docket No. R-20193000562, *Tax Cuts and Jobs Act – Wellsboro Electric Company*, Docket No. R-2018-3000562, Order at 6. (November 8, 2018).

The Commission's Order states:

> Based on the Companies' assertions that accurate tax calculations will not be available in time for January 1, 2019 TCJA implementation dates (and that both Citizens' and Wellsboro expect to file 1308(d) base rate cases in 2019), the Commission grants the Companies permission to reconcile their TCJA surcharges 60 days prior to July 1 and to adjust these surcharges on July 1. Specifically, the Companies need not implement TJCA surcharges on January 1, 2019, but may instead: 1) maintain the current rates in effect through July 1, 2019, 2) submit recalculations, including reconciliations 60 days prior to July 1, 2019, and 3) maintain the July 1st rate change and reconciliation process for subsequent years until the Companies submit rate cases.

Id.

OCA contends that a reasonable approach is for Wellsboro to provide the necessary reconciliation before the rates in this proceeding are determined so that any required over or under recovery can be reflected in these rates and tax savings collected from January 2018 through June 2018, including accumulated interest, can be returned to customers as soon as possible. OCA, therefore, contends that the Commission should require the information to be filed sooner, rather than 120 days after, the rates are determined in this proceeding. OCA Stmt. No. 2 at 11.

Disposition

We agree with Wellsboro regarding the filing of the final reconciliation of the TCJA Voluntary Surcharges. Wellsboro has credibly indicated that such a reconciliation is not possible until it has obtained its 2019 tax data – which will not be until March or April of 2020. Joint Statement No. 3-R at 2. Wellsboro requests to submit its final reconciliation within 120 days after the new rates in this proceeding take effect. Conversely, OCA requests that Wellsboro be required to file its reconciliation before the rates in this proceeding are determined so that any required over or under recovery can be reflected in these rates and tax savings can be returned to customers as soon as possible. OCA Stmt. No. 2 at 10. While OCA's proposal would be ideal, it does not appear reasonably logistically. Given the timeframe when the rates in this proceeding will presumably take effect, and Wellsboro's position that it will not have the necessary tax data until March or April to even begin completing its final reconciliation, Wellsboro's proposal is more reasonable given these constraints. We, therefore, recommend that Wellsboro's proposal be adopted and a final reconciliation of the TCJA Voluntary Surcharge be completed within 120 days after new rates take effect.

In addition, while OCA argues that Wellsboro's 120-day proposal is not consistent with the Commission's Order at Docket No. R-20193000562, OCA fails to specifically indicate the inconsistency and again simply relies on the argument that sooner is better than later. Without more, we recommend that Wellsboro's proposal to submit its final reconciliation of the TCJA Voluntary Surcharges within 120 days after the new rates in this proceeding take effect be adopted.

VIII. RATE STRUCTURE

Establishment of a rate structure is an administrative function peculiarly within the expertise of the Commission. *Emporium Water Company v. Pa. Pub. Util. Comm'n,* 955 A.2d 456, 461 (Pa. Cmwlth. 2008); *City of Lancaster v. Pa. Pub. Util. Comm'n*, 769 A.2d 567, 571-72 (Pa. Cmwlth. 2001). The question of reasonableness of rates and the difference between rates in their respective classes is an administrative question for the Commission to decide. *Pa. Power & Light Co. v. Pa. Pub. Util. Comm'n,* 516 A.2d 426 (Pa. Cmwlth. 1986); *Park Towne v. Pa. Pub. Util. Comm'n,* 43 A.2d 610 (Pa. Super. 1981). This is further refined by the Electric Competition Act, 66 Pa. C.S. § 2801 *et seq.,* and *Lloyd v. Pa. Pub. Util. Comm'n*, 904 A2d 1010 (Pa. Cmwlth. 2006) (*Lloyd*).

A. Allocated Class Cost of Service Study

When a utility files for a rate increase and the proposed increase exceeds one million dollars, the utility must include with its filing a cost-of-service study in which it assigns to each customer class a rate based upon operating costs that it incurred in providing that service. 52 Pa. Code § 53.53. The primary purpose of a class cost of service study is to assist in the design of a utility's rates by identifying all capital and operating costs incurred by the utility in the provision of service to its customers, then directly assigning, or allocating, these various costs to the individual rate classes based on principles of cost causation in order to calculate the rate of return provided by each class. The rate of return identified for each class is then compared to a system average rate of return to determine if each rate class is under-paying or over-paying its allocated cost of service. This information is then used to determine the manner in which the proposed rate increase should be allocated among the various rate classes. The allocation should be based on how the various rate classes caused the costs to be incurred.

In allocating a rate increase among various rate classes, the Commission may consider a number of factors, including such things as cost of service by rate class, the value of service, gradualism and conservation considerations. The Pennsylvania Commonwealth Court has concluded, however, that the concept of class cost of service is the "polestar" of utility ratemaking and is the primary consideration. In its 2006 decision, the Commonwealth Court, in considering a substantial difference in the rate of return by class of a utility's customers, and the concept of gradualism, concluded that the proposed rate of return difference should not stand.

The court stated:

> . . . while permitted, gradualism is but one of many factors to be considered and weighed by the Commission in determining rate designs, and principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time.

Lloyd, 904 A.2d at 1020.

Wellsboro's Position

Wellsboro argues that its allocated class cost of service study (ACCOSS) is reasonable and should be adopted by the Commission because its witness followed the traditional three-step process: (1) functionalization of rate base and costs; (2) classification of functionalized costs as demand-related, commodity-related, or customer-related; and (3) class allocation of the functionalized, classified costs among the rate classes. Wellsboro Stmt. No. 1 at 19. Wellsboro's ACCOSS includes the following functions: (1) primary distribution (including substations as well as conductors operating primarily at voltages of > 600V to 12kV and related assets); (2) secondary distribution (facilities designed to move power from primary distribution system to customers' premises; includes services); and (3) billing (includes meters as well as assets and activities related to enabling the distribution of electricity to customers and billing and collecting revenue). *Id.* at 21.

Wellsboro's witness Gorman classified assets and costs into three categories: (1) customer-related costs; (2) commodity-related costs; and (3) demand (or capacity) related costs. *Id.* at 21-22. Mr. Gorman then assigned or allocated assets and costs, as set forth on Exhibit__(HSG-1), Schedules D (W) through D6 (W) attached to his direct testimony. *Id.* In further support of its ACCOSS, Wellsboro pointed out that its ACCOSS was relied upon by I&E in evaluating its proposed revenue allocation and that OCA's witness Mierzwa did not oppose the ACCOSS generally but expressed concerns about the classification of secondary portions of distribution plant (accounts 364, 365, 366) and transformers (account 368). Wellsboro Stmt. No. 1-R at 7; *see also,* OCA Stmt. No. 4 at 4.

Wellsboro also argued that its classification of secondary distribution plant as part demand-related and part customer-related was appropriate and should be approved by the Commission. Wellsboro noted that while OCA witness Mierzwa found Wellsboro's primary plant classification as demand-related generally acceptable and accepted Wellsboro's classification of 100% of services and meters as customer-related, Mr. Mierzwa disagreed with the classification of a "significant portion of secondary distribution plant upstream of meters and services" as customer-related. OCA Stmt. No. 4 at 8.

In response, Wellsboro argued that fundamental utility accounting practices recognize that upstream distribution plant (e.g., transformers, conductors, poles, and towers) all contain customer costs and therefore the minimum system method is an appropriate means of making this classification. Wellsboro further pointed out that the Commission in *Pa. Pub. Util. Comm'n v. UGI Utilities, Inc. – Electric Division*, Docket No. R.2017-2640058 (Order Entered October 25, 2018)(*UGI Order*) found that the minimum system method is "consistent with the NARUC Manual and more accurately reflects cost-causation principles than the ACCOSS methodology proposed by the OCA." *UGI Order* at 160. In short, Wellsboro argues that absent the use of the minimum system, the distribution costs are incorrectly allocated to each class.

<u>OSBA's Position</u>

OSBA did not contest Wellsboro's cost-of-service study methodology.

OCA's Position

OCA argued that Wellsboro's proposed ACCOSS that classifies a significant portion of secondary upstream distribution plant as customer-related is inappropriate and secondary distribution plant should be classified as 100% demand-related as these costs are incurred to meet the coincident loads of the customers served by the Company. OCA argued that the ACCOSS presented by its witness which classifies secondary distribution plant as demand-related should be adopted because Wellsboro had used a minimum system approach to estimate a customer-related portion of line transformers and what its witness terms a "zero-load analysis" to estimate the customer-related portion of all other upstream secondary distribution plant (poles; towers, fixtures, overhead conductors and devices; underground conduit; and underground conductors and devices). OCA Stmt. No. 4 at 9. In determining the classification for secondary distribution plant as customer-related, however, OCA argued that Wellsboro's witness had failed to account for how the distribution system is engineered and how it is designed to work on a day-to-day basis. Even if one were to accept that a portion of secondary distribution plant should be classified as customer-related, OCA believes Wellsboro's methodologies are flawed and cannot be relied on for use in this proceeding.

To support this position, OCA specifically requested that the classification of poles, towers and fixtures (Account 364); overhead conductors and devices (Account 365); underground conduits and conductors (Account 366); and line transformers (Account 368) be changed to 100% demand-related. OCA Stmt. No. 4 at 16. The allocation of secondary demand-related line transformer costs was changed to Mr. Gorman's NCP-Sec allocator which is how the other secondary upstream distribution demand-related plant is allocated. OCA Stmt. No. 4 at 16. As OCA witness Mierzwa testified, "this change was necessary because Mr. Gorman's cost study accounted for the load-carrying capability of his transformer system, which I have eliminated." OCA Stmt. No. 4 at 16. OCA argued that its ACCOSS provides a better guide for the Commission because it will best reflect the factors that have caused this plant to be constructed — the need to meet local neighborhood peak demands and the need to deliver energy at usable voltages during all hours of the year. OCA Stmt. No. 4 at 14.

OCA submits that the Commission should adopt its ACCOSS for Wellsboro which classifies 100% of the upstream secondary distribution plant as demand-related. Mr. Mierzwa's revised ACCOSS adopts Mr. Gorman's classification of 100% of primary distribution plant as demand-related, 100% of services and meters as customer-related. *See*, OCA Stmt. No. 4 at Sch. JDM-3. OCA argued that the modification of the classification of secondary distribution plant as demand-related would best reflect the factors that have caused this plant to be constructed – the need to meet local neighborhood peak demands and the need to deliver energy at usable voltages during all hours of the year. See, OCA Stmt. No. 4 at 14.

Disposition

We find that Wellsboro's ACCOSS is reasonable and should be adopted by the Commission. As Wellsboro has pointed out, its ACCOSS was relied upon by I&E in evaluating its proposed revenue allocation and OCA's witness Mierzwa did not oppose the ACCOSS generally but expressed a few concerns classification of secondary portions of distribution plant (accounts 364, 365, 366) and transformers (account 368). Wellsboro Stmt. No. 1-R at 7; *see also,* OCA Stmt. No. 4 at 4. Therefore, on the whole, the ACCOSS has been generally accepted by each of the parties.

When viewed in connection with Wellsboro's proposed revenue allocation and rate design, we find that the ACCOSS correctly considers and adheres to the "polestar" consideration of utility ratemaking - class cost of service. We reject OCA's argument that Wellsboro' use of a minimum system approach to estimate a customer-related portion of line transformers and what Wellsboro terms a "zero-load analysis" to estimate the customer-related portion of all other upstream secondary distribution plant (poles; towers, fixtures, overhead conductors and devices; underground conduit; and underground conductors and devices) is inappropriate. Wellsboro is correct that in the *UGI Order*, the Commission found that the minimum system method is "consistent with the NARUC Manual and more accurately reflects cost-causation principles than the ACCOSS methodology proposed by the OCA." *UGI Order* at 160.

In addition, we reject OCA's argument that Wellsboro has incorrectly classified a portion of secondary upstream distribution plant as customer-related. Once again, in the *UGI Order*, the Commission concluded that fundamental utility accounting practices recognize that upstream distribution plant all contain customer costs and that the NARUC Manual supports the use of the minimum system method to make this classification. The ACCOSS presented by Wellsboro adheres to the generally accepted methods of preparing a cost allocation study set forth in the NARUC manual. Likewise, classifying primary and secondary distribution costs as part demand and part customer costs, and allocating other costs based on the maximum non-coincident demand, known as the minimum system method, are methods accepted by and set out in the NARUC Manual as well.

As further noted by Wellsboro, the methods which it has utilized in this proceeding are similar or identical to those used in other proceedings and previously approved by the Commission. In both *Pa. Pub. Util. Comm'n., v. PPL Electric Utilities Corporation*, Docket Nos. R-2012-2290597 (Order entered December 28, 2012 (*2012 PPL Order*) and the *UGI Order*, the Commission approved in those proceedings the same methods used by Wellsboro in this proceeding. In addition, the arguments made by OCA in this proceeding against Wellsboro' methods are the same arguments made by OCA in these two previous proceedings. On each of those occasions, the Commission has rejected OCA's position. We do so again here. OCA has offered no convincing reasons for deviating from this accepted and approved approach in this proceeding.

We find no basis for rejecting Wellsboro's ACCOSS which has been shown to be reasonable, consistent with Commission precedent and in adherence to the methods set forth in the NARUC Manual. For these reasons, Wellsboro's ACCOSS should be accepted and approved by the Commission.

B. Revenue Allocation

The primary goal in revenue allocation is to have rates reflect the actual cost of service to the various customer classes. *Lloyd*. A proposed revenue allocation will only be found to be reasonable if it moves distribution rates for each class closer to the full cost of providing service. *Pa. Pub. Util. Comm'n v. PPL Electric Utilities Corp.*, Docket Nos. R-00049255, 2007 Pa. PUC LEXIS 55 (Order on Remand entered July 25, 2007) (*2007 PPL Order*). Factors such as gradualism, rate shock, rate continuity, competitive concerns, and principles of fundamental fairness must also weigh in the determination. *Lloyd* at 1020-1021. In *City of DuBois*, the Commission stated that "while *Lloyd* establishes cost of service rates as the polestar of ratemaking, it does not preclude consideration of other factors." *Pa. Pub. Util. Comm'n v. City of DuBois*, Docket No. R-2016-2554150, slip. op. at 26 (May 18, 2017).

<u>Wellsboro's Position</u>

In developing its proposed revenue allocation, Wellsboro cited the following objectives:

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

Wellsboro Stmt. No. 1 at 34. Wellsboro's proposed revenue allocation is set forth in Schedule B6-4 (W). Wellsboro maintains that a rate decrease for rate class POL is reasonable and appropriate to bring all classes closer to cost of service. It noted that in the *UGI Order*, OCA opposed a decrease to non-residential class GS-4, arguing that there should be no decrease for any class while rates are increasing. *UGI Order* at 163. However, the ALJs "determined that UGI's proposed revenue requirement allocation among the various rate classes achieves significant progress in moving rate classes toward the system average of relative rate of return." *UGI Order* at 164. The Commission adopted the ALJs' recommendation and approved UGI's revenue allocation, including the decrease for GS-4. Wellsboro Main Brief at 101.

Wellsboro's witness argued that its continued position that the ACCOSS should control revenue allocation, including if a decrease is warranted for a class:

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

Wellsboro Stmt. No. 1-SR – Surrebuttal Testimony of Howard S. Gorman (Wellsboro Stmt. No. 1-SR) at 2.

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

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

Wellsboro Stmt. No. 1-R at 15.

<u>OCA's Position</u>

Based on the results of the revised ACCOSS, OCA witness Mierzwa reviewed Wellsboro's proposed allocation of the revenue increase to the various customer classes and set forth the following principles of revenue allocation and rate design:

- Yield the total revenue requirement;
- Reflect fairness in the apportionment of the total cost of service among the various customer classes.
- Utilize class cost-of-service study results as a guide;
- Provide stability and predictability of the rates themselves, with a minimum of unexpected changes seriously adverse to ratepayers or the utility (gradualism); and

- Provide for simplicity, certainty, convenience of payment, understandability, public acceptability, and feasibility of application.

OCA Stmt. No. 4 at 17 (footnote omitted). OCA provided a comparison of Wellsboro's proposed revenue distribution to its own.

Table 3. Wellsboro Electric Company – Proposed Revenue Distribution

Class	Present Rates	Proposed Rates	Increase	Percent
RS	$2,619,792	$3,259,968	$640,176	24.4%
RSAE	25,825	33,053	7,228	28.0
NRS	390,322	456,990	66,668	17.1
NRH	1,395	1,795	400	28.7
CS	1,322,797	1,464,085	141,288	10.7
CSH	1,109	1,425	316	28.5
IS	656,296	815,087	158,791	24.2
MSL	20,906	21,151	245	1.2
POL	86,066	68,912	(17,154)	(19.9)
EU	7,813	9,822	2,009	25.7
Total:	**$5,132,321**	**$6,132,288**	**$999,967**	**19.5%**

Table 4. Wellsboro Electric Company – OCA Proposed Revenue Distribution				
Class	Present Rates	Proposed Rates	Increase	Percent
RS	$2,619,792	$3,249,171	$629,379	24.0%
RSAE	25,825	32,931	7,106	27.5
NRS	390,322	455,866	65,544	16.8
NRH	1,395	1,788	393	28.2
CS	1,322,797	1,461,702	138,905	10.5
CSH	1,109	1,420	311	28.0
IS	656,296	812,409	156,113	23.8
MSL	20,906	21,147	241	1.2
POL	86,066	86,066	0	0.0
EU	7,813	9,788	1,975	25.3
Total:	**$5,132,321**	**$6,132,288**	**$999,967**	**19.5%**

OCA agrees that it is appropriate to move each class closer to the properly determined cost of service, consistent with the principles of gradualism, avoiding rate shock, rate continuity, and principles of fundamental fairness as set forth by Mr. Mierzwa. OCA Stmt. No. 4 at 17. OCA noted that Wellsboro's proposal, however, would provide for a rate decrease of 19.9 % for the POL class and only a 1.2 % increase for the MSL rate class when other rate classes are experiencing significant increases. OCA Stmt. No. 4 at 18. OCA argues that such a rate decrease for Rate POL when others' rates are increasing is not appropriate and that the Commission has recognized this consideration regarding rate decreases for some classes at a time of significant increases for others. OCA points out that in PPL's 2012 base rate proceeding, the Commission rejected providing rate decreases in a general base rate proceeding, holding, "as a matter of fairness, those customer classes that have not been allotted any rate increase via the Company's original revenue allocation should not receive rate decreases as argued by the OSBA and PPLICA." *PPL 2012*. Under OCA's revenue allocation, the $17,175 decrease proposed for the POL rate class is eliminated and proportionately assigned to the remaining classes to mitigate the increases for those classes. OCA Stmt. No. 4 at 19; OCA Stmt. No. 4-R at 2.

OSBA's Position

OSBA argued that Wellsboro's proposed revenue allocation is based on a comparison of relative class rates of return at present and proposed rates, which does not always provide an accurate indication of the degree of movement toward cost of service. OSBA witness Kalcic performed a revenue subsidy analysis and testified that Wellsboro's proposal would move all classes closer to cost of service, with the exception of the Company's small non-residential heating classes (i.e., Rates NRH and CSH). OSBA Stmt. No. 1 at 7; Schedule BK-2(W). OSBA therefore largely supports Wellsboro's proposal, except for the proposed decrease to the POL class. *Id.*

In support of using class revenue subsidies (rather than relative class rates of return at present and proposed rates) to determine movement toward cost of service, OSBA witness Kalcic argued:

> By definition, if a class is not paying exactly its full cost of service, it is either: a) receiving a subsidy (i.e., paying too little); or b) providing a subsidy (i.e., paying too much). In order to determine whether or not a class is moving toward cost of service, one must ascertain whether the class's present revenue subsidy is growing or shrinking at proposed rates. If its present subsidy is growing, the class is moving in the wrong direction (i.e., away from cost of service). Conversely, if its present subsidy is shrinking, the class is moving closer to cost. In short, the proper yardstick for measuring the degree of movement toward cost of service is the change in the absolute level of class subsidies at present and proposed rates.
>
> Whatever the claims of relative rate of return proponents, the fact of the matter is that the relative rate of return results do not measure changes in class subsidies. Therefore, the relative rate of return guideline should not be relied upon to provide an accurate indication of the degree of movement toward cost of service.

OSBA Stmt. No. 1 at 5-6.

OSBA, therefore, recommended the following revenue allocation of Wellsboro's scaled back revenue request:

Schedule BK-3(W)

WELLSBORO ELECTRIC COMPANY

OSBA Recommended Allocation of WEC's
Requested Increase in Base Revenue
(FPFTY Ending December 31, 2020)

Line	Classification	Present Base Revenue	Recommended Increase Amount	Recommended Increase Percent
		1	2	3
1	Sch. 1 - RS	$2,619,792	$612,474	23.4%
2	Sch. 2 - RSAE	$25,825	$7,227	28.0%
3	Sch. 3 - NRS	$390,322	$66,686	17.1%
4	Sch. 3 - NRH	$1,395	$399	28.6%
5	Sch. 4 - CS	$1,322,797	$141,308	10.7%
6	Sch. 4 - CSH	$1,109	$316	28.5%
7	Sch. 5 - IS	$656,296	$169,292	25.8%
8	Sch. 6 - MSL	$20,906	$245	1.2%
9	Sch. 7 - POL	$86,066	$0	0.0%
10	Sch. 8 - EU	$7,813	$2,009	25.7%
11	Total Rate Revenue	$5,132,321	$999,956	19.5%
12	Other Revenue	$114,725	$0	0.0%
13	Total Company	$5,247,046	$999,956	19.1%

Source: Exh__(HSG-1)
Sch. B6-1 (W)

OSBA Stmt. No. 1; Schedule BK-3(W).

OSBA notes that under its revenue allocation, class increases reflect the same limit of 28.2% as under Wellsboro's proposed allocation but incorporates two adjustments to Wellsboro's proposal. There is no increase to Rate POL, which provides $17,175 of rate relief to other classes (compared to Wellsboro's proposal), and there is a reduction to the aggregate increase to Rates RS and IS by $17,175, while adjusting the individual RS and IS class increases so as to provide for the same percentage movement toward cost of service for each class (as measured by the percentage reduction in their respective present subsidies). All remaining class increases in Schedule BK-3(W) are unchanged from the levels shown in Wellsboro's proposal (see Schedule BK-1(W)). OSBA Stmt. No. 1 at 8.

OSBA noted that since it is not recommending any adjustments to the majority of Wellsboro's proposed class increases, all class subsidy levels are identical across the two proposals except for Rates RS, IS, and POL and with respect to Rate POL, OSBA's recommended revenue allocation provides for the maximum movement toward cost of service for POL customers, short of assigning a rate decrease to the class. OSBA argues that its proposal provides for uniform movement toward cost of service for Rates RS and IS and does not impose any extreme rate impacts on individual rate classes. OSBA Stmt. No. 1, at 9. OSBA witness Kalcic testified that OSBA's recommended allocation adopts the same limit on class increases (28.2%) as utilized in Wellsboro's proposal and that the proposed revenue allocations comply with the decision of the Commonwealth Court in *Lloyd*. *Id.*

I&E's Position

I&E witness Cline made two recommendations regarding revenue allocation. First, he recommended that the POL rate class be allocated no increase or decrease under proposed rates. Second, he recommended that the excess $17,175 in revenue reallocated from the POL rate class be allocated as follows: (1) the first $245 is allocated to the MSL class and (2) the remaining $16,930 be applied to the CS rate class. I&E Stmt. No. 3 at 26.

I&E indicated that its recommendations were based on analyzing how the rate of return for each class compares to the system average rate of return. It argued that in general, a relative rate of return that provides revenue equal to its cost to serve would have a relative rate of return equal to 1.0. I&E Stmt. No. 3 at 21; if a rate class has a relative rate of return of less than 1.0, that class is not generating sufficient revenue to recover the costs the utility spends to serve that class; and if a rate class has a relative rate of return of greater than 1.0, that class is generating revenue greater than its cost to serve. I&E Stmt. No. 3 at 23. I&E witness Cline presented the following analysis to indicate relative rate of return by class under Wellsboro's proposal:

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

I&E Stmt. No. 3 at 24.

I&E argued that Wellsboro's proposal would change subsidies between classes as follows:

Wellsboro Subsidy Given (Received)			
Customer Class	**Under Present Rates**	**Under Proposed Rates**	**Reduction in Subsidy**
RS	($174,438)	($112,351)	36%
RSAE	($6,217)	($6,634)	(7%)
NRS	($306)	$1	100%
NRH	($1,294)	($1,628)	(26%)
CS	$172,673	$129,325	25%
CSH	($1,477)	($1,903)	(29%)

IS	($21,924)	($22,976)	(5%)
MSL	$4,846	$3,278	32%
POL	$28,593	$13,078	54%
EX	($455)	($191)	58%
Total	**$0**	**$0**	

I&E Stmt. No. 3 at 25.

Under this analysis, I&E noted that the relative rate of return for the CS, MSL, and POL rate classes are greater than 1.0, and the Company proposes a revenue reduction to the POL class and rate increases for the MSL and CS classes such that the relative rate of returns are moved closer to 1.0. *Id.* at 24. While I&E witness Cline agreed with Wellsboro that rate classes MSL and CS should move closer to a relative rate of return of 1.0, he disagreed with the proposed decrease in revenue for the POL rate class. *Id.* at 26. Instead, I&E argues that POL should be allocated no increase or decrease, and the excess $17,175 in revenue should be allocated as follows: (1) the first $245 is allocated to the MSL class, which results in no increase in rates for that class, and (2) the remaining $16,930 ($17,175 - $245) be applied to the CS rate class, resulting in an overall CS class increase of $124,378 ($141,308 - $16,930). The resulting change in percent increase, relative rates of return, and subsidy received and given for the CS, MSL, and POL classes would then be shown as follows:

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

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

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

I&E Stmt. No. 3 at 26-27.

I&E witness Cline recommended the CS and MSL classes be credited the revenue from the POL class because they are the only two other rate classes whose relative rate of return were above 1.0 and argued that rather than decreasing the rates of the POL now - only to increase rates again in a future rate proceeding - I&E's proposal to not increase rates for the POL class offers additional rate stability for customers and allows costs to "catch up" to rates more gradually. *Id.* at 28. In addition, I&E witness Cline indicated that by not decreasing the rates of the POL class, the excess revenue can be credited to the MSL and CS classes and facilitate additional movement towards a relative rate of return of 1.0, as shown above. I&E argues that this is a more reasonable method for reducing the relative rate of return for the POL, CS, and MSL rate classes and does not negatively affect any of Wellsboro's other rate classes. I&E witness Cline acknowledged that while his recommendation did not move the POL class towards a relative rate of return of 1.0 as much as Wellsboro's proposal, the movement from 12.46 under present rates to 3.54 still represented a significant movement and it is for this reason and the benefit to the CS and MSL rate classes that I&E feels its recommendation is more reasonable than Wellsboro's proposed allocation.

In response to the position of the other parties, I&E noted that both OCA and OSBA agreed with I&E witness Cline's recommendation that rate class POL not be allocated a rate decrease and the OSBA agreed with the re-allocation recommendation. OCA disagreed with the allocation of the excess $17,175 revenue from the POL class; however, Wellsboro did not agree with either of I&E's recommendations and did not accept that no class should receive a decrease. OCA Stmt. No. 4-R at 2; OSBA Stmt. No. 1-R at 4-5; Wellsboro Stmt. No. 1-R at 8. I&E maintains that its recommendations are most reasonable because its proposal offers additional rate stability for customers; allows costs to "catch up" to rates more gradually, rather than decreasing rates now, just to likely increase them later; and moves classes MSL and CS closer to a relative rate of return of 1.0. I&E Stmt. No. 3-SR at 13. I&E also argues that witness Cline's recommendation provides relief to the only two rate classes who relative rates of return are above 1.0 whereas OCA's recommendation would provide relief to classes whose relative rates of return are below 1.0, i.e., classes not generating sufficient revenue to recover the costs the utility spends to serve those class. *Id.* at 13-14.

Disposition

After carefully considering each of the arguments presented, we generally reject the position that there should never be a rate decrease for a rate class while rates are increasing for others. The primary goal in revenue allocation is to have rates reflect the actual cost of service to the various customer classes. *Lloyd*. A proposed revenue allocation is reasonable if it moves distribution rates for each class closer to the full cost of providing service. *2007 PPL Order*. Factors such as gradualism, rate shock, rate continuity, competitive concerns, and principles of fundamental fairness must also weigh in the determination. *Lloyd* at 1020-1021. This conclusion is corroborated by the Commission's previous decision in the *UGI Order*, wherein OCA opposed a decrease to non-residential class GS-4, arguing that there should be no decrease for any class while rates are increasing. *UGI Order* at 163. However, as Wellsboro pointed out, in the *UGI Order,* the ALJs "determined that UGI's proposed revenue requirement allocation among the various rate classes achieves significant progress in moving rate classes toward the system average of relative rate of return." The Commission adopted the ALJs' recommendation and approved UGI's revenue allocation, including the decrease for GS-4.

Wellsboro Main Brief at 101. Revenue allocation is the result of several factors which must be considered and balanced.

Looking at the various arguments, we find that it is I&E's proposed revenue allocation which best considers and balances these factors. I&E made two recommendations regarding revenue allocation. First, it recommended that the POL rate class be allocated no increase or decrease under proposed rates. Second, it recommended that the excess $17,175 in revenue reallocated from the POL rate class be allocated as follows: (1) the first $245 is allocated to the MSL class and (2) the remaining $16,930 be applied to the CS rate class. I&E Stmt. No. 3 at 26.

I&E 's recommendations are based on an analysis of how the rate of return for each class compares to the system average rate of return. I&E has demonstrated that the relative rate of return for the CS, MSL, and POL rate classes is greater than 1.0 and Wellsboro proposes a revenue reduction to the POL class and rate increases for the MSL and CS classes such that the relative rate of returns are moved closer to 1.0. *Id.* at 24. I&E agreed with Wellsboro that rate classes MSL and CS should move closer to a relative rate of return of 1.0 but disagreed with the proposed decrease in revenue for the POL rate class. *Id.* at 26. Instead, I&E argues that POL should be allocated no increase or decrease and the excess $17,175 in revenue should be allocated as follows: (1) the first $245 is allocated to the MSL class, which results in no increase in rates for that class, and (2) the remaining $16,930 ($17,175 - $245) be applied to the CS rate class, resulting in an overall CS class increase of $124,378 ($141,308 - $16,930).

We agree with I&E that the CS and MSL classes should be credited the revenue from the POL class because they are the only two other rate classes whose relative rate of return were above 1.0. We also agree that rather than decreasing the rates of the POL now – only to increase rates again in a future rate proceeding – is an issue. I&E's proposal to not increase rates for the POL class offers additional rate stability for customers and allows costs to "catch up" to rates more gradually. *Id.* at 28. In addition, any excess revenue can be credited to the MSL and CS classes and facilitate additional movement towards a relative rate of return of 1.0. We agree with I&E's analysis that this is a more reasonable method for reducing the relative rate of return for the POL, CS, and MSL rate classes while at the same time refraining from negatively affecting other rate classes.

We acknowledge that I&E's recommendation does not move the POL class towards a relative rate of return of 1.0 as aggressively as Wellsboro's proposal. However, we agree that the movement from 12.46 under present rates to 3.54 still represents a significant movement and provides relief to the CS and MSL rate classes.

We note that both OCA and OSBA agreed with I&E's recommendation that rate class POL would not receive a rate decrease. Likewise, OSBA agreed with the re-allocation recommendation however OCA disagreed with the allocation of the excess $17,175 revenue from the POL class. Wellsboro does not agree with either of I&E's recommendations and did not accept that no class should receive a decrease. OCA Stmt. No. 4-R at 2; OSBA Stmt. No. 1-R at 4-5; Wellsboro Stmt. No. 1-R at 8. We, however, find that I&E's recommendations are most reasonable as they offer additional rate stability for customers and allow costs to "catch up" to rates more gradually rather than simply decreasing rates now only to increase them later. I&E's recommendations also move classes MSL and CS closer to a relative rate of return of 1.0. I&E Stmt. No. 3-SR at 13. I&E is correct that its recommendation provides relief to the only two rate classes whose relative rates of return are above 1.0. Therefore, we agree that OCA's recommendation should be rejected as it would provide relief to classes whose relative rates of return are already below 1.0 – and therefore not generating sufficient revenue to recover the costs the utility spends to serve those class. *Id.* at 13-14.

Therefore, we recommend I&E's revenue allocation as its proposal most appropriately balances the many factors which must be considered. This proposal most closely reflects the actual cost of service to the various customer classes, most reasonably moves distribution rates for each class closer to the full cost of providing service and most thoroughly considers factors such as gradualism, rate shock, rate continuity, competitive concerns, and principles of fundamental fairness to make a determination.

C. <u>Rate Design</u>

Wellsboro's proposed rates for each rate class are set forth in Schedules B6-3 (W) and B7 (W) (in table format).

<u>Wellsboro's Position</u>

Wellsboro proposes to begin including a small portion of demand costs (equal to the minimum demand for residential customers pursuant to the ACCOSS) through its residential monthly customer charges. Specifically, the Company proposes to include $1.48 of demand costs in a $13.40 customer charge for residential customers and a similar structure for other customer classes. Wellsboro Stmt. No. 1 at 43-44; *see* Exhibit (HSG-1), Schedule E1-C (W). Wellsboro argued that this proposed rate design reflects several developments since Wellsboro's last rate case in 2016.

1) Wellsboro is now functioning with its entire system operating with advanced metering infrastructure. Now that the Company has the metering technology to measure demand across its entire customer base, the Company is positioned to begin moving toward rates that reflect real demand-related costs, either as a demand element of its rate design or, as proposed here, in the fixed monthly charge based on demand levels that the vast majority of the accounts experience each month. Wellsboro Stmt. No. 1 at 38.

2) In 2018, the General Assembly passed Act of July 1, 1978, P.L. 598, as amended, added by Act of June 28, 2018, P.L. 58, 66 Pa. C.S. § 1330 ("Act 58"), providing clear legislative authority to approve alternative ratemaking methodologies. 66 Pa.C.S. § 1330

3) In 2019, the Commission established a Final Policy Statement on alternative ratemaking, where it identified a set of factors the Commission will consider in determining just and reasonable distribution rates that promote meet certain policy objectives, including to "ensure adequate revenue to maintain the safe and reliable operation of fixed utility distribution systems." *See, Fixed Utility Distribution Rates Policy Statement, Final Policy Statement Order*, Docket No. M-2015-2518883 (Order entered July 18, 2019).

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

Wellsboro indicated that multiple factors support its rate design proposal. Wellsboro argues that its proposal moves towards cost of service-based rates and facilitates reasonable recovery of fixed minimum demand costs while honoring gradualism and protecting customers and it also aligns with the Commission's enumerated policy factors established in its Final Policy Statement. 52 Pa. Code § 69.3302.

For RS (Residential Service), RSAE (Residential Service All Electric), NRS (Non-Residential Service), and NRH (Non-Residential Service Space Heating), Wellsboro proposes to increase the monthly charge from $10.79 to $13.40, with the balance of the revenue target to be recovered from the volumetric kWh charge. *See,* Wellsboro Stmt. No. 1 at 43-44; Exhibit__(HSG-1), Schedule B7 (W). The proposed monthly charge includes two components:

- **Customer-related costs**. These are costs, based on the ACOS, that have historically been included in the fixed monthly charge. This totals to $11.92 of the $13.40 customer charge.
- **Demand-related costs.** The demand-related costs total to $1.48 of the $13.40 and represent a portion of demand costs. Specifically, $1.48 represents the cost of 0.09 kW for RS, RSAE, and NRS, based on the $16.33 per kW-month demand costs applicable to those classes, as set forth in the ACCOSS. Wellsboro Stmt. No. 1, Exhibit__(HSG-1), Schedule E1-B (W). For NRH, the demand costs are slightly higher, so the demand portion of the fixed charge represents a slightly different amount of demand (i.e., not precisely 0.09).

Wellsboro Stmt. No. 1 at 43-44.

Wellsboro indicated that it had determined the portion of demand-related costs to include in the fixed monthly charge by considering the percentage of customers that reached specific demand levels. Wellsboro found that 96.6% of Residential monthly customer bills had demand of 0.1 kW in 2018. Wellsboro Stmt. No. 1 at 43. Additionally, Wellsboro noted that more than 98% of Residential customers had demand of 0.10 kW in at least one month during 2018 and if a cost based demand charge of $16.33 per kW-month was incorporated into the rate structure, at least 96.6% to 98% of the customer bills would assess a higher level of demand and demand costs than what Wellsboro is proposing to include in the fixed charge (depending on whether monthly demand or highest annual demand was used). Wellsboro argues that its proposal to allocate the cost for 0.09 kW-demand ($1.48 per month) to the Residential customer charge shifts only the minimum demand costs to the fixed charge. *Id.*

Wellsboro also proposes to increase the monthly fixed charge from $32.03 to $35.00 for CS (Commercial Service) and from $45.81 to $58.00 for CSH (Commercial Service Space Heaters), structured as follows:

- **Customer-related costs:** $20.71, representing the costs that have historically been included in the fixed monthly charge. Wellsboro Stmt. No. 1, Exhibit__(HSG-1), Schedule E1-C (W), line 27.
- **Demand-related costs:** The remainder of the fixed monthly charge goes toward demand-related costs. CS and CSH customers are required to have 7 kW of demand. Wellsboro Stmt. No. 1 at 45, 46.
    - For CS, which has a separate demand charge, this means the existing CS demand charge (at the rate proposed by the Company, at $6.60 per Schedule B7) will result in each CS customer paying a minimum of $46.20 in demand charges each month – far too little to cover the actual demand costs incurred by the Company for that customer. Wellsboro Stmt. No. 1 at 45. Specifically, those same 7 kW of demand are projected to cost the Company over $120.00 (Demand Cost of $17.53 (CS) or x 7 kW) (Schedule E1-B) *Id.* Consequently, the demand *costs* will far outpace the amount the Company collects in demand *charges*. Even when dedicating a small portion of the monthly fixed charge to demand costs, all CS customers will still pay less for demand than they cost the Company for their demand. Consequently, as explained by Mr. Gorman, "the same rationale supporting approval of the Residential monthly charge,

including Act 58, applies to the CS monthly charge." *Id.* CSH also has a minimum demand of 7 kW but has no separate demand charge. Because those 7 kW of demand are projected to cost the Company over $120.00 (Demand Cost of $17.64 x 7 kW), demand costs will still far outpace the demand component of CSH's fixed monthly charge.

- Similar to CS, all CSH customers will still pay less for demand than they cost the Company for their demand. Consequently, like CS, it aligns with cost-of-service ratemaking principles and can be supported by the same rationale that supports approval of the Residential monthly charge.

Wellsboro Stmt. No. 1 at 46.

Wellsboro indicated that "costs to serve customers are mostly based on the peak demand that customers may impose on the system" and for a system like Wellsboro demand is the primary factor allocating costs. Wellsboro Stmt. No. 1-R at 39.

Wellsboro argued that moving the residential rate design towards cost of service would require addition of a demand billing element and that incorporating demand costs into the monthly customer charge will be easier for residential customers to understand. To recognize cost of service in the proposal, Wellsboro chose a demand level attained by 98% of the RS accounts at least annually, and over 96.6% monthly. Wellsboro feels that this reflects a gradual approach to making this transition. Wellsboro Stmt. No. 1 at 43.

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

Wellsboro also addressed its proposal in relation to the Commission's Final Policy Statement Order which establishes 14 specific factors the Commission may consider in reviewing proposed alternative ratemaking mechanisms. These factors and how Wellsboro believes that its proposed rate design addresses each are set forth in Wellsboro Main Brief Table 7.

#	Issue Concerning Proposed Ratemaking Mechanism & Rate Design	Analysis
1	Alignment of revenues with cost causation principles as to both fixed and variable costs.	**More closely aligns rates with costs**, which largely reflect peak demand.
2	Impact on fixed utility's capacity utilization.	**Does not materially impact this factor (presently)**. However, it may serve as a step toward future designs promoting efficient resource utilization by customers.
3	Level of demand associated with the customer's anticipated consumption levels.	**Does not materially impact this factor (presently)**. However, it may serve as a step toward future rate designs reflecting customers' actual demand levels even more closely.
4	Limits on or elimination of interclass and intraclass cost shifting.	Begins to reduce intraclass cost-shifting by **aligning rates with costs more closely**.
5	Limits on or elimination of disincentives for the promotion of efficiency programs.	The Company's proposal promotes revenue stability for the Company and provides some insulation for reduction in usage, which **reduces Company disincentives to promote efficiency efforts**.

6	Impact on customer incentives to employ efficiency measures and distributed energy resources.	The Company's proposal is the **first step in educating customers about the factors that drive costs**, and then developing rate structures that reflect those costs (i.e., demand-based rates).
7	Impact on low-income customers and support customer assistance programs.	**Does not materially impact this factor.**
8	Impact on customer rate stability principles.	The utility's costs throughout the year are largely fixed, and the Company's proposal would **promote customer rate stability throughout the year**.
9	Impact on utility revenue	**Does not materially impact this factor**.
10	Impact on the frequency of rate case filing and regulatory lag.	The Company's proposal promotes revenue stability and thus **may reduce the frequency of rate cases**.
11	Interaction with other revenue sources, such as Section 1307 automatic adjustment surcharges.	**Does not materially impact this factor**.
12	Inclusion of appropriate consumer protections.	The Company's proposal is based on cost causation principles, which **protects customers from unreasonable rates**.
13	Understandability to consumers.	The Company's proposal does **not introduce a new surcharge or other rate mechanism** but serves as a first step to developing rates that fully reflect demand-based costs, which will likely **require customer education**.

14	Support of improvements in utility reliability.	By aligning rates with costs, the Company's proposal **supports the Company's ongoing efforts to invest in reliability projects**.

See, Wellsboro Stmt. No. 1 at 40-42.

Wellsboro argues that its proposal to include a small part of demand costs in the fixed monthly fee is reasonable, aligns closely with cost-causation principles and supports Commission policies provided in the Final Policy Statement Order.

Wellsboro noted that both I&E and OCA opposed its proposal to include a portion of demand costs in the monthly fixed charge but instead proposed that the Residential Class monthly fixed charge be set at the level of customer-related costs determined in the ACCOSS. I&E argued that a utility's investment in demand infrastructure is not a fixed cost as there remains some possibility that future capital investment could be avoided if customers reduce consumption and peak demands and 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 Stmt. No. 3 at 30-31. I&E, therefore, recommended that monthly fixed charge generally be set at the level of customer-related costs determined in the ACCOSS, consistent with the Commission's present policy on fixed monthly charges.

OCA argued that the costs of the Company's distribution system vary with demand, that volumetric energy charges offer meaningful price signals to customers and that volumetric charges are more consistent with energy conservation policies. *See,* OCA Stmt. No. 4 at 26. OCA also asserted that volumetric charges will "help minimize electric distribution system costs over the long term." *Id.*

Wellsboro argues that both OCA and I&E ignore the fact that the Company's proposal to allocate a small portion of demand costs to the customer charge preserves the price signals associated with volumetric rates while appropriately allowing the Company to assess fixed charges for what amounts to the minimum demand usage for the impacted customers. Wellsboro witness Gorman stated that costs are incurred based on peak demand not on usage and it was appropriate to include some portion of demand-related costs in the monthly charge, in order to align the utility's revenue and costs more closely and to help stabilize the utility's revenue and customers' costs. Wellsboro Stmt. No. 1 at 38. Wellsboro argued that including the minimum customer demand in the fixed customer charge is consistent with cost-causation principles, retains price signals, and respects the principle of gradualism.

OCA's Position

OCA summarized Wellsboro's proposed rate design. Wellsboro has two residential rate classes, RS (electric) and RSAE (all electric heating). For rate class RS, Wellsboro proposes to increase the residential RS customer charge from $10.79 to $13.40 per month, or a 24.2 % increase. OCA Stmt. No. 4 at 23. Wellsboro also proposes to increase the RS volumetric energy charge from $0.0467 per kWh to $0.05737 per kWh energy charge, or a 24.5 % increase in the energy charge. OCA Stmt. No. 4 at 23. For its residential heating customers, Wellsboro proposes to increase the RSAE rates from a $10.79 per month customer charge to a $13.40 per month customer charge, or a 24.2 % increase and to increase the $0.039361 per kWh energy charge to $0.050720 per kWh energy charge, or a 28.8 % increase. OCA Stmt. No. 4 at 23.

The customer-related cost component of $11.92 per month was calculated by the Company based upon the service, meter, customer accounting software investment costs and the related operation and maintenance expenses that have been identified in the Company's cost of service study. OCA Stmt. No. 4 at 24. OCA does not dispute the customer-related components that the Company has included and noted that it would result in a customer charge of $11.92 per month. OCA Stmt. No. 4 at 27. However, OCA argues that demand charges should not be included in the residential customer charge and recommends that the monthly customer charges for residential customers should also reflect the final authorized increase approved by the Commission. OCA Stmt. No. 4 at 28.

OCA witness Mierzwa testified that Wellsboro is proposing to include a demand-related component in Residential customer charges to help stabilize the utility revenues and customers' costs, even though it acknowledges that its past rate design practices achieved this result. OCA Stmt. No. 4 at 24-25. Wellsboro calculated the amount of the proposed demand-related costs to include in residential customer charges as follows:

> Mr. Gorman first determined the average demand costs per kilowatt ("kW") for the Residential class based on each Company cost study. For Wellsboro the average demand cost was $17.56 per kW-month…For Wellsboro, he included the costs of 0.10 kW-demand in the monthly Residential customer charge…He claims that these amounts represent a fair balance between revenue stability and the principle of gradualism.

OCA Stmt. No. 4 at 25; *see also*, Wellsboro Stmt. No. 1 at 43.

While Mr. Gorman proposed to include 0.10 kW- demand of his identified calculation in the customer charge, OCA asserted that he also argues that the demand-related amounts should increase over time. Wellsboro Stmt. No. 1 at 44; OCA Stmt. No. 4 at 25. OCA does not support the inclusion of demand-related costs in the monthly customer charge or agree that the demand-related amounts should increase over time. OCA argues that Wellsboro's proposal marks a dramatic change in how it and the Commission have developed customer charges in the past without any support and that such a change would also alter the price signals customers have become accustomed to without any meaningful benefit.

OCA witness Mierzwa testified:

> First, Mr. Gorman acknowledges that the historic practices of Wellsboro and Citizens' with respect to the design of monthly Residential customer charges have achieved revenue stability for each Company and cost stability for ratepayers. He has presented no analysis indicating otherwise.
>
> In addition, the cost structure of the distribution systems of Wellsboro and Citizens' largely reflect costs which vary with changes in demand. As such, the customer charge does not provide price signals that are particularly relevant to the cost structure. The inclusion of demand charges of any type in the customer charge is not appropriate. The volumetric energy charge is the primary source of meaningful price

> signals. A lower customer charge ensures that a greater portion of costs are recovered through energy charges, is more consistent with the Commonwealth's energy conservation and efficiency goals and will help minimize electric distribution system costs over the long-term.

OCA Stmt. No. 4 at 25-26.

OCA argues that Wellsboro's proposal does not align with the goals enumerated in the Fixed Utility Distribution Rates Policy Statement and Final Policy Statement Order implementing the Policy Statement which specifically states that the purpose of the Policy Statement is to encourage the efficient use of electricity. *See*, *Final Policy Statement Order* at 1; 52 Pa. Code § 69.3301. As the Final Policy Statement Order states:

> On May 23, 2018, the Pennsylvania Public Utility Commission (Commission) issued for comment a Proposed Policy Statement that identifies factors the Commission will consider in determining just and reasonable distribution rates that promote the efficient use of electricity, natural gas or water, and the use of distributed energy resources, as well as reduce disincentives for such efficient use and resources and ensure adequate revenue to maintain the safe and reliable operation of fixed utility distribution systems.

Final Policy Statement Order at 1. Similarly, Section 69.3301 of the Purpose and Scope of the Policy Statement states:

> Federal and State policy initiatives promote the efficient use of electricity, natural gas and water through technologies and information, including distributed energy resources. The purpose of this policy statement is to invite the proposal, within a utility's base rate proceeding, of fixed utility distribution ratemaking mechanisms and rate designs that promote these Federal and State objectives, the objectives of 66 Pa. C.S. § 1330 (relating to alternative ratemaking for utilities), and may include reducing disincentives for promoting these objectives, providing incentives to improve system economic efficiency, and avoiding unnecessary future capital investments, while ensuring that fixed utilities receive adequate revenue to maintain safe, secure and reliable operation of their distribution systems. At the same time, an alternative rate design methodology should reflect the sound application of cost of service principles, establish a rate structure that is just and reasonable, and consider customer impacts.

52 Pa. Code § 69.3301.

It is, therefore, OCA's position that Wellsboro's proposed inclusion of demand charges as a part of the customer charge has the opposite effect because the inclusion of demand charges in the fixed customer charge prevents the customer from seeing price signals that would otherwise encourage conservation and the efficient use of electricity. OCA witness Mierzwa testified:

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

OCA Stmt. No. 4 at 27.

Moreover, Mr. Mierzwa argued, following Mr. Gorman's recommendations to the final steps and logical conclusion would result in the entire cost of service for Wellsboro being recovered through monthly customer charges and that this would send customers inappropriate price signals, significantly reduce the incentive for customers to conserve energy and reduce consumption, and increase total costs in the long term. OCA Stmt. No. 4 at 26.

OCA also notes that Section 69.3302 identifies 14 factors to be considered in support of the proposed alternative ratemaking mechanisms and Wellsboro's proposed inclusion of demand charges as a part of the customer charges fails to meet the necessary criteria to be approved. Mr. Gorman's direct testimony did address each of the 14 factors; however, OCA argues that the Company's responses do not align with the goals identified by the *Final Policy Statement Order*. *See*, Wellsboro Stmt. No. 1 at 39-42.

In his response to testimony presented by I&E, Wellsboro's witness Gorman responds that I&E's arguments are based on "claims that demand costs are not fixed because some future capital investment [could] be avoided and that higher fixed charges do not signal to customers either to avoid usage at the peak or to conserve energy at all times." Wellsboro Stmt. No. 1-R at 8-9. Wellsboro argues that the Company should include a modest portion of demand-related costs in the fixed monthly charge, and then at some point in the future, explore programs that will "link rates to how well customers manage their peak demand and their usage, while protecting low-income and low-usage customers." Wellsboro Stmt. No. 1-R at 9. OCA responds by indicating that Wellsboro's arguments cannot overcome the fact that customers would not receive any price signals that are relevant to the distribution system cost structure. To approve demand charges and then look at some point in the future at how the demand charges in a fixed customer charge should link to peak demand and customer usage will not further any energy efficiency or demand response goals.

OCA witness Mierzwa testified:

> The cost structure of the Wellsboro distribution system largely reflects costs which vary with changes in demand. As such, the customer charge does not provide signals that are particularly relevant to the cost structure. Although Mr. Gorman believes programs that link rates to how well customers manage their high demand and usage should be explored, no such programs are in place to link demand charges and customer demands. Under Mr. Gorman's rate design proposal, for each meter size, the same demand charge would be included in the customer charge of each Residential customer, and the demand charge assessed to each customer will not change if a customer reduces or increases its peak demand. In addition, demand charges fail to provide Residential customers with adequate price signals because the majority of Residential customers have no way of knowing when peak demand periods are occurring. Therefore, the inclusion of demand charges of any type in the customer charge is not appropriate. The volumetric energy charge is currently the primary source of meaningful price signals. A lower customer charge ensures that a greater portion of costs are recovered through energy charges, is more consistent with the Commonwealth's energy conservation and efficiency goals and will help minimize electric distribution system costs over the long-term.

OCA Stmt. No. 4-SR at 9.

OCA argues that the inclusion of demand charges in the fixed customer charge should be denied because Citizens has failed to show that the proposed change would facilitate the energy efficiency purposes of the Commonwealth or the Commission's Policy Statement, the proposed customer charge would unduly prejudice low usage customers and would not provide a price signal to encourage customer conservation.

OSBA's Position

OSBA indicated that it opposed the level of Wellsboro's proposed customer charges for the NRS, NRH, CS and CSH service classes. Wellsboro is proposing to increase the customer charge for the NRS and NRH classes from \$12.22 to \$13.40 per month, or 9.7%. OSBA Stmt. No. 1 at 10. OSBA argues that Wellsboro's proposal is inconsistent with its own customer cost analysis and therefore recommends that the customer charge remain unchanged at \$12.22 per month. Since neither NRS or NRH customers pay a demand charge, OSBA feels the balance of each class's assigned revenue requirement should be recovered in the energy (\$/kWh) charge. *Id.* at 11.

Wellsboro is also proposing to increase the current energy charge for rate CS from \$32.02 to \$35.00, an increase of 9.3% per month. OSBA again argues that Wellboro's proposal is inconsistent with its own customer cost analysis and therefore recommends that the customer charge remain unchanged at \$32.03 per month. Since Rate CS customers pay a demand charge (\$/kW), the revenue shortfall associated with leaving the CS customer charge unchanged should be recovered in the class's demand charge. *Id.* at 12.

Last, Wellsboro is proposing to increase the customer charge for CSH from \$45.81 to \$58.00 per month, or 26.6%. *Id.* Similar to its analysis of the NRS/NRH and CS customer charges, OSBA argues that the proposed customer charge for CSH is inconsistent with the Company's own customer cost analysis and therefore recommends that the CS customer charge remain unchanged at \$45.91 per month. Since Rate CSH customers do not pay a demand charge (\$/kW), OSBA argues that the balance of the class's assigned revenue requirement should be recovered in the energy (\$/kWh) charge. *Id.* at 13.

I&E's Position

I&E outlined Wellsboro's proposed increases to the customer charges:

Wellsboro Proposed Class Customer Charges

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

I&E Stmt. No. 3 at 29.

I&E argued that Wellsboro's proposal allows it to receive greater revenue recognition from fixed monthly charges with less contribution from usage charges by including demand-related costs in the customer charges, which are based on a customer cost analysis. *Id.* at 29. I&E also noted that Wellsboro believed it was appropriate to recover demand-related costs in customer charges because the Company incurs distribution system costs based on the number of customers connected to the system and the peak demand the system is designed to serve. *Id.* at 30. In response, I&E argued that:

> It is correct that the energy charge does not perfectly reflect demand-related costs imposed on the system. However, an energy charge is far superior to allocating demand-related costs to all residential customers equally through the fixed customer charge. An investment may be considered a fixed cost once it is in service, but that does not dictate the manner in which the fixed cost should be recovered through rates. The specific fixed costs recovered through the customer charge have historically been limited to the direct costs associated with billing an individual customer. Each individual customer requires a meter to determine their usage and a bill to show them what they owe. Therefore, as an example, there is a direct correlation between number of customers and the cost of meters. There is no direct relationship between the number of customers and the size or the cost of poles, conductors, or transformers. Those items are instead common costs that should be billed to the

customer class through volumetric rates, which is the method that the Commission has approved in the past.

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

I&E Stmt. No. 3 at 30-31.

I&E, therefore, proposed customer charges be limited to what can be supported by Wellsboro's customer cost analysis:

I&E Proposed Class Customer Charges

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

Id. at 37.

I&E's recommendation is based on Wellsboro's customer cost analysis which shows that the RS and RSAE class customer charges should only be increased to $12.00 and that there is no cost basis for increasing the NRS, NRH, CS, and CSH classes from their existing customer charges. *Id.* Additionally, Wellsboro witness Gorman stated that the Company's costs to maintain the system do not change even as customers implement net metering and reduce their total kWh usage, because those customers may return to their old usage levels at any point and that it is therefore reasonable for some of those costs to be recovered as demand related in the monthly fixed charge.

I&E argued that past capital investments are different from proposed or future capital investments and the ability to avoid future capital investments exists if customers reduce their energy consumption and peak demands. I&E argues that future capital investment can be avoided by retaining appropriate demand charges.

I&E also disagrees with Wellsboro's argument that the proposed adjustment to the customer charge should be considered "alternative ratemaking" and accepted by the Commission. Wellsboro Stmt. No. 1 at 31-32. I&E witness Cline disagrees with Wellsboro witness Gorman that the 14 factors enumerated by the Commission in its Final Proposed Policy Order entered on July 18, 2019 at Docket No. M-2015-2518883 are satisfied. I&E addressed each of the 14 factors, but primarily disagrees with Wellsboro's proposal based on the following concerns:

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

- Low-income customers: Low-income customers who are also low usage customers will experience a higher percentage increase to their bill than under traditional Commission approved rate making. I&E Ex. No. 3, Schedule 11. Additionally, the Company's proposal does not include any specific consumer protections.

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

I&E acknowledged that the rate proposal promotes revenue stability for the Company and provides some insulation for reduction in usage that may be caused by efficiency efforts, however, revenue stability for the utility must be balanced against affordability and conservation concerns. I&E Stmt. No. 3 at 35. I&E submits that the Commission has maintained certain core utility ratemaking principles that Wellsboro's proposal violates and that, consistent with the 14 factors cited above, the Commission regulations promulgated by the Policy Order plainly state the Commission's policy regarding alternative ratemaking is to promote efficient use of energy sources; avoid unnecessary future capital investments; and "reflect the sound application of cost of service principles, establish a rate structure that is just and reasonable, and consider customer impacts".[19] I&E argues that with respect to efficiency, a higher fixed charge and lower usage charge discourages customers' from adopting efficiency measures and future capital investments can be avoided if customers reduce their energy consumption and peak demands, i.e., the demand portion of their bill. I&E notes that the customer charge has historically been limited to the direct costs associated with billing an individual customer because those costs are typically unavoidable on an individual basis. Regarding cost of service principles, I&E asserts that Wellsboro's proposal violates its cost of service study by assigning demand charges to the customer charge and its proposal contains no specific customer protections.

Last, I&E argues that while Wellsboro primarily justifies its proposal by reference to reliability, reliability may have some bearing on the Commission's analysis; however, the

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[19] 52 Pa. Code § 69.3301. The 14 factors considered by I&E witness Cline and Wellsboro witness Gorman are now found at 52 Pa. Code § 69.3302.

multiple concerns cited by I&E should outweigh this singular consideration. Therefore, I&E requests that the Commission reject Wellsboro's proposal to assign a portion of demand charge to customer charge and instead adopt I&E's recommendations in accord with Wellsboro's cost of service study.

Disposition

We agree that demand charges should not be included in the customer charge. Therefore, we reject Wellsboro's proposal to include such charges within the customer charge. I&E is correct that customer charges have historically been limited to the direct costs associated with billing an individual customer because those costs are typically unavoidable on an individual basis.

OCA is correct that the goals enumerated in the Fixed Utility Distribution Rates Policy Statement and Final Policy Statement Order implementing the Policy Statement states that the purpose of the Policy Statement is to encourage the efficient use of electricity. *See*, *Final Policy Statement Order* at 1; 52 Pa. Code § 69.3301. We agree that the inclusion of demand charges as a part of the customer charge would pose the opposite effect. The inclusion of demand charges in the fixed customer charge prevents customers from seeing price signals that would otherwise encourage conservation and the efficient use of electricity.

We agree with I&E that customer charges should be limited to what can be supported by Wellsboro's customer cost analysis – as well as OSBA's position that Wellsboro's proposed customer charges are not supported by the customer cost analysis. This analysis shows that the RS and RSAE class customer charges should only be increased to $12.00 and that there is no cost basis for increasing the NRS, NRH, CS, and CSH classes from their existing customer charges. I&E Stmt. No. 3 at 37. We also disagree that Wellsboro's proposed adjustment to the customer charge constitutes "alternative ratemaking" which should be accepted by the Commission. Wellsboro Stmt. No. 1 at 31-32. Wellsboro did address each of the 14 factors which the Commission may consider in reviewing proposed alternative ratemaking mechanisms.

However, we share some of the same concerns expressed by I&E regarding those factors and Wellsboro's proposal.

As discussed in relation to OCA's position, we agree that Wellsboro's proposal would have a detrimental effect on customer incentives to employ efficiency measures and distributed energy resources. OCA and I&E both correctly argue that a customer's utilization of resources is determined by the price signals that customer receives via their bill. We agree that a higher fixed charge and lower usage charge would only serve to dampen price signals as changes in usage would have less effect on a customer's bill. We agree with I&E's example relating to a customer's purchase of energy efficient appliances. A customer would be less likely to purchase more expensive energy efficient appliances if the benefits of such a purchase are not readily seen in their monthly bill.

We also agree with I&E's argument that low-income customers who are also low usage customers would experience a higher percentage increase to their bill under Wellsboro's proposal than under traditional Commission-approved rate making. I&E Exhibit No. 3, Schedule 11. Wellsboro argues that its proposal is based on cost causation principles which protect customers from unreasonable rates. Wellsboro has, however, failed to fully explain or support this argument.

With respect to cost causation, we agree that Wellsboro's proposed rate design does not align revenues with cost causation principles. Wellsboro has improperly counted demand costs as fixed costs and its rate design fails to reduce intraclass cost-shifting. We agree with I&E's position that rate design is based on the revenue allocations determined through the use of the cost of service study and that rates individually have no impact on intraclass cost-shifting as long as the demand portion of the rate is allocated to each class appropriately. We acknowledged that Wellsboro rate proposal promotes revenue stability and provides some insulation for reduction in usage that may be caused by efficiency efforts. However, we agree with I&E that revenue stability for the utility must be balanced against affordability and conservation concerns. I&E Stmt. No. 3 at 35.

We reject Wellsboro's argument that its proposed adjustment to the customer charge constitutes alternative ratemaking. The Commission has maintained certain core utility ratemaking principles. Commission regulations promulgated by the *Policy Order* state that the Commission's policy regarding alternative ratemaking is to promote efficient use of energy sources; avoid unnecessary future capital investments; and reflect the sound application of cost of service principles, establish a rate structure that is just and reasonable, and consider customer impacts. 52 Pa. Code § 69.3301.

As discussed, Wellsboro's proposal fails to promote efficient use of energy sources as its inclusion of demand charges in the fixed customer charge prevents customers from seeing price signals that would otherwise encourage conservation and the efficient use of electricity. It also fails to reflect the sound application of cost of service principles. Wellsboro's cost analysis shows that the RS and RSAE class customer charges should only be increased to $12.00 and that there is no cost basis for increasing the NRS, NRH, CS, and CSH classes from their existing customer charges.

For all of the reasons discussed above, we recommend that the Commission reject Wellsboro's proposal to assign a portion of demand charges to customer charges. Instead, we recommend that the Commission adopt I&E's proposed customer charges which are supported by Wellsboro's customer cost analysis as described above.

D. Scale Back

Wellsboro's Position

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

Wellsboro argues that its recommendation of a proportionate scale back is consistent with the cost-causation principles. Wellsboro has proposed to move each class closer to its actual cost to serve and argues that to preserve this movement, a proportionate scale back, including to rate decreases, is appropriate. Wellsboro requests that any scale back of rates should be proportionate based on the allocated cost of service study methodology accepted by the Commission and updated to reflect the revenue requirement authorized by the Commission.

Wellsboro noted that I&E, OCA, and OSBA each proposed modifications to Wellsboro's scale back proposal.

I&E requests a proportionate scale back based on the Commission's final approved cost of service study, with the exception that only those customer charges, usage rates, and rate classes that received a proposed increase should be scaled back. I&E Stmtt. No. 3-SR at 17.

OCA proposed a proportionate scale back limited to the increase for each rate class. OCA Statement No. 4 at 19.

OSBA recommended that scale backs be done proportionately to the recommended increases in Schedule BK-3(W), with the exception of Rate Class RSAE, NRH, and CSH, which OSBA recommended be excluded from any scale back. OSBA Statement No. 1 at 9.

<u>OCA's Position</u>

OCA noted that both it and I&E recommend a proportionate scale back for each rate class, including the customer charge. OCA Stmt. No. 4 at 19, 28; I&E Stmt. No. 3 at 38. For the scale-back of the customer charge, OCA witness Mierzwa proposed:

> [W]ellsboro has proposed an overall increase in rates of 19.5 percent. Under Wellsboro's requested increase, a customer charge for Residential customers based solely on customer-related costs would be $11.92. This

> would reflect an increase of $1.13 in Wellsboro's current monthly Residential customer charge. If the Commission authorizes an overall increase in rates which is 50 percent of Wellsboro's requested increase, the monthly Residential customer charge should be increased by 50% of $1.13, or 57 cents, to $11.36 ($10.79 + ($1.13.50 percent)).

OCA Stmt. No. 4 at 28.

For the scale back of the revenue allocation, OCA proposed a proportional scale back of his revenue distribution to reflect the increase actually authorized by the Commission in this proceeding. OCA Stmt. No. 4 at 19. OSBA argued that under this proposed scale back, the RSAE, NRH, and CSH rate classes would move away from the cost of service and therefore, those rate classes should be excluded from any scale back. OCA does not agree the rate classes RSAE, NRH, and CSH should be completely excluded from the scale back and argued that movement to or further away from the cost of service is not the only basis to evaluate a proposed revenue distribution. OCA Stmt. No. 4-SR at 5-6. OCA provided a modified scale back proposal as follows:

> The need for gradualism must be considered. In this proceeding the increases proposed by Wellsboro for RSAE, NRH, and CSH rate classes are approximately 1.44 times the system average increase. Although there is no hard and fast rule as to what level of increase is consistent under the principal of gradualism, it is my experience that application of the principle of gradualism would limit the increase to a particular rate class to 1.5 to 2.0 times the system average. Therefore, I recommend that the increases proposed for the RSAE, NRH, and CSH classes not be scaled back until the increase for each class reaches 1.5 times the system average increase. I would note that the RSAE, NRH, and CSH rate classes represent less than 1.0 percent of Wellsboro's total cost of service. Therefore, any scale back of the increases initially proposed for each of these three rate classes would likely have a minimal impact on the rates of the other rate classes served by Wellsboro.

OCA Stmt. No. 4-SR at 6.

OCA argues that Mr. Mierzwa's modified proposal for a scale back addresses the concerns raised by OSBA, respects the principles of gradualism, and moves the classes toward the system average rate of return.

OSBA's Position

OSBA's recommended modifications to Wellsboro's revenue allocation adopts the same limit on class increases (28.6%) as utilized in Wellsboro's proposal. OSBA Statement No. 1 at 9. In the event the Commission awards Wellsboro an increase less than the $0.999 million request, OSBA recommends that the class increases shown in column 2 of Schedule BK-3(W), excluding Rates RSAE, NRH, and CSH, should be reduced proportionally. OSBA argues that rates RSAE, NRH and CSH should be excluded from any scale back since these class exhibit little or no movement toward cost of service at Wellsboro's proposed maximum increase. *Id.*

I&E's Position

I&E recommended that the Commission proportionally scale back rates based upon the cost of service study, including customer charges and usage rates only if they received a proposed increase. I&E Statement No. 3 at 38. I&E acknowledged that OSBA disagreed this recommendation and instead argued that the RSAE, NRH, and CSH rate classes should not be included in any scale back because these classes would make little or no progress towards cost of service. I&E Statement No. 3-SR at 17 (citing OSBA Statement No. 1-R at 5). I&E disagrees with OSBA's position and argued that, making even a little progress towards cost of service is a reasonable basis to include these rate classes in a scale back of rates while making no progress, is not a harmful outcome. I&E Statement No. 3-SR at 18.

Disposition

All of the parties generally agree that any scale-back which may occur should be proportionate. We agree with Wellsboro that any scale back of rates should be proportionate based on the allocated cost of service study methodology. We also agree with OCA and I&E regarding a proportionate scale back for each rate class, including the customer charge. OSBA argued that the RSAE, NRH, and CSH rate classes would move away from the cost of service and should be excluded from any scale back. We agree with OCA and I&E that these rate classes should not be totally excluded.

As OCA pointed out, movement to or further away from the cost of service is not the only basis to evaluate a proposed revenue distribution. OCA noted that the RSAE, NRH, and CSH rate classes represent less than 1.0 percent of Wellsboro's total cost of service. Therefore, any scale back of the increases initially proposed for each of these three rate classes would likely have a minimal impact on the rates of the other rate classes served by Wellsboro.

We also agree with I&E's position that a proportionate scale back of rates based upon the cost of service study is appropriate only if they received a proposed increase. We previously acknowledged that the concept of class cost of service is the "polestar" of utility ratemaking. We, therefore, agree with I&E that making even a little progress towards cost of service (rather than moving further away) is a reasonable basis to include these rate classes in a scale back. We therefore recommend that the Commission adopt a proportional scale back of rates based upon the cost of service study and rate classes only if they received a proposed increase. We note that we previously recommended adopting I&E's customer charge adjustment and therefore recommend adjusting the usage rate to meet class revenue requirements.

IX. MISCELLANEOUS ISSUES

A. Reporting Requirements

I&E witness Cline recommended in his direct testimony that Wellsboro be required to provide, no later than April 20, 2020, an update to its plant in service projections by updating Wellsboro Ex. _(HSG-1), Sch. C3(W) showing actual capital expenditures, plant additions and retirements by month for the twelve months ending December 31, 2019, as well as an additional update no later than April 1, 2021, showing actuals through December 31, 2020. I&E Stmt. No. 3-SR at 4-7. No other party addressed this issue. I&E notes in its Main Brief that this reporting requirement has been accepted by the Commission in numerous other rate proceedings and requests that it be required in this proceeding as well. I&E Main Brief at 71.

In response, Wellsboro argues that it is already required under the Public Utility Code and Commission regulations to make numerous filings with the Commission each year, including annual reports that include detailed plant, expense, and sales data. Wellsboro notes that Commission regulations also require quarterly updates while a filing is pending. It argues that year end balances are already provided by other means. Wellsboro Main Brief at 112-113. Wellsboro further argues that the Commission has not yet adopted regulations that comprehensively address requirements for utilities that utilize the FPFTY. It argues that Wellsboro should not be required to comply with additional filing requirements that have not been adopted by the Commission and are not applicable to all NGDCs. Wellsboro Main Brief at 113.

We agree with Wellsboro on this issue and will not require the updated filings sought by I&E at this time. We are unwilling to single out Wellsboro for unique filing or reporting requirements associated with its plant in service projections that are not uniformly applicable to all electric utilities The Commission may include such requirements at such time as it adopts comprehensive FPFTY regulations that will apply to all similarly situated electric utilities. We will not do so in this proceeding involving a single electric utility.

We are unpersuaded by I&E's argument that the reporting requirement it seeks here was approved by the Commission in numerous prior proceedings. As noted by I&E in its Main Brief, all of the proceedings cited by I&E in support of its request were settled and the Commission was asked to approve Joint Petitions for Settlement in each case. Accordingly, in those proceedings, the utility voluntarily agreed to the requested reporting requirements. That is not the case here.

For these reasons, we recommend that I&E's request that Wellsboro be required to provide, no later than April 20, 2020, an update to its plant in service projections by updating Wellsboro Ex._(HSG-1), Sch. C3(W) showing actual capital expenditures, plant additions and retirements by month for the twelve months ending December 31, 2019, as well as an additional update no later than April 1, 2021, showing actuals through December 31, 2020, be denied.

X. ORDER

THEREFORE,

IT IS RECOMMENDED:

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

2. That Wellsboro Electric Company shall be permitted to file tariffs, tariff supplements or tariff revisions containing proposed rates, rules and regulations to increase annual revenues in the total amount of not more than $954,649.00.

3. That Wellsboro Electric Company's tariffs, tariff Supplements or tariff revisions may be filed on less than statutory notice, and pursuant to the provisions of 52 Pa. Code §§ 53.31 and 53.101, may be filed to be effective on at least one day's notice after entry of the Commission's Final order, for service rendered on and after the date of entry of the Commission's Final Order in this matter.

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

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

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

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

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

Date: February 28, 2020

/s/
Steven K. Haas
Administrative Law Judge

/s/
Benjamin J. Myers
Administrative Law Judge

Office of Administrative Law Judge Recommended Decision

TABLE I

Wellsboro Electric Company

INCOME SUMMARY

R-2019-3008208

		Pro Forma Present Rates (Revised) [(1)]	OALJ Adjustments [(2)]	OALJ Pro Forma Present Rates	OALJ Revenue Increase	Total Allowable Revenues
		(1)	(2)	(3) = (1) + (2)	(4)	(5) = (3) + (4)
1.	Operating Revenue	5,234,499	1,734	5,236,233	954,649	6,190,882
2.	Expenses:					
3.	O & M Expense	2,983,310	(40,376)	2,942,934	0	2,942,934
4.	Depreciation	1,366,345	0	1,366,345	0	1,366,345
5.	Taxes, Other	321,712	102	321,814	56,324	378,138
6.	Income Taxes:					
7.	State	52,448	4,219	56,667	89,743	146,410
8.	Federal	136,436	7,983	144,419	169,802	314,221
9.	Total Expenses	4,860,251	(28,072)	4,832,179	315,869	5,148,048
10.	Net Inc. Available for Return	374,248	29,806	404,054	638,780	1,042,834
11.	Rate Base	14,614,186	(7,314)	14,606,872	0	14,606,872
12.	Rate of Return	2.56%		2.77%		7.14%

(1) Company Main Brief
(2) From Table II Adjustments

Revenue Change (%):	18.23%
% of requested Increase	95.46%

Office of Administrative Law Judge Recommended Decision

TABLE I(A)

Wellsboro Electric Company

RATE OF RETURN

R-2019-3008208

		Structure	Cost	After-Tax Weighted Cost	Effective Tax Rate Complement	Pre-Tax Weighted Cost Rate
		(1)	(2)	[(3)=(1)x(2)]	(4)	[(5)=(3)x(4)]
1.	Total Cost of Debt			2.45663400%		2.45663400%
2.	Long-term Debt	49.33%	4.98%	2.45663400%		2.46%
3.	Short-term Debt	0.00%	0.00%	0.00000000%		0.00%
4.	Preferred Stock	0.62%	4.00%	0.02480000%	0.711079	0.03%
5.	Common Equity	50.05%	9.31%	4.65790300%	0.711079	6.55%
6.		100.00%		7.13933700%		9.0366%
7.	Pre-Tax Interest Coverage	3.68				
8.	After-Tax Interest Coverage	2.91				
9.	Tax Rate Complement (1-(21%+(9.99% X (1-21%))	71.10790%				

Office of Administrative Law Judge Recommended Decision

TABLE I(B)

Wellsboro Electric Company

REVENUE FACTOR

R-2019-3008208

1.	100%		1.00000000	1.00000000
	Less:			
2.	Uncollectible Accounts Factor (*)		0.00000000	0.00000000
3.	PUC, OCA, OSBA Assessment Factors (*)		0.00000000	0.00000000
4.	(Line 1-(Line 2 + Line 3)		100.0000%	100.0000%
5.	Gross Receipts Tax		0.05900000	0.00000000
6.	Other Tax Factors		0.00000000	0.00000000
7.	(Line 5 + Line 6)		5.9000%	0.0000%
8.	Effective GRT/CST (Line 7 x Line 4)		5.9000%	0.0000%
9.	Factor after GRT and CST (Line 4 - Line 8)		94.100%	100.000%
10.	State Income Tax Rate (*)		9.9900%	9.9900%
11.	Effective State Income Tax Rate		9.4006%	9.9900%
12.	Factor After Local and State Taxes		84.6994%	90.0100%
13.	Federal Income Tax Rate (*)		21.00%	21.00%
14.	Effective Federal Income Tax Rate		17.787%	18.902%
15.	Revenue Factor (100% - Effective Tax Rates)		66.9125%	71.1079%
		recipricol/gross up	1.494488	1.406314
				1.4690128

Office of Administrative Law Judge Recommended Decision

TABLE II

Wellsboro Electric Company

SUMMARY OF ADJUSTMENTS

R-2019-3008208

	Adjustments (1)	Rate Base (2)	Revenues (3)	Expenses (4)	Depreciation (5)	Taxes-Other (6)	State Income Tax (7)	Federal Income Tax (8)
1.	RATE BASE:							
2.	CWC:							
3.	Int. & Div. (Table IV)	0						
4.	Taxes (Table V)	0						
5.	O & M (Table VI)	(5,047)						
6.	EDIT Adjustment	(2,267)						
7.		0						
8.		0						
	REVENUES:							
9.	Forfeited Discounts		1,734			102	163	308
10.	EXPENSES:							
11.	Eliminate 3% Inflation Factor for 2020 **(1)**			(50,154)			5,010	9,480
12.	Maint. Overhead Lines/Vegetation Mgmt (Acct 593)			(23,845)			2,382	4,507
13.	Rate Case Expense Normalization			0			0	0
14.	Operations Supv. & Engineering Exp. (Acct 580)			16,935			(1,692)	(3,201)
15.	Misc. Distribution Exp. (Acct 588)			(48,314)			4,827	9,132
16.	Maint. Supervision & Engineering (Acct 590)			0			0	0
17.	Safety and Communications (Accts 908-913)			3,902			(390)	(738)
18.	Office Supplies (Acct 921)			61,100			(6,104)	(11,549)
19.	Regulatory Commission Expense (Acct 928)			0			0	0
				0			0	0
				0			0	0
				0			0	0
20.	TAXES:							
21.	Interest Synchronization (Table III)						23	44
22.	TOTALS	(7,314)	1,734	(40,376)	0	102	4,219	7,983

(1) Based on Wellsboro's Statement No. 1-R, Rebuttal Testimony of Howard S. Gorman page 4. Accounts 593, 580, 588, 590, 908, 921 and 928 were adjusted individually to reflect the annualized amounts. Otherwise, this adjustment reflects all other individual accounts annualized amounts prior to the 3% inflation increase.

Wellsboro Electric Company

INTEREST SYNCHRONIZATION

R-2019-3008208

		Amount $
1.	Company Rate Base Claim (UGI Electric Main Brief)	14,614,186
2.	ALJ Rate Base Adjustments (From Table II)	(7,314)
3.	ALJ Rate Base (Line 1 - Line 2)	14,606,872
4.	Weighted Cost of Debt (From Table IA)	2.456634%
5.	ALJ Interest Expense (Line 3 x Line 4)	358,837
6.	Company Claim (1)	359,071
7.	Total ALJ Adjustment (Line 6 - Line 5)	234
8.	Company Adjustment	0
9.	Net ALJ Interest Adjustment (Line 7 - Line 8)	234
10.	State Income Tax Rate	9.99%
11.	State Income Tax Adjustment (Line 9 x Line 10) (Flow to Table II)	23
12.	Net ALJ Adjustment for F.I.T. (Line 9 - Line 11)	211
13.	Federal Income Tax Rate	21.00%
14.	Federal Income Tax Adjustment (Line 12 x Line 13) (Flow to Table II)	44
	(1) Company Main Brief	

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

	Accrued Interest			Preferred Stock Dividends	
		Long-Term Debt	Short-Term Debt		
	(1)	(2)	(3)	(4)	(5)
1.	Company Rate Base Claim	$14,614,186	$14,614,186	Company Rate Base Claim	$14,614,186
2.	ALJ Rate Base Adjustments	($7,314)	($7,314)	ALJ Rate Base Adjustments	($7,314)
		$14,606,872	$14,606,872		$14,606,872
3.	ALJ Rate Base	$14,606,872	$14,606,872	ALJ Rate Base	$14,606,872
4.	Weighted Cost of Debt	2.456634%	0.00%	Weighted Cost Pref. Stock	0.02%
5.	ALJ Annual Interest Exp.	$358,837	$0	ALJ Preferred Dividends	$3,623
6.	Average Revenue Lag Days (1)	0.0	0.0	Average Revenue Lag Days (1)	0.0
7.	Average Expense Lag Days (1)	45.00	0.0	Average Expense Lag Days (1)	0.0
8.	Net Lag Days	-45.0	0.0	Net Lag Days	0.0
9.	Working Capital Adjustment				
10.	ALJ Daily Interest Exp.	$983	$0	ALJ Daily Dividends	$10
11.	Net Lag Days	-45.0	0.0	Net Lag Days	0.0
12.	ALJ Working Capital	($44,235)	$0		$0
13.	Company Claim (1)	$0	$0	Company Claim (1)	$0
14.	ALJ Adjustment	($44,235)	$0		$0
15.	Total Interest & Dividend Adj.	($44,235)			
	(1) Company Main Brief.				

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

	Description	Company Proforma Tax Expense Present Rates	ALJ Adjustments	ALJ Pro forma Tax Expense Present Rates	ALJ Allowance	ALJ Adjusted Taxes at Present Rates	Daily Expense	Net Lead/ Lag Days	Accrued Tax Adjustment	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	
1.	PUC Assessment	$0	$0	$0	$59,000	$59,000	$161.64	0.00	$0	
2.	Public Utility Realty	$12,000	$0	$12,000		$12,000	$32.88	0.00	$0	
3.	Capital Stock Tax	$0	$0	$0		$0	$0.00	0.00	$0.0	
4.	Gross Receipts Tax	$0	$0	$0		$0	$0.00	0.00	$0	
5.		$0	$0	$0		$0	$0.00	0.00	$0	
6.		$0	$0	$0		$0	$0.00	0.00	$0	
7.	State Income Tax	$52,448	$4,219	$56,667	$94,006	$150,673	$412.80	0.00	$0	0.00
8.	Federal Income Tax	$136,436	$7,983	$144,419	$177,868	$322,287	$882.98	0.00	$0	0.00
		$200,884	$12,202	$213,086	$330,874	$543,960			$0	
9.							ALJ Allowance		0	
10.							Company Claim (1)		0	
11.							ALJ Adjustment		0	

(1) Company Main Brief

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

	Description	Company Pro forma F.T.Y. Expense	ALJ	ALJ Pro forma Expenses	Lag Days	Lag Dollars
	(1)	(2)	(3)	(4)	(5)	(6)
1.	O&M	$2,983,310	$0	$2,983,310	45.63	$136,113,519
2.	Less: Uncollectibles	($20,600)	$0	($20,600)	45.63	($939,875)
3.	Less: PUC Assessment?	($59,000)	$0	($59,000)	45.63	($2,691,875)
4.		$0	$0	$0	45.63	$0
5.		$0	$0	$0	45.63	$0
6.		$0	$0	$0	45.63	$0
7.		$0	$0	$0	45.63	$0
8.	Total O&M Adj (2)	$0	($40,376)	($40,376)	45.63	($1,842,155)
9.		$0	$0	$0	45.63	$0
10.		$0	$0	$0	45.63	$0
11.		$0	$0	$0	45.63	$0
12.		$0	$0	$0	45.63	$0
13.		$0	$0	$0	45.63	$0
14.		$0	$0	$0	45.63	$0
15.		$0	$0	$0	45.63	$0
16.		$2,903,710	($40,376)	$2,863,334	0.00	$130,639,614
17.	ALJ Average Revenue Lag	0.0				
18.	Less: ALJ Avg. Expense Lag	45.6				
19.	Net Difference	-45.6	Days (1/8 Method)			
20.	ALJ Pro forma					
22.	O & M Expense per Day	$7,845				
23.	ALJ CWC for O & M	($357,917)				
24.	Less: Company Claim (1)	($362,964)	C1-6 R			
25.	ALJ Adjustment	($5,047)				
	(1) Company Main Brief					
	(2) Table II Adjusments					