

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	R-2019-3008212
Office of Consumer Advocate	:	C-2019-3011849
	:	
v.	:	
	:	
Citizens' Electric Company of Lewisburg	:	

RECOMMENDED DECISION

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

TABLE OF CONTENTS

I.	INTRODUCTION.....	1
A.	Citizens' Electric Company of Lewisburg.....	1
B.	History of the Proceeding.....	2
C.	Burden of Proof.....	3
II.	RATE BASE.....	5
A.	Utility Plant in Service and FPPTY.....	6
B.	Accumulated Depreciation.....	9
C.	Materials and Supplies.....	10
D.	Accrued Pension/OPEB Liability.....	11
E.	Cash working Capital and Construction Work in Progress.....	11
F.	Customer Deposits.....	13
G.	ADIT and EDIT.....	13
H.	Summary.....	14
III.	REVENUES.....	16
A.	Bucknell Solar Project.....	16
B.	Customer Counts.....	19
C.	Forfeited Discounts.....	21
IV.	EXPENSES.....	22
A.	Inflation Adjustment.....	23
B.	Individual Adjustments.....	27
	1. Maintenance of Overhead Lines / Vegetation Management (Account 593).....	28
	2. Operations Supervision & Maintenance Expense (Account 580).....	30
	3. Miscellaneous Distribution Expense (Account 588).....	32
	4. Customer Records & Collection Expense (Account 903).....	33
	5. Outside Services (Account 923).....	35
	6. Employee Pension & Benefits (Account 926).....	37
	7. Rate Case Expense – Normalization Period.....	40
	8. Cash Working Capital.....	43
	9. Depreciation Expense.....	44
C.	Conclusion.....	45

V.	FAIR RATE OF RETURN.....	45
A.	Legal Standards	45
B.	Capital Structure.....	48
C.	Cost of Long-Term Debt.....	48
D.	Cost of Common Equity.....	48
	1. Barometer Groups.....	53
	2. Discounted Cash Flow.....	56
	3. Capital Assets Pricing Model.....	63
	4. Size Adjustment.....	65
	5. Management Effectiveness Adjustment.....	75
E.	Summary of Citizens’ Return on Common Equity.....	78
F.	Conclusion.....	78
VI.	TAXES.....	79
A.	Excess Accumulated Deferred Income Taxes.....	79
B.	Deferred Regulatory Liability.....	82
VII.	RATE STRUCTURE.....	85
A.	Allocated Class Cost of Service Study (ACCOSS).....	85
B.	Revenue Allocation.....	92
C.	Rate Design.....	107
D.	Scale Back.....	122
VIII.	MISCELLANEOUS ISSUES.....	124
A.	Reporting Requirements.....	124
IX.	ORDER.....	125

APPENDICES

Table I – Income Summary
Table I(A) – Rate of Return
Table I(B) – Revenue Factor
Table II – Summary of Adjustments
Table III – Interest Synchronization
Table IV – Cash Working Capital – Interest and Dividends
Table V – Cash Working Capital – Taxes
Table VI – Cash Working Capital – O&M Expense

I. INTRODUCTION

This Recommended Decision recommends that the proposed tariff supplement filed by Citizens' Electric Company of Lewisburg to increase total annual operating revenue by \$792,246.00, or approximately 16.5%, be denied because the Company has not met its burden of proving by a preponderance of the evidence the justness and reasonableness of every element of its requested increase. Instead, this decision recommends the approval of an increase in annual operating revenue in the amount of \$515,144.00, or approximately 10.5%. Under the recommended increase, an average residential customer's monthly bill would increase by approximately \$7.70, or 6.44%. The suspension date is May 1, 2020.

A. Citizens' Electric Company of Lewisburg

Citizens' Electric Company of Lewisburg (Citizens' or the Company) is an investor-owned Electric Distribution Company (EDC) providing service in and around Lewisburg, Pennsylvania. Citizens' is wholly owned by C&T Enterprises, Inc. (C&T). C&T is a holding and management services company that also owns Wellsboro Electric Company (Wellsboro) and Valley Energy, Inc. (Valley). Citizens' service territory encompasses an area of approximately 55 square miles in and around Lewisburg, Pennsylvania. As of December 31, 2018, Citizens' served approximately 7,043 customers, of which approximately 5,871 were residential and 1,172 were commercial, industrial or lighting.

Through the instant proceeding, Citizens' seeks approval from the Pennsylvania Public 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. 132 to Tariff Electric Pa. P.U.C. No. 14, filed on July 1, 2019, sought an increase in annual distribution rates of approximately \$792,246.00 (16.5%). Subsequently, the Company filed replacement base rate schedules and tariff sheets by which it revised its requested increase to \$701,000.00. If granted in full, the total monthly bill for an average residential customer would increase by approximately \$8.55 per month, or approximately 7.2% over existing rates.

Citizens' argued that, under current rates, it earned a rate of return on its distribution business in 2018 of only 5.84%, a return that it argues will not support the long-term health of the Company. Citizens' further argued that, by 2020, its FPFTY, the Company's return is projected to decline substantially to 3.97%. If the full request is granted, the Company believes it will have the opportunity to earn a return of approximately 7.62%.

B. History of the Proceeding

On July 1, 2019, Citizens' filed Supplement No. 132 to Tariff Electric Pa. P.U.C. No. 14 proposing an annual distribution revenue increase of \$792,246 (16.5%) effective for service rendered on or after August 30, 2019. The Office of Consumer Advocate (OCA) filed a Formal Complaint against Citizens' rate increase on July 30, 2019. Subsequently, the Bureau of Investigation and Enforcement (I&E) and the Office of Small Business Advocate (OSBA) filed Notices of Appearance in this proceeding.

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 September 9, 2019, Citizens' filed a tariff supplement voluntarily extending the suspension period until April 29, 2020. On October 2, 2019, Citizens' filed an updated tariff supplement voluntarily extending the suspension period until May 1, 2020. The Commission assigned Administrative Law Judges (ALJs) Steven K. Haas and Benjamin 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 Wellsboro and Valley at Docket Nos. R-2019-3008208 and R-2019-3008209, respectively. Prior to the Prehearing Conference, on August 2, 2019, Citizens' provided the parties with its Direct Testimony. In accordance with the procedural schedule, on October 15, 2019, OCA, I&E and OSBA submitted Direct Testimony and associated exhibits. On

November 14, 2019, Citizens', OCA and OSBA submitted Rebuttal Testimony. On December 4, 2019, the parties submitted Surrebuttal Testimony.

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 Citizens', Wellsboro, and Valley rate proceedings. All prepared Statements and Exhibits were entered into the record by verification or by witness authentication. Company witnesses Gorman, D'Ascendis and Kelchner were sworn in and presented oral Rejoinder Testimony and submitted to cross-examination. I&E witnesses Patel and Cline and OCA witnesses Sherwood, Morgan, and Mierzwa were sworn in and submitted to cross-examination. The testimony of other witnesses was entered into the record by stipulation without cross-examination.

Main Briefs were filed 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. It is well-established that the evidence adduced by a utility to meet this burden must be substantial.

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 – 360 (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. Citizens' Main Brief at 16; Citizens' Stmt. No. 1-R at 2; Citizens' 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. Citizens' Stmt. No. 1 at 5.

According to the Company, its final claimed rate base of \$12,847,545 reflects all adjustments adopted by the Company in this proceeding. Citizens' Main Brief at 16; Citizens' Stmt. No. 1-R, Exhibit __ (HSG-1R2), 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")

Citizens' Stmt. No. 1, Exhibit __ (HSG-1), Schedule C1 (R). The Company notes that I&E proposed changes to CWIP 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. Citizens' Main Brief at 16.

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

A. Utility Plant in Service and FPFTY

Positions of the Parties

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. Citizens' Main Brief at 17, 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. Citizens' Main Brief at 18, 19. The Company also asserts that the Commission stated that by using an FPFTY, "a utility is essentially permitted to require ratepayers to pre-pay a return on its projected investment in future facilities." *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 a Future Test Year (FTY). Citizens' Main Brief at 19, 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. *Id.*

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. Citizens' Main Brief at 21. Specifically, the Company states that OCA would eliminate half of the benefits of using the FPFTY by only allowing \$592,756 in plant additions in 2020, where Citizens' has planned for \$1,185,512 of plant additions for the FPFTY. *Id.* (citing OCA Stmt. No. 2, Schedule LKM-1).

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.*; Citizens' Stmt. No. 1-R at 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 10.

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. 1 at 4. 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 12, 13. 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 OCA's proposed average which would decrease the Company's proposed rate base by \$592,756 from \$26,687,785 to \$26,095,029. OCA Stmt. No. 1 at Sch. SLS-3.

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

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 Order* 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 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 an FPFTY. Given that fact, and the factors discussed above, we conclude that the Company is permitted to use an 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 \$13,537,134 for the FPFTY. Citizens’ Stmt. No. 1, Exhibit__(HSG-1), Schedule C1-6. As described by Citizens’ witness Gorman, accumulated depreciation is calculated by adding annual depreciation expense at each year-end and subtracting retirements to the previous year-end balance. Citizens’ Stmt. No. 1 at 13.

The Company notes that I&E did not oppose the Company's accumulated depreciation claim. Citizens’ Main Brief at 22; 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. OCA's FPFTY average balance calculation of \$26,095,029 resulted in a \$378,420 reduction in accumulated depreciation amount, for a total accumulated depreciation of \$13,158,754. OCA Stmt. No. 2, Schedule LKM-1.

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*.

Citizens' Main Brief at 22. Therefore, the Company argues that OCA's position regarding accumulated depreciation should be rejected based on the *UGI Order*. *Id.* at 22, 23.

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*. Citizens' Main Brief at 22, 23. Therefore, the Company argues that OCA's position regarding accumulated depreciation should be rejected based on the UGI holding. *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, the Company's claim for accumulated depreciation is recommended for approval 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 small Materials and Supplies adjustment proposed by OCA and I&E, reducing its claim by \$4,209 from \$178,276 to \$174,067. Citizens' Main Brief at 23; Citizens' Stmt. No. 1-R at 6. 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. Citizens' Main Brief at 23; Citizens' Stmt. No. 1 at 14. Neither OCA nor I&E proposed any adjustments to the Company's claim. *Id.*; 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 it be approved.

E. Cash Working Capital and Construction Work in Progress

Positions of the Parties

Regarding the issue of Cash Working Capital (CWC), the Company claimed an increase of \$342,049 to rate base. Citizens' Stmt. No. 1, Exhibit__ (HSG-1) Schedule C1-6. The Company derived the CWC by using the formula of 1/8 of non-fuel cash operating costs. Citizens' Stmt. No. 1 at 14. 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. Citizens' Main Brief at 24; I&E Stmt. No. 1 at 23; 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. Citizens' Main Brief at 24; Citizens' Stmt. No. 1-R at 5, 12. If O&M expenses are adjusted, the Commission should use the same 1/8 method utilized by the Company, 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 \$70,492 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. Citizens' Exhibit_(HSG-1), Schedule C1-6. 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 \$70,492 CWIP claim should be removed from the FPFTY rate base as originally filed.

I&E also noted that the Company claimed \$342,049 for CWC, which was later revised to \$342,721. Citizens' Exhibit_(HSG-1), Schedule C1-6; I&E Exhibit No. 1-SR, Schedule 1 at 3. 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 Citizens' O&M expense claims be reduced by \$106,623, which reduces the Company's CWC allowance by \$13,328. I&E Stmt. No. 1-SR at 24.

Disposition

I&E recommends a deduction from Citizens' 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 \$13,328 for CWC because Citizens' 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 CWC in that CWC should be adjusted based on the level of operating expenses approved in this case and that the 1/8 method be used to adjust the CWC. We also note that no other party has objected to the Company's acceptance of such an adjustment. We also note that the Company has agreed to I&E's recommended adjustment regarding CWC. We also note that no other party has objected to the Company's acceptance of such an adjustment. We conclude that the CWIP and CWC adjustments are reasonable; therefore, it should be approved.

F. Customer Deposits

Positions of the Parties and Disposition

Regarding the issue of reductions from rate base, the Company notes that OCA proposed a \$209 adjustment to Customer Deposits, which the Company accepted. Citizens' Main Brief at 24; OCA Stmt. No. 2 at 6; Citizens' Stmt. No. 1-R at 13. As no other parties raised any objection or counterproposal, we conclude that the small adjustment is reasonable and is, therefore, approved.

G. ADIT and EDIT

Positions of the Parties

The Company notes that ADIT addresses the difference between actual tax liability for accumulated depreciation paid by Citizens' and the amount of tax expense for accumulated depreciation paid by ratepayers in the revenue requirement. Citizens' Stmt. No. 1

at 13-14. 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 \$94,708 for the end of the FPFTY. This amount is equal to the difference between accumulated depreciation based on Federal tax expense borne by ratepayers (i.e., based on straight line method) and accumulated depreciation based on Citizens' actual tax Federal tax expense (i.e., based on double declining balance method), times the current Federal income tax rate. Citizens' Stmt. No. 1 at 13-14; *see also*, Citizens' 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. Citizens' Stmt. No. 1 at 14. The EDIT is computed on Schedule C1-6, lines 34-39 and carried up to Schedule C1-6, line 7. *Id.* The Company is amortizing the balance over the estimated remaining book life of the assets – ten years. *Id.* The EDIT balance included in rate base declines each year during this ten-year period. *Id.* The annual EDIT accretion (Schedule C1-6, line 40) is carried forward to reduce Income tax expense (Schedule C1-4, line 28). *Id.*

No party challenged the Company's calculation of ADIT; however, OCA proposed adjustments to the Company's calculation of EDIT. Citizens' Main Brief at 25. EDIT is fully addressed in another part of Citizens' Main Brief and was not discussed in the Rate Base Section. *Id.* EDIT is discussed 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 \$4,209 from \$178,276 to \$174,067;

2) A deduction of \$70,492 from the Company's claimed rate base in its original filing, reflecting the disallowance of CWIP;

3) A reduction to rate base for Accrued Pension / OPEB liability. This reduction reflects the excess of amounts charged to expense over amounts paid. The deduction amount is \$578,182;

4) A \$209 adjustment to Customer Deposits;

5) An EDIT balance reducing rate base by \$40,787. (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)); and

6) A reduction to rate base of \$94,708 for ADIT for the end of the FPPTY.

Additionally, CWC will be reduced by \$5,005 which reflects our adjustment to operating expenses of \$81,330, and an adjustment reducing EDIT by \$17,480 which reflects the OCA's flowback of EDIT for 2018; making our total adjustments \$22,485.

Given the above adjustments, we conclude that the final rate base that we recommend for Commission approval is \$12,825,060.

III. REVENUES

Citizens' projects in this proceeding that its system usage will decline from 178,055,729 kWh in 2018 to 167,748,001 kWh in 2020. Citizens' Stmt. 1, Ex. (HSG-1), Sch. C1. It calculates that, under present rates, this decline in usage will reduce distribution revenues from \$5,003,249 in 2018 to \$4,860,408 in 2020. Citizens' Stmt. 1, Ex. (HSG-1), Sch. C1. The three revenue-related issues in dispute in this proceeding are: (1) Bucknell University's solar project; (2) Customer counts; and (3) Forfeited discounts.

A. Bucknell Solar Project

Bucknell University (Bucknell) has submitted an interconnection application to Citizens' by which it is seeking approval to connect a planned solar generation facility to Citizens' distribution system. Citizens' proposes in this proceeding to reduce its sales revenue figure for its FPFTY to reflect an anticipated loss of kWh sales and revenues for various Bucknell accounts resulting from installation and operation of the solar project. Citizens' expects the project to be completed in 2020, during its FPFTY. Citizens' Main Brief at 26.

OCA has challenged Citizens' proposal and recommends an upward adjustment to the company's FPFTY revenues in the amount of \$12,024. OCA Stmt. 4 at 29-30, Sch. JDM-5. OCA argues that, ". . . the record evidence demonstrates that the completion and timeframe for completion of the proposed Bucknell solar installation is uncertain and is not a known and measurable change that should be reflected in Citizens' revenue requirement." OCA Stmt. 4 at 29; OCA Main Brief at 18.

In support of its proposed adjustment, OCA refers to a newspaper article attached to OCA witness Mierzwa's direct testimony. It notes that the East Buffalo Township Planning Commission tabled discussions about the solar project earlier in 2019 due to zoning concerns related to the project. OCA Stmt. 4, Sch. JDM-1 at 1. The article indicated, and Citizens' witness Kelchner acknowledged, a solar zoning ordinance is first needed in the Township for East Buffalo Township to consider Bucknell's project. OCA Stmt. 4, Sch. 2 at 1; Citizens' Stmt.

4-R at 9. A second article referenced by OCA witness Mierzwa notes that the project plan had been withdrawn from consideration from the Township Planning Commission by Bucknell pending resolution of the zoning issues. OCA Stmt. 4 at 14, Sch. JDM-7; OCA Main Brief at 19.

OCA notes that the Township Planning Commission proposed a solar project zoning ordinance in December 2019. OCA argues, and Citizens' witness Kelchner acknowledges, the proposed zoning ordinance still needs to be reviewed and approved by the Township Board of Supervisors. Tr. at 147; OCA Main Brief at 19. OCA argues in its Main Brief:

In cross-examination, Mr. Kelchner acknowledged that in theory, the township could also decide to change or amend the proposed zoning ordinance before finalizing it. Tr. pp. 148-149. Moreover, when asked if the ordinance did get passed, when the zoning ordinance would become effective, Company witness Kelchner responded, "I don't know." Tr. p. 148. If the solar ordinance is approved at some date in the future, Bucknell would then need to present its plan to the township. When asked if the township could potentially recommend changes to the proposal or could, in theory, deny it, Mr. Kelchner responded "sure" to both questions. Tr. pp. 148-149. Finally, even if all of these steps are successful, the project would still need to construct the solar installation, interconnect it, and have it operational at the proposed 3 MW level. There is no evidence that this will occur in any part of the FPFTY.

OCA Main Brief at 19-20.

OCA concludes, ". . . there is not sufficient certainty for ratemaking purposes that the project will ever be implemented or will be implemented and operational during the Fully Projected Future Test Year." OCA Main Brief at 20.

In response, Citizens' argues that its ". . . expectations concerning the Bucknell Solar Project are based on Bucknell strategic planning, communications with Bucknell staff, and, most significantly, the active interconnection application received by Citizens' from Bucknell for the Solar Project." Citizens' Main Brief at 27. Citizens' argues that it remains in

communication with Bucknell about the design of the project, and that, once final approval is obtained, the project can be constructed and placed into service in a matter of months. Citizens' argues:

Citizens' has been in communication with Bucknell about the design of the Solar Project. Tr. p. 154. As explained by Mr. Kelchner in Rebuttal Testimony, solar projects such as the one planned by Bucknell can be placed into service in a matter of months, and a "delayed vote by a local planning Commission" 14-15 months before the end of the FPFTY "is not a material obstacle to completing a solar project by December 2020. Citizens' Statement No, 4-R at 9.

Citizens' Main Brief at 27.

Citizen's further relies, in arguing that the project will be completed before the end of its FPFTY, on the fact that Bucknell has not withdrawn its interconnection application submitted to Citizens'. Tr. at 142-43. Citizens' Main Brief at 27. Citizens' concludes, "[b]ased on the Company's direct communication with Bucknell University, the active interconnection application, and the likely approval of the zoning ordinance, the Company's projection that the Solar Project will be completed in 2020 is reasonable." Citizens' Main Brief at 28.

Although completion of construction of the solar project and being made operational before the end of the FPFTY may certainly be possible, we agree with OCA that reaching that conclusion in this proceeding is too speculative and uncertain to recommend approval of Citizens' proposed adjustment to its revenue calculation. While we have no reason to dispute Citizens' contention that, once approved, the solar project may be constructed within several months, we are more persuaded by the uncertainty surrounding the length of the Township's ordinance review and approval process and potential timeframe, as well as the process for review and approval of Bucknell's plans, once submitted.

As addressed by OCA, and as acknowledged by Citizens' witness Kelchner, prior to final approval of a solar zoning ordinance by East Buffalo Township, the Planning Commission's proposed ordinance must first be reviewed and approved by the Supervisors.

There simply is no evidence in the record demonstrating how long this process will take. Further, once a final solar zoning ordinance has been adopted by the Township Supervisors, Bucknell's solar plan must be re-submitted, reviewed and approved. As acknowledged by Citizens' witness Kelchner, Bucknell's proposed plan may be revised or amended, or potentially denied outright, thereby causing further delays. Tr. at 148-149; OCA Main Brief at 19-20. The fact that Bucknell's interconnection application has not been withdrawn has no bearing on these concerns. We find that there is too much uncertainty surrounding the date when the solar project will be completed and placed into service to conclude with reasonable certainty that the project will be completed in the FPFTY. Accordingly, we recommend that OCA's proposed adjustment to Citizens' revenue calculation in the amount of \$12,024.00 be approved.

B. Customer Counts

Citizens' proposed present rate revenue estimate of \$4,860,408 is derived from its estimated customer counts for the FPFTY. The company estimates in this proceeding that its FPFTY will include an average customer count of 7,043. Citizen's Stmt. 1, Sch. B3. This figure represents an increase of only nine customers from the company's HTY average number of customers. I&E Stmt. 3, Ex. 3, Sch. 6. The company notes that, while it has seen a very modest number of new connections, during its FTY, it lost 32 customers in the East Lewisburg area as part of a transfer of those customers to PPL Electric Utilities Corporation (PPL). Citizen's Stmt. 4 at 7.

I&E challenged Citizens' customer count estimates. I&E witness Cline proposed an average FPFTY customer count of 7,096, resulting in an increase of present rate revenue of \$28,032 over Citizens' projection. I&E based its projections on the average change in customer counts from 2015-2018 for each rate class. I&E Stmt. 3-SR, I&E Ex. 3-SR, Sch. 2. I&E argues that, rather than a net increase of nine customers from HTY to FPFTY, as proposed by Citizens', a net gain of 62 new customers is appropriate. Its net increase figure of 62 customers is calculated, ". . . by assuming 47 new customers per year for a 94-customer net gain from HTY to FPFTY ($47 \times 2 = 94$), adjusted for the 32 lost customers in FTY due to the East Lewisburg transfer to PPL ($94 - 32 = 62$)." Citizens' Main Brief at 30-31.

In further support of its position, I&E cites a Union County Housing Study which projects that demand for housing will increase by 89 units in Lewisburg Borough, 545 units in Buffalo Township, and 885 units in East Buffalo Township through 2050. I&E Stmt. 3-SR, Sch. 1 at 32; I&E Main Brief at 13.

As noted, I&E argues that Citizens' understates its projected customer growth, proposing instead an increase in the present rate revenue calculation of \$28,032.00. I&E Stmt. 3-SR at 13; I&E Ex. 3-SR, Sch. 3.

Citizens' argues that, although I&E's calculations may be mathematically correct, I&E did not consider and factor into those calculations very limited opportunities in the Lewisburg area to add new customers. Citizen's witness Kelchner stated:

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

Citizens' Stmt. 4-R at 12.

Citizens' noted that the total customer count for the company rose by only 7 during the 7-month period from December 2018 to July 2019, representing an average of only one customer gained per month (the loss of 32 customers did not occur during this time period). Citizens' argues that its final 2019 customer growth figure is likely to show a significant loss. Citizens' Main Brief at 32. Citizen's further supports its position by citing the Union County Planning Commission Annual Report (UCPC Annual Report), which indicates that Lewisburg Borough, Buffalo Township and East Buffalo Township (most of Citizen's territory) have plans for only 20 new lots as of 2018. Citizens' Stmt. 4-R at 12-13, Ex. JK-4R at 6-7; Citizens' Main Brief at 33. Mr. Kelchner concludes, "[b]ased on the rapid drop off in new service connections in Citizens' territory, and the corresponding public information on new residential construction, I

do not believe the customer growth observed by Mr. Cline will be recurring going forward.” Citizens’ Stmt. 4-R at 12-13.

We are more persuaded by I&E’s position in this proceeding and recommend adoption of its upward adjustment to Citizens’ present rate revenues in the amount of \$28,032. Both parties cited external studies in support of their respective positions – Citizens’ to the UCPC Annual Report and I&E to the Union County Housing Study. Both studies arguably support the positions put forth by the party citing each study. Both studies, however, represent estimates or projections of what their respective authors anticipate will happen in the future. By contrast, I&E also presented actual figures of what, in fact, happened from 2015 through 2018. Although those figures may suggest a downward trend in new customers, there is no certainty that the trend will continue along the same trajectory or to what degree, and we will not so assume here. We are more persuaded by I&E’s averaging the actual known figures since 2015 to estimate a reasonable customer count figure for the company’s FPFTY. Accordingly, we recommend adoption of I&E’s upward adjustment to Citizens’ present rate revenues in the amount of \$28,032.

C. Forfeited Discounts

Citizens’ claims in this proceeding \$27,126.00 in revenue from Forfeited Discounts (late payment charges) for 2020. Citizens’ Stmt. No. 1, Ex. (HSG-1), Schedule B6. 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 22. 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 Citizens’ be increased by \$3,376.00, to \$30,502.00. I&E Stmt. No. 3 at 23.

In response, Citizen’s 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. Citizens' Stmt. No. 1-R at 7. Citizens' recommends that, because the difference between the two changes will likely be immaterial, I&E's recommended adjustment should be rejected. Citizens' Stmt. No. 1-R at 7. In the alternative, Citizens' 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 to revenue in the amount of \$3,376.00 from Forfeited Discounts claimed by Citizens'. As noted, Citizens' witness Gorman acknowledged in rebuttal testimony that Forfeited Discounts will likely increase with higher revenue. Citizen's Stmt. No. 1-R at 7. Accordingly, Citizens' agrees with I&E on this issue. We will reject Citizens' request that its Uncollectible Accounts expense amount be increased by a corresponding amount. While Citizens' projected 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 \$5,418,984.00.

IV. EXPENSES

As a matter of constitutional 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); *Butler Township Water Co. v. Pa. Pub. Util. Comm'n*, 473 A.2d 219, 221 (Pa. Cmwlth. 1984). 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. Citizens' 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

Citizens' 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." Citizens' Stmt. No. 1-R at 10. To that extent, the Company contends that historic O&M expenses show a greater than 3% increase every year from 2012 to 2018. Citizens' Stmt. No. 1, Exhibit__ (HSG-1), Schedule C1-1 at 2. In preparing its fiscal year 2020 budget, Citizens' expects expenses to increase by over 3% from 2019 to 2020, with significantly higher increases in some areas being offset by management's efforts to manage costs. Citizens' Stmt. No. 4-R at 4. 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.

The Company used the Producer Price Index (PPI) as a guideline in forming its 3% inflation projection. OCA Stmt. No. 2 at 7. 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%. Citizens' Main Brief at 42-47.

Citizens' cites to *Pa. Pub. Util. Comm'n v. Pennsylvania-American Water Co.*, Docket No. R-00038304, at 35 (Order entered Jan. 29, 2004) and *Pa. Pub. Util. Comm'n v. Pennsylvania-American Water Co.*, Docket No. R-880916, at 54 (Order entered Oct. 21, 1988), for the proposition that the Commission has recognized the use of inflation factors in projecting costs. Citizens' 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. Citizens' 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. Citizens' Main Brief at 45.

OCA strongly objects to the use of a 3.0% inflation adjustment. OCA submits that the proposed 3.0% inflation factor applied to all expenses is not known and measurable or consistent with the law. OCA's Main Brief at 24. 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 Citizens' because the only explanation is the choice of the inflation escalation rate. OCA Stmt. 2-SR at 5.

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. OCA Stmt. No. 2 at 8. 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 3.0% 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 8-9. OCA notes that the PPI family of indexes 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 that Citizens' 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 FPFTY, it did not eliminate the "known and measurable" standard. We believe that if a

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.

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).

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.

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 not a real quantitative approach. Citizens' 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 Citizens' not be permitted to apply a blanket 3% inflation adjustment to all of its O&M accounts in its FTY budget.

B. Individual Adjustments

I&E and OCA have proposed individual adjustments to Citizens' expense claims, an approach that Citizens' takes exception. Citizens' 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.

Citizens' states that the approach of analyzing individual adjustments raises particular problems for a small utility like Citizens', that shifts resources and priorities during the year as operational needs arise. Citizens' argues that this approach actually penalizes the Company for being responsive and for applying resources where most needed and ignores the Company's success in managing overall costs very close to its budgeted costs (the Company's 9-month annualized expenses, adding a 3% inflation factor, is \$2,695,345, which is \$279 greater than the Company's FPFTY claim of \$2,695,066). Citizens' Main Brief at 39-41. Given the fact that Citizens' has managed its expenses close to budget, and the fact that Citizens' expenses are tracking slightly higher than projected for 2019, Citizens' argues that it is appropriate to approve its expense claim in entirety.

Citizens' 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

Citizens' made an original claim of \$456,019 for maintenance of overhead lines² for the FPFTY. This projection is an increase in costs of \$401,475 in the HTY to \$456,019 for the FPFTY. Citizens' Stmt. No. 1, Exhibit __ (HSG-1), Schedule C1-1. According to Citizens', the increased in costs is due to maintenance and repair of damage dealt to trees in Citizens' service territory by the Emerald Ash Borer. The Borer is an insect that causes death and damage to trees, particularly ash trees, in Pennsylvania. Citizens' claims that trees damaged by the Borer pose a significant risk to its distribution lines, as the damaged trees are poised to fall onto overhead lines resulting in unnecessary outages and damage to its facilities. Citizens' claims it will experience increased contractor costs when it comes to contracting with third parties in order to identify and remedy damaged trees, particularly damaged off right-of-way priority trees. Citizens' Stmt. No. 4 at 13-14.

Nine-month data for the FTY (as of September 30, 2019), provided by the Company shows a FTY amount of \$367,362. The FTY data annualized shows an amount of \$489,816. Applying a 3% inflation adjustment to the FTY annualized amount would show a new claim amount of \$504,510 for the FPFTY. Citizens' Stmt. No. 1-R at 4.

Citizens' argues its claim is conservative. Citizens' Witness Kelchner testified that future tree trimming costs will be higher than projected in the filing, based upon bids that it has received from contractors and the fact that demand for contracting services has escalated because of the existence of the Borer. Citizens' Stmt. No. 4-R at 6.

I&E recommended an adjustment of \$9,564 to Citizens' claim. I&E's recommendation is based on the HTY "material" expense, arguing that the Company

² This expense includes salaries and wages, overhead, transportation, and material expense, and tree trimming (contractor services). I&E Exhibit No. 1, Schedule 6.

experienced a fluctuating trend in material expense from 2016 through 2018. I&E argues that the Company did not support the significant increase of 25.15% from the HTY material expense to the FPPTY material expense. I&E's Stmt. No. 1 at 17-18. I&E notes that Citizens' claimed that material and contractor costs are "one and the same,"³ but I&E alleges that there is no clear substantiation or breakdown of material expense to verify this claim. I&E did not dispute the increase to the contractor subcategory or any other subcategory of cost for the FTY and FPPTY.

OCA recommended an adjustment of \$40,632 to Citizens' claim. OCA argues that there has been a significant variance in vegetation management costs. As a result, OCA used a three-year average methodology to average the vegetation management contractor costs, concluding with a \$40,632 reduction to Citizens' claim. OCA Stmt. No. 1-SR at 5.

Disposition

We agree with Citizens' on this issue. We find that Citizens' 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 this Account.

I&E's adjustment to the expense is based on the material subcategory; however, as testified to by Citizens' witness, the material expense subcategory also includes contractor costs. Citizens' provided sufficient evidence to show that its contractor costs will increase in order to combat the Borer vegetation crisis. The Company provided evidence that demand for contractors have increased in response to combating the Borer, based upon bids it has received from contractors. Thus, accepting an adjustment based off historic material expense costs from 2016-2018, we believe is inappropriate as historic costs do not factor in the new threat posed by the Borer.

³ Citizens' claims that outside contractor tree-trimming costs are recorded in the materials sub-category. Tr. at 138-39.

OCA's adjustment is also inappropriate. OCA's approach of using historical averages does not reflect the increased expense that the Company will experience in combating the new threat posed by the Borer.

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.

Therefore, we recommend that the Commission approve the Company's claim for maintenance of overhead lines / vegetation management. However, the Company's costs will be higher than what the Company initially projected in its filing. Given the fact that the Company's original claim of \$456,019 is less than what its new claim would be at \$504,510, we recommend an allowance of \$489,816 for Account 593, which is the new claim minus the inflation adjustment.

2. Operations Supervision & Maintenance Expense (Account 580)

Position of the Parties

Citizens' made an original claim of \$144,762 for operations supervision and maintenance expense in the FPFTY.

Nine-month data for the FTY (as of September 30, 2019), provided by the Company shows a FTY amount of \$91,768. The FTY data annualized shows an amount of \$122,357. Applying a 3% inflation adjustment to the FTY annualized amount would show a new claim amount of \$126,028 for the FPFTY. Citizens' Stmt. No. 1-R at 4.

I&E recommended an adjustment of \$21,644 to Citizens' claim. I&E's recommendation for the FPFTY was based on the annualized FTY ending December 31, 2019 expense of \$119,532 plus a 3% inflation increase for employee payroll and benefits expense.

This reflects removal of a one-time additional payroll cost (\$53,998) due to employee overlap (while Citizens' was training a new Senior Director of Engineering and Operations) incurred in the HTY ended on December 31, 2018. I&E Stmt. No. 1 at 10-11.

Citizens' argues that I&E's adjustment should be rejected, because Citizens' is preparing to address a significant number of retirements in the upcoming years. To address the retirements, Citizens' indicates that they are implementing a long-term and methodical transition strategy that will prevent a lapse in experience and job knowledge. Citizens' will incorporate additional short-term staff overlaps during 2019 and beyond. Citizens' Stmt. No. 4 at 15-16. Therefore, Citizens' claims that the overlap is not "one-time" as it will recur in a variety of transitions. Citizens' Main Brief at 51.

I&E argues that Citizens' witness testimony relating to anticipated retirements does not expressly relate to this expense claim. As such, there is no justification to rely on the testimony. I&E argues that its recommendation is justified because neither the historical nor annualized FTY experience for this expense support Citizens' claim. I&E Stmt. No. 1 at 9-11.

Disposition

We agree with I&E on this issue. We agree with I&E and reject Citizens' claim because we agree that employee overlap based off anticipated employee retirements is speculative in nature. Granting Citizens' claim based off anticipated retirements runs of the risk of Citizens' over collecting on this claim, given that employees who they anticipate will retire may not retire. There is no guarantee that the employees Citizens' claim will retire will, in fact, retire. Thus, Citizens' did not prove that employee overlap will occur in a variety of transitions. To the extent that expenses imprudently incurred or abnormally overstated during the test year, Citizens should be disallowed and found not recoverable through rates.

However, although we agree with I&E on this issue, its recommendation of \$123,118 (\$144,762 - \$21,644) includes a 3% inflation adjustment. As stated earlier in this Decision, we recommend that a 3% inflation adjustment not be used in this proceeding.

Therefore, we recommend an allowance of \$119,532 for Account 580.

3. Miscellaneous Distribution Expense (Account 588)

Position of the Parties

Citizens' made an original claim of \$275,814 for miscellaneous distribution expense⁴ in the FPFTY.

Nine-month data for the FTY (as of September 30, 2019) provided by the Company shows a FTY amount of \$201,725. The FTY data annualized shows an amount of \$268,967. Applying a 3% inflation adjustment to the FTY annualized amount would show a new claim amount of \$277,036 for the FPFTY. Citizens' Stmt. No. 1-R at 4.

I&E recommended an adjustment of \$9,218 to the Company's original claim. I&E's recommendation is based on the HTY material expense, arguing that the Company's significantly increased material expense claim (+44.63%) in the FPFTY over the HTY expense was not justified and supported by the most recent three years' declining expense trend. I&E Stmt. No. 1 at 13. I&E argues that the Company's projection of a significant increase in material expense (40.42%) in the FTY over 2018 expense was not explained or supported when Citizens' experienced a declining trend in material expense from 2016 through 2018. I&E Reply Brief at 11.

In response to I&E's proposed adjustment, Citizens' argues that its year-to-date (YTD) data from September 30, 2019 supports a FPFTY expense total of \$277,036 for this expense, which is \$1,221 above the Company's claim. Citizens' argues that historic averages are not controlling when the Company demonstrates FPFTY expense increases. Citizens' Reply Brief at 15.

Disposition

⁴ This expense includes employee salaries and wages, overhead (employee benefits), transportation, material, safety material, travel, and retiree health expenses. I&E Exhibit No. 1, Schedule 4.

We agree with I&E's argument that the entirety of Citizens' claim for this account is not justified. Citizens' did not put forth sufficient evidence to support its increased material expense claim in the FPFTY over the HTY expense, given the fact that the material expense has declined in recent years. The YTD data from September 30, 2019, supports a FPFTY expense total of \$268,967 (not including a 3% inflation factor). Thus, although Citizens' claim of \$275,814 is not justified, a FPFTY amount of \$268,967 is justified for this expense based on annualization of the 9-month, September 30, 2019 data.

Therefore, we recommend an allowance of \$268,967 for Account 588.

4. Customer Records & Collection Expense (Account 903)

Position of the Parties

Citizens' made an original claim of \$469,626 for customer records and collection expense⁵ in the FPFTY.

Nine-month data for the FTY (as of September 30, 2019) provided by the Company shows a FTY amount of \$327,891. The FTY data annualized shows an amount of \$437,188. Applying a 3% inflation adjustment to the FTY annualized amount would show a new claim amount of \$450,304 for the FPFTY. Citizens' Stmt. No. 1-R at 4.

I&E recommended an adjustment of \$13,650 to the Company's claim. I&E's recommendation is based on the HTY "material" expense, claiming that the Company's significantly increased material expense claim (+13.15%) in the FPFTY over the HTY expense is not justified and supported by the most recent three years' declining expense trend. I&E Stmt. No. 1-SR at 14-15. I&E argues that the Commission should find I&E's recommended allowance for material expense based on the HTY's expense is appropriate because the Company experienced a declining trend in material expense from 2016 through 2018 and it did not support

⁵ This expense includes employee salaries and wages, overhead (employee benefits), transportation, and material expenses. I&E Exhibit No. 1, Schedule 5.

the significant increase in the FTY and FPFTY's material expense claim included in the customer records and collection expense. *Id.*

As the total account expense for Account 903 is tracking below projected amounts, Citizens' states that the Company accepts I&E's proposed adjustment to this account if the Commission addresses the Advocates' proposed adjustments on an account-by-account basis. Citizens' Main Brief at 52.

OCA recommended an adjustment of \$43,591 to the Company's claim. OCA claims that the Company includes costs that are not normal or on-going in its forecast for Account 903. OCA Stmt. 1 at 6. Those costs are costs relating to the training of a new employee and employee overlap planned for 2019 and 2020. To remove the overlap expense, OCA recommends using the 2018 labor and average material cost for the years 2016 through 2018. OCA Stmt. 1 at 6.

Disposition

We agree with I&E on this issue in that Citizens' did not support the entirety of its original claim of \$469,626. Given that its original claim of \$469,626 is greater than the costs this Account is tracking by the end of the year (\$450,304, including the inflation adjustment), Citizens' needed to provide sufficient evidence to justify its original claim, which it did not. Citizens' did not justify why it projected the material expense subcategory of this expense to increase in the FPFTY when the Company had experienced a declining trend in the material expense subcategory in recent years. Citizens' also indicated it accepts I&E's adjustment because Account 903 is tracking below projections.

Therefore, we recommend an allowance of \$437,188 for Account 903, based on annualization of the 9-month, September 30, 2019 data.

5. Outside Services (Account 923)

Position of the Parties

Citizens' made an original claim of \$81,370 for outside services⁶ in the FPFTY. The claim is lower than the expense in the HTY due to the Company removing one-time expenses from HTY. OCA Stmt. 1 at 7.

Nine-month data for the FTY (as of September 30, 2019) provided by the Company shows a FTY amount of \$47,175. The FTY data annualized shows an amount of \$62,900. Applying a 3% inflation adjustment to the FTY annualized amount would show a new claim amount of \$64,787 for the FPFTY. Citizens' Stmt. No. 1-R at 4.

I&E recommended an adjustment of \$25,380 to Citizens' original claim. I&E's recommendation for the FPFTY is based on the annualized FTY's Outside Services expense of \$55,990,⁷ which reflects the removal of one-time legal expenses incurred in the HTY and is reasonably consistent with the last three years' expense level. I&E Stmt. No. 1 at 19-20. Specifically, I&E notes that the Company's historic outside services for 2016, 2017, and 2018 (after adjusting the one-time legal expense) were \$53,612, \$52,217, and \$55,762.⁸ I&E argues that the Company's claim for the significant increased level of legal expense in the FPFTY is unsupported as Citizens' witness Kelchner has not explained the reason for the large increase in legal expenses in the FTY (after adjusting the one-time legal expense). I&E Main Brief at 22.

OCA recommended an adjustment of \$28,456 to the Company's original claim. OCA claims that the Company does not appear to have removed all one-time expenses from its claim. OCA Stmt. 1-SR (Revised), at 6. OCA witness Sherwood notes that Company witness Gorman's annualized FTY expense amount is \$18,470 below the Company's claim for FPFTY,⁹

⁶ This expense includes accounting and legal services. I&E Exhibit No. 1, Schedule 7.

⁷ I&E appears to base its adjustment on the annualized FTY expense as of June 30, 2019.

⁸ The figure for 2018 includes a \$35,988 downward adjustment for a one-time legal expense (\$91,750-\$35,988). I&E Stmt. No. 1 at 19-20. \$35,988 reflects the change in legal expense from 2017 to 2018. I&E Exhibit No. 1 (Proprietary), Schedule 7.

⁹ OCA appears to base its adjustment on the annualized FTY expense as of June 30, 2019.

which indicates that the Company's claim is likely higher than what will actually be incurred. OCA Stmt. 1-SR (Revised), at 6. Ms. Sherwood's recommended adjustment reflects a normalized period for 2016 and 2017, excluding 2018 to eliminate one-time expenses, which results in a reduction of \$28,456. OCA Main Brief at 29.

Alternatively, Citizens' also argues that a claim for \$64,787 is reasonable if the Commission agrees that a downward adjustment is necessary, which is the annualized 9-month (as of September 30, 2019) YTD projection, plus an inflation adjustment. Citizens' Main Brief at 52.

Disposition

We agree with I&E on this issue. One-time legal expenses should be removed from the Company's claim, as it was an expense that was imprudently incurred in the HTY and will not occur again in the FPFTY. Furthermore, the Company did not justify its claim for the significant increased level of legal expense in the FPFTY. However, I&E appears to base its adjustment on the annualized FTY expense as of June 30, 2019, when data as of September 30, 2019 is available. Thus, we will use more up-to-date data in making our recommendation. We will recommend that the Commission approve an allowance of \$62,900 for Account 923, which is the annualized 9-month YTD projection, minus an inflation adjustment. This figure should also remove any concern that OCA might have about one-time costs in the projected FTY expense amount.

Therefore, we recommend that the Commission approve an allowance of \$62,900 for Account 923.

6. Employee Pension & Benefits (Account 926)

Position of the Parties

Citizens' made an original claim of \$10,300 for employee pension and benefits in the FPFTY.

Nine-month data for the FTY (as of September 30, 2019) provided by the Company shows a FTY amount of \$11,931. The FTY data annualized shows an amount of \$15,908. Applying a 3% inflation adjustment to the FTY annualized amount would show a new claim amount of \$16,385 for the FPFTY. Citizens' Stmt. No. 1-R at 4.

OCA recommends an adjustment of \$8,039 to the Company's original claim. OCA notes that this account includes employee appreciation expenses such as employee gifts, Christmas parties, picnics, and retirement parties. OCA Stmt. 1 at 8. In 2018, the Company spent \$1,150 on a retirement party and \$3,270 on a Christmas party. OCA proposes to disallow such expenses, claiming that such expenses "do not serve to enhance service to customers and should not be supported by rates." After eliminating such expenses, and leaving expenses such as coffee, equipment lease, national night out, and a safety breakfast as the remaining employee appreciation expenses, Citizens' would be left with a figure of \$2,261 for the FPFTY. *Id.* OCA cites to *Pa. Pub. Util. Comm'n v. Pennsylvania-American Water Co.*, 1993 Pa. PUC LEXIS 79, *121-23 and *Pa. Pub. Util. Comm'n v. Citizens' Utilities Water Co. of Pa.*, 169 PUR 4th 552, 584-85 (1996) for the proposition that the Commission has consistently disallowed these types of entertainment expenses.

Citizens' defines the expenses that OCA seeks to disallow as employee activity expenses relating to employee recognition events. Citizens' cites to the *UGI Order*, for the proposition that a utility may "claim employee activity as an expense where the employee activity is for the purpose of employee recognition." *UGI Order* at 70.

Company CEO Kelchner stated the following with respect to Company events paid for under Account No. 926:

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

Citizens' Stmt. No. 4-R at 7.

The CEO claimed that the special events are to recognize the employees' hard work and dedication, as well as to boost employee engagement and the morale of the overall workforce. *Id.*

Disposition

We agree with Citizens' on this issue. The key question is whether the employee activity costs in question are reasonable and necessary in the providing utility service to customers. We determine that such costs are reasonable and necessary in the provision of 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), 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 statement 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 the Commission has previously held that employee activity costs clearly identified as employee recognition costs can be claimed as an expense. See *Pa. Pub. Util. Comm’n v. UGI Utilities, Inc. – Electric Division*, R-2017-2640058 (Order entered October 25, 2018) (citing *Pa. Pub. Util. Comm’n v. York Water Co.*, 62 Pa. PUC 459 (1986) and *Pa. Pub. Util. Comm’n v. Columbia Water Company*, Docket No. R-2013-2360798 (Order entered January 23, 2014)). Employee recognition costs improve employee/management and employee/customer relations, leading to a direct impact on utility service provided by those employees which in turn enhances service to customers.

We believe that Citizens’ provided sufficient evidence to show that the employee activity costs in question are employee recognition costs. As testified by the Company’s CEO,

the activities in question have an element of employee recognition in that members of the Company's senior staff recognize employee contributions to the Company.

As such, we recommend that the Commission approve the Company's claim for Account 926. The Company's original claim is \$10,300. Its annualized 9-month YTD projection, minus an inflation adjustment, is \$15,908. Therefore, we recommend an allowance of \$15,908 for Account 926.

7. Rate Case Expense – Normalization Period

Position of the Parties

Citizens' made a claim for Rate Case Expense of \$326,000, to be normalized over 36 months resulting in a normalized claim of \$108,667. Citizens' acknowledged that the average filing interval for its last three rate cases is 48 months but explained that 48 months is neither the most "typical" filing frequency nor the Company's anticipated time frame before the next base rate filing. Citizens' notes that its filing intervals have been 37 months, 75 months and 34 months, and claims that rejecting Citizens' claim to normalize its Rate Case Expense over 36 months would be penalizing them for being able to forego a rate case for 3.25 additional years (75 months -36 months). Citizens' Stmt. No. 1-R at 5. Citizens' additionally argues that the Company's continued expenses related to tree trimming, capital replacements, and other reliability enhancing projects, combined with the Company's limited prospects for load growth, results in a reasonable expectation of a 36-month period between rate cases. Citizens' Stmt. No. 1-R at 5; Citizens' Stmt. No. 4-R at 5. Specifically, Citizen Witness Kelchner testified to the following:

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

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

Citizens' Stmt. No. 4-R at 5.

Citizens' cites 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, citing to *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 recommends that Citizens' claim for Rate Case Expense of \$326,000 be normalized over a period of 48 months resulting in a normalized claim of \$81,500. I&E states that normalization of the rate case expense should be based on historic evidence of the Company's filing frequency, citing to *Pa. Pub. Util. Comm'n v. Emporium Water Co.*, Docket No. R-2014-2402324 (Opinion and Order entered January 18, 2015). I&E submits that the factors that Citizens' cites to justify its claim for a 36-month normalization period do not merit deviation from the Commission's endorsed practice of reviewing historical filing frequency. I&E's Main Brief at 25. I&E notes 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 Stmt. No. 1-SR at 6.

OCA recommends that Citizens' claim for Rate Case Expense of \$326,000 be normalized over a period of 45 months resulting in a normalized claim of \$86,933; 45 months is the average period of Citizens' last four rate cases, including this present case. OCA states that when coming to the normalization of the Rate Case Expense, the Commission utilizes the average period between rate cases. OCA states that this method is not done to penalize a Company from filing a rate case; rather, it is a way to match the expense recovery over the average period of time when cases are filed. OCA Stmt. 1-SR (Revised) at 11.

Disposition

We agree with Citizens' 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. Citizens' requested a 36-month normalization period, I&E requested a 45-month normalization period, and OCA requested a 48-month normalization period. The filing intervals for Citizens' last three rate cases have been 37 months, 75 months, and 34 months, which averages out to be 48 months

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 Corp.*, 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. We are persuaded that the Company's expenses relating to tree trimming, capital replacements, and other reliability enhancing projects, in addition to the Company's limited prospects for load

growth, lead to the likelihood of another rate case filing occurring within the next three years as opposed to four years.

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. Notably, in the *UGI Order*, UGI had not filed a rate case for 22 years. The Commission did not look at UGI's historic filing frequency but instead based its determination to grant UGI's three-year normalization request based off UGI's future expectations that it would be more likely to file its next rate case within a three-year period.

Citizens' future expectations indicate that the three-year filing period between the present case and the last rate case in 2016 is not a one-time occurrence. The historic filing frequency is inflated by Citizens' choose to forgo a rate case filing for approximately six years (75 months / 12 = 6.25) since the last rate case was filed. Traditionally, Citizens' files rate cases within a three-year window.

We also find that accepting either I&E or OCA's proposal would likely result in an under collection in the likely event that Citizens' files a rate case within the next three years. It is more likely that Citizens' will file a rate case within the next three years as opposed to the next four years, given the history of Citizens' filings not factoring in the 75-month outlier.

Therefore, we recommend that the Commission accept Citizens' expense claim for rate case expense, to be normalized over three years (\$108,666).

8. Cash Working Capital

As noted previously in this Decision, Citizens' 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 (\$83,187), CWC will be adjusted downwards by \$10,398 ($\$83,187 * 12.5\%$).

9. Depreciation Expense

Position of the Parties

As a result of Citizens' use of the end of test year rate base, Citizens' has based its test year depreciation expense on the projected balance of plant in service as of the end of the FPFTY. OCA Stmt. 2 at 7; OCA Main Brief at 33.

OCA recommends an adjustment to the depreciation expense in order to 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; therefore, OCA claims the accumulated depreciation expense should be reduced by \$22,663. OCA Reply Brief at 21; OCA Stmt. 2 at 8.

Disposition

We agree with Citizens' 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*, 390 A.2d 849 (Pa. Cmwlth. 1978). The issue between Citizens' and OCA with respect to depreciation expense is the question of which methodology should be used to base the depreciation expense. Citizens' 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 claim 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*, Citizens' should be permitted to utilize the end-of-year methodology in the FPFTY. Thus, it is proper for Citizens' 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.

C. Conclusion

Consistent with the above discussion, we recommend an adjustment of total claimed expenses for the FPFTY in the amount of \$81,330, which equates to total O&M expenses of \$2,722,403. We have accepted Citizens' 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

Citizens' is seeking an overall rate of return of 7.62%, including a cost of long-term debt of 4.86% and a cost of common equity of 10.30%. Citizens' Main Brief at 100. As more fully explained below, we recommend an overall rate of return of 7.34%, including a cost of long-term debt of 4.86% and a return on common equity of 9.74%. The return on common equity rate of 9.74% includes the 25-basis point addition requested by the company for management effectiveness.

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. Public 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 be 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. *Id.* 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 this 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*, 488 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 several 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. Cmwlt. 1978); *Octoraro Water Co. v. Pa. Pub. Util. Comm'n*, 391 A.2d 1129 (Pa. Cmwlt. 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. Cmwlt. 1979).

B. Capital Structure

Citizens' is proposing a capital structure of 49.33% debt and 50.67% equity. Citizens' Joint Stmt. 2 at 13-14. No parties dispute Citizens' proposal. OCA Stmt. 3 at 3; I&E Stmt. 2 at 16. We recommend adoption of Citizens' proposed capital structure.

C. Cost of Long-Term Debt

Citizens' is proposing a cost of long-term debt rate of 4.86%. No parties dispute Citizens' proposal. OCA Stmt. 3 at 3; I&E Stmt. 2 at 17. We recommend adoption of Citizens' proposed cost of long-term debt rate.

D. Cost of Common Equity

Citizens' seeks a 10.30% return on common equity, which results in an 7.62% overall rate of return. Citizens' Main Brief at 100. This is based on its proposed capital structure of 49.33% long-term debt and 50.67% common equity.

Description	Capitalization Ratio	Embedded Cost	Return-%
Long-Term Debt	49.33%	4.86%	2.40%
Common Equity	50.67%	10.30%	5.22%
Total	100.00%		7.62%

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 6.64%, including a cost of common equity of 8.38%. OCA Main Brief at 36.

Description	Capitalization Ratio	Embedded Cost	Return-%
Long-Term Debt	49.33%	4.86%	2.40%
Common Equity	50.67%	8.38%	4.24%
Total	100.00%		6.64%

I&E used the DCF model and the CAPM as a comparison to the DCF results. I&E recommends a 6.50% overall rate of return and an 8.10% return on equity. I&E Main Brief at 27.

Description	Capitalization Ratio	Embedded Cost	Return-%
Long-Term Debt	49.33%	4.86%	2.40%
Common Equity	50.67%	8.10%	4.10%
Total	100.00%		6.50%

Citizens' 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 Stmt. No. 2-R, Exhibit __ (DWD-1R), Sch. 1R at 2; Citizens' Main Brief at 60.

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

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

Citizens' Joint Stmt. 2 at 4-5; Citizens' Main Brief at 62-63.

The results derived from each are as follows:

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

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

6.	Size Adjustment	1.00	1.00
7.	Performance Factor Adjustment	<u>0.25</u>	<u>0.25</u>
8.	Recommended Common Equity Cost Rate	<u>10.30</u> %	<u>10.60</u> %

Citizens’ Joint Stmt. 2-R, Exhibit __ (DWD-1R), Sch. 1R at 2.

As indicated in the above table, the Rebuttal update reduced the recommended ROE for Citizens’ from 11.15% to 10.30%. Citizens’ Main Brief, Table 4 at 64.

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, at 96-97 (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 and 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.

Citizens' Stmt. 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. 2 at 10-11.

OCA witness Habr accepted the proxy group developed by Mr. D'Ascendis with two exceptions. OCA Main Briefat 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 Citizens' Joint Stmt. 2-R at 4; Citizens' Reply Brief at 20.*

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. 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 Stmt. No.*

2-R at 4; *see also*, I&E Stmt. No. 2 at 13-15.¹⁰ 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 Stmt. 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.

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. Citizens'

¹⁰ 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* Citizens' Joint Stmt. 2-R at 4.

Stmt. 2-R at 3. As previously referenced, the main difference between Citizens' 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. Spadaccio states that the sixth criterion ensures that each company in the proxy group operates in a similar deregulated market. I&E Stmt. 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. As such, we will accept Mr. D'Ascendis' proxy group.

2. Discounted Cash Flow (DCF)

Citizens' 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 Spadaccio 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.

My analysis employs the constant growth DCF model as portrayed in the following formula:

$$K = D_1/P_0 + g$$

Where:

$$K = \text{Cost of equity}$$

D_1 = Dividend expected during the year
 P_0 = Current price of the stock
 g = Expected growth rate

I&E Stmt. 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
Citizens'	8.27%	10.30 % ¹¹
OCA	8.16-8.51%	8.38% ¹²
BIE	8.10%	8.10%

We note that 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 Citizens' 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. Dividend Yield

To derive the dividend yield for his DCF model, Mr. D'Ascendis calculated each proxy company's dividends as of September 30, 2019, and divided by the average closing market price for the 60 trading days ending September 30, 2019. *See* Statement No. 2 at 17; *see also* Statement No. 2-R, Exhibit ___

¹¹ Citizens' 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.

¹² 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.

(DWD-1R), Schedule 1R at 3, fn. 1 (showing updated dividend yield reflecting data available as of September 30, 2019). Mr. D'Ascendis applied a conservative adjustment to reflect prospective increases to the dividend yield, in accordance with the Gordon Periodic version of the DCF model. Mr. D'Ascendis describes the necessary adjustment in his Direct Testimony as follows:

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

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

ii. Growth Rate

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

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

Id. Subsequently to submitting Direct Testimony, Mr. D'Ascendis eliminated Reuters' growth rates from his calculation because the organization stopped publishing projected earnings growth rates on its website. Joint Stmt. 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.

Citizens' Main Brief at 65-66.

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

Citizens’			
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. Citizens’ 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 Citizens’, OCA witness Dr. Habr instead conducted multiple DCF analyses for each company within his electric proxy group. See 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. 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 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	<i>Value Line</i> 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:

Based upon his analysis, 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%.¹³ 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 $\frac{1}{2}$ the expected growth rate in order to account for changes in the dividend paid in period 1.¹⁴

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%.¹⁵

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%.¹⁶

I&E Main Brief at 31-32.

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:

¹³ I&E Stmt. No. 2 at 27.

¹⁴ I&E Stmt. No. 2 at 25.

¹⁵ I&E Stmt. No. 2 at 26.

¹⁶ 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 OCA. As all parties' DCF results were fairly similar and thus appear reasonable, we have selected Citizens' DCF model on the slight strength of the proxy group.

3. Capital Asset Pricing Model (CAPM)

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." Citizens' Main Brief at 68. 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.¹⁷ 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.¹⁸ I&E Main Brief at 33.

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. 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,

¹⁷ 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.

¹⁸ In rebuttal testimony, Citizens' witness D'Ascendis provided analysis disputing various data sources relied upon by I&E witness Spadaccio in his CAPM analysis. Citizens' Stmt. No. 2-R at 26-27. As I&E Witness Spadaccio explains, even if Citizens' 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.

2019. *Id.* The calculated betas were then adjusted using *Value Lines* adjusted formula. OCA Stmt. 3 at 16; OCA Main Brief at 52. 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 54.

Mr. D'Ascendis also conducts a CAPM ROE analysis. The traditional CAPM "is applied by adding a risk-free rate of return to a market risk premium, which is adjusted proportionately to reflect the systemic risk of the individual security relative to the total market as measured by the beta coefficient." *See* Joint Stmt. No. 2 at 32. Citizens' Main Brief at 68.

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 Stmt. 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%.¹⁹ Citizens' Main Brief at 86-89.

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." Citizens' Joint Stmt. 2 at 34; Citizens' Main Brief at 68. A detailed description of each of the six data-based market risk premiums is presented in Mr. D'Ascendis' Direct Testimony. Joint Stmt. 2 at 34; *see also*

¹⁹ 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 Stmt. 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 Stmt. No. 2-R, Exhibit __ (DWD-1R), Schedule DWD-1R at 42, fn.2.

Citizens' Joint Stmt. 2-R, Ex. __ (DWD-1R), Sch. DWD-1R at 42. Mr. D'Ascendis' Exhibit __ (DWD-1R) shows the derivation of his 10.05% market risk premium based on the updated average of the aforementioned six data-based market risk premiums. As reflected on page 41 of Mr. D'Ascendis' Exhibit __ (DWD-1R), applying the above-referenced risk-free rate and market risk premium to the traditional CAPM and the ECAPM for the Electric Utility Proxy Group results in a CAPM equity cost rate of 8.27% and an ECAPM equity cost rate of 9.38%. Citizens' Joint Stmt. 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%. Citizens' Main Brief at 69. We note the standalone CAPM ROE and DCF ROE were both 8.27%, thus making Mr. D'Ascendis' DCF analysis appears reasonable.

4. Size Adjustment

Citizens' 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. Citizens' 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. 2 at 45. Citizens' 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 Stmt. No. 2 at 42. Mr. D'Ascendis additionally cites to the "The Capital Asset Pricing Model: Theory and Evidence," in which Fama and French observe that:

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

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

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

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

To determine whether a size adjustment should be incorporated, Mr. D'Ascendis conducted a market capitalization analysis to quantify the relative size risk. Joint Statement No. 2 at 44. Mr. D'Ascendis' study observed that, as of March 29, 2019, Citizens' had a market capitalization of \$26.840 million compared with an average company market capitalization of \$16,675.447 million for the Electric Utility Proxy Group. *Id.* at 45. This amounts to a size difference of 621.3x.²⁰ *Id.*

In order to quantify the appropriate size adjustment, Mr. D'Ascendis relied on "size premiums for portfolios of New York Stock Exchange, American

²⁰ *Id.* Notably, Mr. D'Ascendis also pointed to Citizens' rate base as an indicator of size, observing that even the combined \$45 million rate base of Citizens', Valley, and Wellsboro are multiple times smaller than the \$1.6 billion rate base of the average electric utility granted a ROE of approximately 9.60%. *See* Tr. 44.

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

Citizens' Main Brief at 95-96.

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

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

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

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

Decile	Market Capitalization (\$Mil)		Size Premium	OLS Beta
	Low	High		
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 Stmt. 3 at 29-30. (Footnote omitted). Accordingly, 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 30-31.

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 60.

Citizens' 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 assess 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 than market capitalization to assess size risk. Further, even accepting OCA's premise, the size premium calculated by Mr. D'Ascendis represents the *spread* between the Company decile size premium and average proxy group decile size premium. See Joint Statement No. 2 at 45.

As demonstrated by the Duff & Phelps size premiums chart provided in OCA's testimony, the spread between decile 10 and decile 1 remains consistent with Mr. D'Ascendis' proposed size adjustment of 100 basis points. *See* OCA Statement No. 3 at 29.

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

Citizens' Main Brief at 99.

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

Witness Spadaccio rebutted Citizens' 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.²¹ I&E witness Spadaccio also opines Citizens' 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.

Specific to the utility industry, I&E witness Spadaccio cites an article stating a size adjustment for risk is not applicable to utility companies.²² 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

²¹ I&E Stmt. 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 were 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."))

²² I&E Stmt. No. 2 at 41-42.

industrials, the findings suggest that there is no need to adjust for the firm size in utility rate regulation.²³

I&E Main Brief at 48-49.

Citizens' responds to I&E's arguments on page 97 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.

Citizens' Main Brief at 97.

I&E responds to Citizens' argument on page 49 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.²⁴ Additionally, Dr. Zepp admitted the limited relevance of the two studies,

²³ Wong, Annie, "Utility Stocks and the Size Effect: An Empirical Analysis" *Journal of the Midwest Finance Association* (1993), pp. 95-101.

²⁴ I&E Stmt. No. 2-SR at 22.

stating “to the extent that water utilities are representative of all utilities, there is support for smaller utilities being more risky than larger ones”.²⁵

I&E Main Brief at 49.

Citizens’ 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:

Main Brief Table 8

Relationship Between Size and Risk for the Value Line Universe of Utility Companies



²⁵ Citizens’ Stmt. 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).

Joint Stmt. 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 Stmt. No. 2-R, p. 36.

Citizens' Main Brief at 98-99.

We are persuaded that there is a general inverse relationship between size and risk; 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. Similarly, 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 Citizens' is a smaller company.

Citizens' addresses this issue on pages 94-95 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 Stmt. No. 2 at 42. Per Mr. D'Ascendis' explanation, failure to reflect the increased risk faced by smaller public utilities such as Citizens' would understate the ROE demanded by investors. Citizens' witness Mr. Kelchner further details the realities of small company risk in the following excerpt from his Direct Testimony:

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

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

Citizens' Main Brief at 94-95.

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. Citizens' 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 Citizens’ mean and median constant growth DCF results. We note that the top of Citizens’ 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.

Citizens’			
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.

Citizens' 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.

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

In managing operations and costs, Citizens' has gone beyond what it is required to do by improving the quality of public utility service for customers in multiple respects. As Company Chief Executive Officer John

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

In order to highlight the gravity of the accomplishments Citizens' has made, a few of these achievements will be explained in more detail. With respect to Citizens' low number of customer complaints, for the years of 2016 to 2018, Citizens' received 13 informal complaints but no formal complaints. *Id.* at 9. Further, each informal complaint was either resolved within nineteen days or dismissed by the Commission. *See id. at Exhibit__ (JK-1)*. Citizens' high responsiveness in customer support calls is reflected in Exhibit__ (JK-3) attached to Mr. Kelchner's Direct Testimony, which shows that, on average, Citizens' responds to 97% of customer phone calls within thirty seconds. *See id. at Exhibit__ (JK-3)*. The Company has also sustained excellent reliability metrics in 2018 by meeting, and in some cases, out-performing, all applicable Commission reliability objectives. *Id.* at 10. Through Citizens' completion of an electronic attachment mapping and audit project the Company was able to realize a 9.2% increase in pole attachment billing from 2018 to 2019. *Id.* at 11. The revenues from pole attachment billing aided Citizens' in offsetting the increased distribution system expenses and reducing the revenue requirement to be recovered from ratepayers. Further, Citizens' has continued to invest approximately \$1.4 million per annum in system replacements and improvements which ultimately help the Company to continue providing excellent and reliable service to its customers. *Id.* at 12. Notably, Citizens' implemented these system improvements through effective management of base rate revenues, without employing a DSIC. *Id.*

Both OCA and I&E challenge Citizens' 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. 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 Citizens' 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. 2 at 43.

We agree with Citizens' 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, Citizens' 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 Citizens' request that it be given a 25-basis point upward adjustment for management effectiveness be approved.

E. Summary of Citizens' Return on Common Equity

Citizens' 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." *City of Dubois Water Bureau* 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 will use the top of Citizens' DCF range of 9.49% reflecting Citizen's status as a company many magnitudes smaller than the companies in the proxy group.

Additionally, we grant Citizens' the additional 25% management effectiveness adjustment for a ROE of 9.74%.

F. Conclusion

The parties do not dispute a capital structure consisting of 49.33% debt and 50.67% equity; nor do the parties disagree to a cost of debt of 4.86%. Although agreement could

not be reached regarding the cost of equity, we have examined the testimony and determined a 9.74% 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 7.34%.

Description	Capitalization Ratio	Embedded Cost	Return-%
Long-Term Debt	49.33%	4.86%	2.40%
Common Equity	50.67%	9.74%	4.94%
Total	100.00%		7.34%

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 (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 Citizens' customers, there is disagreement as to the appropriate commencement date of the flowback.

Citizens' Position

Citizens' 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. Citizens' Stmt. No. 1 at 14. The EDIT balance included in rate base declines each year during this ten-year period. The annual EDIT accretion (Schedule C1-6, line 40) is carried forward to reduce Income tax expense (Schedule C1-4, line 28). *Id.*

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 19. Citizens' 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." Citizens' Stmt. No. 1-R at 13. Citizens', 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 Citizens' 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 9.

In response to Citizens' assertion that rates were changed in 2018 to reflect the TCJA, which gave rise to the EDIT, OCA argues that Citizens' did not provide any documentation to support this claim. OCA Stmt. No. 2-SR at 8-9. OCA specifically denied that Appendix A, Attachment C, Page 2 of Citizens' filing identifies any flowback of the EDIT in the determination of the Company's rate reduction or otherwise demonstrates how the EDIT was returned to customers during that period. OCA Stmt. No. 2-SR at 9. Referring to Appendix A, OCA's witness testified that, according to Citizens' in Docket No. R-2018-3000558, the Commission reduced its rates by -0.82 % 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 -0.82 % rate reduction. OCA Stmt. No. 2-SR at 8-9.

Effect of Tax Cuts and Jobs Act (TCJA) on Rates

<u>Pre TCJA Taxes</u>	<u>Net Tax Effect</u>
Federal- Current (Page 1, Column 4, Line 23)	\$ 274,492
Federal- Deferred	\$ 1,984,100
<u>Less: Post TCJA Taxes</u>	
Federal- Current (Page 1, Column 4, Line 24)	\$ 169,539
Federal- Deferred	\$ 1,438,800
Effect of TCJA On Income (A)	\$ 104,953
Change in ADIT	\$ 545,300
Commission Approved Rate of Return (Note 1)	5.27%
Effect of ADIT Change on Income (B)	\$ 28,737
Earnings Excess (Line A - Line B) Complement of Tax Rate	\$ 76,216 0.711079
Revenue Excess	\$ 107,183
Commission Allowed Revenues (Note 2)	\$ 13,135,279
Percent Decrease Per Bill	-0.8160%

Note 1: Citizens' last approved rate case was a black box settlement. The rate used in the above calculation is based on the rate of return from the 2017 earnings report.

Note 2: Excludes Other Operating Revenues.

Since the rates do not appear to have been changed to flow back the EDIT, OCA recommended an adjustment on Schedule LKM-5 to reverse the flowback of EDIT reflected in the Company's filing. This adjustment increases the EDIT balance by \$17,480 and reduces rate base by the same amount. OCA Stmt. No. 2 at 10, Sch. LKM-5; *see*, OCA witness Sherwood's flow-through of Mr. Morgan's adjustment at OCA Stmt. No. 1 at 3; OCA Stmt. No. 1-SR (Revised) at Sch. SLS-3C; App. A, Table II.

I&E's Position

I&E indicated that its various recommendations have a flow-through impact on Citizens' taxes for the FPPTY as depicted in Table I which was submitted with its main brief.

OSBA's Position

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

Disposition

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 9. Looking at Docket No. R-2018-3000558, the Commission reduced Citizens' 2018 rates by -0.82 % 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 -0.82 % rate reduction. OCA Stmt. No. 2-SR at 8-9. We agree that Citizens' 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 LMK-5 to reverse the flowback of the EDIT reflected in the Company's filing. This adjustment increases the EDIT balance by \$17,480 and reduces rate base by the same amount. OCA Stmt. 2 at 10, Sch. LMK-5; *see*, OCA witness Sherwood's flow-through of OCA witness Morgan's adjustment at OCA Stmt. 1-SR (Revised) at Sch. SLS-3; OCA Main Brief at 63-66, App. A, Table II.

B. Deferred Regulatory Liability

In Docket No. M-2018-2641242, the Commission ordered each utility to create a deferred regulatory liability account to record the tax savings associated with the TCJA for the January 1, 2018 through June 30, 2018 time period. *Tax Cuts and Jobs Act of 2017*, Docket No. M-2018-2641242 (Order entered May 17, 2018). Citizens' implemented a voluntary surcharge (TCJA Voluntary Surcharge) that served as a sur-credit to flow back benefits to customers. Joint Stmt. No. 3 – Direct Testimony of Melissa Sullivan (Joint Stmt. No. 3) at 13. Citizens' 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. 3 at 13. Subsequently, Citizens' submitted a reconciliation statement in May 2019, but proposed to keep the distribution rates at the current levels pending resolution of this rate case.

Citizens' proposes to maintain the current distribution rates reflecting the TCJA Voluntary Surcharges during the pendency of this base rate case, after which a final reconciliation for the TCJA Voluntary Surcharge will be calculated. Citizens' requested to provide a final reconciliation of the TCJA Voluntary Surcharges within 120 days after new rates take effect. Joint Stmt. No. 3 at 13. OCA does not agree with this proposal.

Citizens' Position

Citizens' supports its proposal by arguing that it will not have the 2019 tax data to perform the reconciliation until March or April of 2020. Citizens' 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, Citizens' cautions that this may not be possible. Joint Stmt. No. 3-R – Rebuttal Testimony of Melissa Sullivan (Joint Stmt. No. 3-R) at 2. Therefore, based on the availability of final 2019 tax data, Citizens' 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 Citizens' proposal should not be adopted because it is not consistent with the Commission's Order at Docket No. R-2019-3000558. 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 TCJA 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.

Tax Cuts and Jobs Act – Citizens’ Electric Company of Lewisburg, Pa., Docket No. R-2018-3000558, Order at 5. (November 8, 2018) (footnotes omitted).

OCA believes that a reasonable approach is for Citizens’ 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 the rates from this proceeding and tax savings collected from January 2018 through June 2018, including accumulated interest, be returned to customers as soon as possible. OCA, therefore, believes 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 10.

Disposition

We agree with Citizens’ regarding the filing of the final reconciliation of the TCJA Voluntary Surcharges. Citizens’ 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 Stmt. No. 3-R at 2. Citizens’ requests to submit its final reconciliation within 120 days after the new rates in this proceeding take effect. Conversely, OCA requests that Citizens’ 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 Citizens’ position that it will not have the necessary tax data until March or April to even begin completing its final reconciliation, Citizens’ proposal is more reasonable given these constraints. Therefore, we recommend that Citizens’ proposal be adopted and a final reconciliation of the TCJA Voluntary Surcharge be completed within 120 days after the new rates take effect.

In addition, while OCA argues that Citizens' 120-day proposal is not consistent with the Commission's Order at Docket No. R-2019-3000558, 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 Citizens' 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.

VII. 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).

A. Allocated Class Cost of Service Study (ACCOSS)

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:

[W]hile 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 v. Pa. Pub. Util. Comm’n, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006)(*Lloyd*).

Citizens’ Position

Citizens’ argues that its 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. Citizens’ Stmt. No. 1 at 17. Citizens’ 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 17-18.

Citizens’ 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 18. Mr. Gorman then assigned or allocated assets and costs, as set forth on Exhibit __ (HSG-1), Schedules D through D6 attached to his direct testimony. *Id.* In further support of its ACCOSS, Citizens' 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). Citizens' Stmt. No. 1-R at 14.

Citizens' 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. Citizens' noted that while OCA witness Mierzwa found Citizens' primary plant classification as demand-related generally acceptable and accepted Citizens' 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, Citizens' 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. Citizens' 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 OCA." *UGI Order* at 160. In short, Citizens' argues that absent the use of the minimum system, the distribution costs are incorrectly allocated to each class.

OSBA's Position

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

I&E's Position

I&E did not identify any issues with Citizens' cost-of-service study methodology.

OCA's Position

OCA argued that there were flaws in Citizens' ACCOSS and recommended modifications which it believes more properly reflect the costs of providing service to each class.

In his ACCOSS, company witness Gorman classified 100% of primary distribution plant as demand-related, 100% of services and meters as customer-related, and a significant portion of secondary distribution plant upstream of meters and services as customer-related. Mr. Gorman also reflected the completion of a 3 MW solar installation at Bucknell in the cost study. OCA has accepted Citizens' classification of primary distribution plant as demand-related and the classification of services and meters as customer-related. It does not, however, accept the reduction in revenue associated with the proposed solar installation in the ACCOSS. OCA argues that Citizens' has inappropriately classified secondary distribution costs upstream of the meters and service drops as partially customer-related and that classifying secondary distribution plant costs as demand-related is a better reflection of cost causation principles. OCA Stmt. No. 4 at 8. In addition, Citizens' proposed ACCOSS reflects a loss of revenue from the solar installation at Bucknell and classifies a significant portion of secondary upstream distribution plant as customer related. OCA argues that this is inappropriate because 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, and no revenue loss should be included in the ACCOSS.

OCA witness Mierzwa testified that the secondary portion of upstream distribution plant should be classified as 100% demand related. OCA Stmt. No. 4 at 4, 10. Citizens' witness uses a minimum system approach to estimate a customer-related portion of line transformers and what he terms a "zero-load analysis" to estimate the customer-related portion of all other upstream secondary distribution plant (poles; towers, fixtures, overhead conductors and

devices; underground conduit; and underground conductors and devices). OCA Stmt. No. 4 at 9. In determining the classification for secondary distribution plant as customer-related, however, OCA argues that Citizens' failed to account for how the distribution system is engineered and how it is designed to work on a day-to-day basis and that "zero-load analysis" has no basis in how secondary distribution costs are actually incurred or the reason for the incurrence of such costs. OCA argues that secondary distribution plant costs are incurred to meet the coincident loads of customers and the size and costs are a function of the diversity of customers' loads and expected future coincident loads and that Citizens' assumptions shift cost responsibility. OCA Stmt. No. 4 at 10.

OCA also noted that Citizens' used a minimum system analysis for the portion of secondary distribution plant represented by line transformers to determine the percentage that is customer related. The cost of the hypothetical system is deemed to be customer related and the remaining actual cost is deemed to be demand-related. OCA Stmt. No. 4 at 9. OCA argues that even if a partial customer classification were appropriate, the Company's minimum system study used to determine the customer percentage for line transformers is flawed. Citizens' witness classified a portion of line transformer costs as customer-related based upon his estimate of the minimum size transformer. OCA Stmt. No. 4 at 12. OCA argues that this methodology is unsupported as the use of a minimum system analysis for transformers fails to reflect that the number, size, and costs of transformers will depend on the diversity of loads of the customers in a locality, the mix of customers served from the system in the area, the density of the population and the general configuration of the distribution system in the locality. Moreover, the size of the transformer which Citizens' has deemed minimum has significant load carrying capability. OCA submits that Citizens' proposed minimum system analysis for line transformers should be rejected.

OCA also modified the ACCOSS to determine the impact of the classification of upstream secondary distribution plant as 100% demand-related. 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. 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. 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." The Citizens' cost study was also modified to include the electric service requirements for Bucknell. OCA asserts that the rates of return for the residential class generally improve as a result of the modifications. OCA Stmt. No. 4 at 16. OCA submits that the Commission should adopt its ACCOSS which classifies 100% of the upstream secondary distribution plant as demand-related, classification of 100% of primary distribution as demand-related and 100% of services and meters as customer-related. *See*, OCA Stmt. No. 4 at Sch. JDM-4.

OCA also argued that Citizens' has inappropriately included in its proposed revenues the installation of a 3 MW solar installation. OCA does not agree that there is evidence to demonstrate that the solar installation will be completed in any part of the FPFTY. In addition to including the solar installation project in the FPFTY revenues, Citizens' witness Gorman also reflected the completion of this 3 MW solar installation in his cost study. OCA Stmt. No. 4 at 8. OCA does not accept the reduction in revenue associated with the proposed solar installation in the ACCOSS. *Id.* OCA submits that the Company's proposed inclusion of the revenue loss in the ACCOSS from the solar installation is inappropriate in this proceeding.

Disposition

We find that Citizens' ACCOSS is reasonable and should be adopted by the Commission – with one caveat that will be discussed below. As Citizens' 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, rather, expressed a few concerns about the classification of secondary portions of distribution plant (Accounts 364, 365, 366) and transformers (Account 368). Citizens' Stmt. No. 1-R at 14. Therefore, on the whole, the ACCOSS has been generally accepted by each of the parties.

When viewed in connection with Citizens' 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 Citizens' use of a minimum system approach to estimate a customer-related portion of line transformers and what Citizens' 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. Citizens' 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 OCA." *UGI Order* at 160.

In addition, we reject OCA's argument that Citizens' 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 Citizens' 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 Citizens', 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 Citizens' in this proceeding. In addition, the arguments made by OCA in this proceeding against Citizens' methods are the same arguments made by OCA in these two previous proceedings. On each of those occasions, the Commission rejected OCA's position. We do so again here. OCA has offered no convincing reasons for deviating from this accepted and approved approach.

It must be noted that there is a single caveat to our recommendation regarding Citizens' ACCOSS. We agree, as discussed above and in previous sections, that there is insufficient evidence to demonstrate that the Bucknell solar installation will be completed in any part of the FPFTY. As such, we agree with OCA that Citizens' proposed inclusion of the Bucknell solar revenue loss in the ACCOSS is inappropriate in this proceeding. Otherwise, we find no basis for rejecting Citizens' 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 Citizens' ACCOSS, without the inclusion of the Bucknell solar revenue loss, 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 v. Pa. Pub. Util. Comm'n*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2004) (*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).

Citizens' Position

In developing its proposed revenue allocation, Citizens' 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.

Citizens' Stmt. No. 1 at 29-30. The proposed revenue allocation is set forth in Schedule B6-4. Citizens' maintains that a rate decrease for rate class GLP-3 is reasonable and appropriate to bring all classes closer to cost of service. Citizens' 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, 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. Citizens' Main Brief at 107.

Citizens' witness Gorman stated, "the Company supports moving its classes closer to cost of service, including through rate reductions where appropriate." Citizens' Stmt. No. 1-R at 8. He also explained the Company's 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 scaleback...if the ACOS indicates a class is significantly over-earning at present rates, that class should receive a decrease in revenue.

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

Citizens' 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.

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

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

OCA's Position

OCA witness Mierzwa testified:

As is the case for Wellsboro, I agree that it is appropriate to move each class closer to its indicated cost of service and that extreme impacts should be mitigated. Similar to Wellsboro, I also believe that no class should receive a rate decrease at a time when rates are increasing. While I generally find Mr. Gorman's proposed revenue distribution to be reasonable, I disagree with Mr. Gorman's proposed rate decrease for the GLP-3 rate class.

OCA Stmt. No. 4 at 20-21. Mr. Mierzwa also testified that "[u]nder Mr. Gorman's proposed revenue distribution, no rate class receives an increase that is more than 1.6 times the system average increase." *Id.* at 20. OCA provided a comparison of Citizens' proposed revenue distribution to its own.

Table 5. Citizens' Electric Company of Lewisburg, PA – Proposed Revenue Distribution

Rate Class	Present Rates	Proposed Rates	Increase	Percent
RS	\$2,647,362	\$3,315,161	\$667,799	25.2%
SH	24,362	30,256	5,894	24.2
GLP-1	917,008	1,055,971	138,963	15.2
GLP-3	1,110,186	1,074,356	(35,830)	(3.2)
MBL	17,615	22,246	4,631	26.3
OL ²⁶	73,307	86,532	11,225	14.9
Total:	\$4,791,840	\$5,584,522	\$792,682	16.5%

²⁶ The typographical error in the tables indicating Rate PL has been corrected to Rate OL.

**Table 6. Citizens' Electric Company of Lewisburg, PA –
OCA Proposed Revenue Distribution**

Rate Class	Present Rates	Proposed Rates	Increase	Percent
RS	\$2,647,362	\$3,279,887	\$632,525	23.9%
SH	24,362	29,945	5,583	22.9
GLP -1	917,008	1,055,971	138,963	15.2
GLP -3	1,110,186	1,110,186	0	0.0
MBL	17,615	22,001	4,386	24.9
OL ¹	73,307	86,532	11,225	14.9
Total:	\$4,791,840	\$5,584,522	\$792,682	16.5%

OCA agrees that it is appropriate to move each class close 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 20. OCA noted, however, that Citizens' proposal would provide for a rate decrease of 3.2 % for the GLP-3 rate class. *Id.* at 20-21. OCA argued that such a rate decrease for Rate GLP-3 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." *2012 PPL Order* at 124.

OCA argues that the \$35,830 rate decrease proposed for the GLP-3 rate class be eliminated and proportionately distributed to the rate classes receiving an increase that is greater than or equal to 1.5 times (rounded) the system average increase. OCA Stmt. No. 4, at 21-22; OCA Stmt. No. 4-R at 4. OCA noted that I&E also recommends that \$35,830 decrease proposed for the GLP-3 rate class be eliminated with \$10,500 assigned to the OL rate class, and the remaining \$25,316 be applied to the GLP-1 rate class. I&E Stmt. No. 3 at 30-32; *see also*, OCA Stmt. No. 4-SR at 10-11.

OCA noted, however, that it does not agree with I&E's proposed redistribution of the resulting dollars or with OSBA's three-step proposal and argues that its proposed allocation does move the GLP-3 class closer to cost of service without a rate decrease at the time of increasing rates for other rate classes. OCA witness Mierzwa testified:

Under the initial revenue distribution presented in his Direct Testimony, the GLP-3 rate class would receive a 3.2 % rate reduction while the RS, SH, and MBL rate classes would each receive a rate increase of approximately 25 %. My proposal provided for additional rate mitigation for these three rate classes and further promoted the concept of gradualism which Mr. Gorman supports. I would note that as indicated in my Direct Testimony, Mr. Gorman has previously supported the rate design principle that no class should receive a rate decrease at a time when overall, rates are increasing. As subsequently shown in my Surrebuttal Testimony in responding to Mr. Kalcic, there is substantial movement of the GLP-3 rate class toward the cost of service even without a rate reduction. Therefore, my proposed revenue distribution is consistent with moving the GLP-3 rate class toward the cost of service.

OCA Stmt. No. 4-SR at 11-12.

He further explained how overall the rate classes would move closer to cost of service without a rate decrease:

Mr. Kalcic's claims concerning GLP-1 and MBL are based on the alleged changes to the subsidies for each class at present and proposed rates. As indicated in my response to Mr. Kalcic concerning his claims with respect to my proposed revenue distribution for Wellsboro, the problem with Mr. Kalcic's subsidy approach is the change in subsidy is based on two different costs of service, and a better alternative approach is a comparison of the percentages of the cost of service being recovered under present versus proposed rates. This alternative comparison is presented in Table 1-S.

**Table 1-S.
Citizens' Electric Company of Lewisburg, PA
Percentage of Cost of Service Recovered at
Present and OCA Proposed Revenues**

Rate Class	Present Rates	OCA Proposed Rates	Change
RS	84.3%	90.2%	5.8%
SH	86.3	90.4	4.1
GLP-1	113.1	111.6	(1.5)
GLP-3	158.5	135.3	(23.2)
MBL	32.5	30.8	(1.7)
OL	128.6	114.0	(14.6)
TOTAL:	100.0%	100.0%	0.0%

As shown in Table 1-S, contrary to Mr. Kalcic's claim, my proposed revenue distribution results in movement toward the cost of service for GLP-1 rate class. That is, at present rates GLP-1 customers are paying 113.1 % of the cost of service, and under my proposed revenue distribution, GLP-1 customers would be paying 111.6 % of the cost of service, a decrease of 1.5 %. For the GLP-3 rate class, the percentage decrease is 23.2 %. I would note that my evaluation of the impact on the MBL rate class does reflect a slight movement away from the cost of service (1.7 %).

OCA Stmt. No. 4-SR at 12-13. In order to address OSBA's concern, OCA argues that there could be a reallocation of \$245 from rate class MBL to other customer classes. *See*, OCA Stmt. No. 4-SR at 13.

OSBA's Position

OSBA argued that Citizens' proposed revenue allocation was deficient because it was grounded upon 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 indicated that, as demonstrated by the class revenue subsidies at present and

proposed rates shown in Schedule BK-2(C), Citizens' proposal fails to move all classes closer to cost of service and should therefore be rejected. OSBA Stmt. No. 1 at 7.

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 proposed the following revenue allocation in OSBA Stmt. No. 1, Schedule BK-3(C):

CITIZENS' ELECTRIC COMPANY OF LEWISBURG, PA

OSBA Recommended Allocation of the Company's
 Requested Increase in Distribution Revenue
 (FPFTY Ending December 31, 2020)

Line	Classification	Present	OSBA	
		Base Revenue	Recommended Amount	Increase Percent
		1	2	3
1	Residential	\$2,647,362	\$694,038	26.2%
2	Space Heating	\$24,362	\$6,387	26.2%
3	GLP-1	\$917,008	\$82,772	9.0%
4	GLP-3	\$1,110,186	\$0	0.0%
5	Municipal Lighting	\$17,615	\$4,618	26.2%
6	Outdoor Lighting	<u>\$75,307</u>	<u>\$4,880</u>	6.5%
7	Total Rate Revenue	\$4,791,840	\$792,695	16.5%
8	Other Revenue	<u>\$68,568</u>	<u>\$0</u>	0.0%
9	Total Company	\$4,860,408	\$792,695	16.3%

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

OSBA notes that under its revenue allocation, class increases range from 0.0% (Rate GLP-3) to 26.2% (Rates RS, SH and MBL) at Citizens' requested revenue requirement level.

OSBA argued that, contrary to Citizens' proposed subsidies as shown in Schedule BK-2(C), OSBA's recommended revenue allocation would (i) move all rate classes closer to their respective cost of service, with the exception of Rate MBL, and (ii) provide for greater movement toward cost of service for Rates RS, SH, GLP-1 and OL than under Citizens' proposal and adopts the same limit on class increases (26.2%) as utilized in Citizens' proposal. OSBA Stmt. No. 1 at 8, 9. In recognition that moving the MBL class closer to cost of service would otherwise require assigning the class an increase in excess of 97.6%, OSBA proposed to exclude the class from the OSBA's recommended scale back. *Id.*

I&E's Position

I&E noted that the Company's proposed revenue distribution is presented in the following table found in I&E Stmt. No. 3 at 26:

Citizens' Proposed Revenue Distribution				
Class	Present Rates	Proposed Rates	Increase	Increase Percent
RS	\$2,647,362	\$3,314,765	\$667,403	25.2%
GLP-1	\$917,008	\$1,055,954	\$138,946	15.2%
GLP-3	\$1,110,186	\$1,074,356	(\$35,830)	(3.2%)
SH	\$24,362	\$30,254	\$5,892	24.2%
MBL	\$17,615	\$22,233	\$4,618	26.2%
OL	\$75,307	\$86,523	\$11,217	14.9%
Total	\$4,791,840	\$792,246	\$5,584,085	16.5%

I&E witness Cline made two recommendations regarding revenue allocation. First, he recommended that the GLP-3 rate class be allocated no increase or decrease under proposed rates. Second, he recommended that the excess \$35,816 in revenue be reallocated from the GLP-3 rate class and allocated as follows: (1) the first \$10,500 is allocated to the OL class and (2) the remaining \$25,316 be applied to the GLP-1 rate class. I&E Stmt. No. 3 at 30.

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 of serve would have a relative rate of return equal to 1.0; 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 25, 27, 28.

I&E witness Cline presented the following analysis to indicate relative rate of return by class under Citizens' proposal:

Citizens' Relative Rates of Return		
Class	At Present Rates	At Proposed Rates
RS	(0.39)	0.66
GLP-1	1.87	1.43
GLP-3	4.81	2.12
SH	0.12	0.69
MBL	(1.37)	(0.51)
OL	2.07	1.32
Total	1.00	1.00

I&E Stmt. No. 3 at 28. I&E argued that Citizens' proposal would change subsidies between classes as follows:

Citizens' Subsidy Given (Received)			
Customer Class	Under Present Rates	Under Proposed Rates	Reduction in Subsidy
RS	(\$352,004)	(\$222,659)	37%
GLP-1	\$75,880	(\$75,669)	0%
GLP-3	\$293,121	\$175,639	40%
SH	(\$2,163)	(\$1,972)	29%
MBL	(\$26,224)	(\$34,017)	(30%)
OL	\$11,990	\$7,340	39%
Total	\$0	\$0	

I&E Stmt. No. 3 at 29.

Under this analysis, I&E noted that the relative rate of return for the GLP-1, GLP-3, and OL rate classes are greater than 1.0, and the Company proposes a revenue reduction to the GLP-3 class and rate increases for the GLP-1 and OL classes such that the relative rate of returns

are moved closer to 1.0. I&E Stmt. No. 3 at 28. While I&E witness Cline agreed with Citizens' that rate classes GLP-1 and OL should move closer to a relative rate of return of 1.0, he disagreed with the proposed decrease in revenue for the GLP-3 rate class. I&E Stmt. No. 3 at 26.

Instead, I&E argues that GLP-3 should be allocated no increase or decrease, and the excess \$35,816 in revenue be allocated as follows: (1) the first \$245 is allocated to the OL class, which results in an increase \$717 and a relative rate of return of 1.00 for that class, and (2) the remaining \$25,316 be applied to the GLP-1 rate class, resulting in an overall GLP-1 class increase of \$113,715 and a relative rate of return 1.33. The resulting change in percent increase, relative rates of return, and subsidy received and given for the GLP-3, OL, and GLP-1 classes would then be shown as follows:

Change in Percent Increase (I&E Ex. No. 3, Sch. 14, line 39)			
Rate Class	Company As-Filed		I&E Recommended
GLP-3	(3.2%)		0.0%
OL	14.9%		1.0%
GLP-1	15.2%		12.4%
Change in Relative Rate of Return (I&E Ex. No. 3, Sch. 14, lines 8, 34-35)			
Rate Class	Present Rate	Company As-Filed	I&E Recommended
GLP-3	4.81	2.12	2.28
OL	2.07	1.32	1.00
GLP-1	1.87	1.43	1.33
Change in Subsidy Received (Given) (I&E Ex. No. 3, Sch. 14, lines 41-42)			
Rate Class	Company As-Filed		I&E Recommended
GLP-3	40%		32%
OL	39%		99%
GLP-1	0%		23%

I&E witness Cline recommended the OL and GLP-1 classes be credited the revenue from the GLP-3 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 GLP-3 now – only to increase rates again in a future rate proceeding – I&E’s proposal to not increase rates for the GLP-3 class offers additional rate stability for customers and allows costs to “catch up” to rates more gradually. I&E Stmt. No. 3 at 31. In addition, I&E witness Cline indicated that by not decreasing the rates of the GLP-3 class, the excess revenue can be credited to the GLP-1 and OL classes which serves to 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 GLP-3, GLP-1, and OL rate classes and does not negatively affect any of Citizens’ other rate classes. I&E witness Cline acknowledged that while his recommendation did not move the GLP-3 class towards a relative rate of return of 1.0 as much as Citizens’ proposal, the movement from 4.81 under present rates to 2.28 still represented significant movement and it is for this reason and the benefit to the GLP-1 and OL rate classes that I&E feels its recommendation is more reasonable than Citizens’ 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 GLP-3 not be allocated a rate decrease. OCA Stmt. No. 4-R at 4 and OSBA Stmt. No. 1-R at 7. However, OCA and OSBA both disagreed with the allocation of the excess \$35,816 revenue from the GLP-3 class. Citizens’ did not agree with either of I&E’s recommendations and did not accept that no class should receive a decrease. Citizens’ continues to support moving it classes closer to cost of service. Citizens’ Stmt. No. 1-R at 8.

I&E maintains its recommendations are most reasonable, with one exception. First, regarding his recommendation not to reduce rates for the GLP-3 class, I&E witness Cline reiterated his rationale, explaining his 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 GLP-1 and OL closer to a relative rate of return of 1.0. I&E Stmt. No. 3-SR at 13. And although OCA and OSBA did agree revenue reduction to the GLP-3 should be disallowed, I&E argued that its recommendation for reallocation was more

reasonable as it provides relief to the only two rate classes whose 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. I&E Stmt. No. 3-SR at 16-17.

I&E noted that OSBA would allocate additional revenue from the RS and SH rate classes to the GLP-1 and OL rate classes; however, I&E argues that it is not reasonable to allocate additional increase to rate classes that are already proposed to experience two of the three highest percent increases. OSBA Stmt. No. 1-R at 8-9. I&E Stmt. No. 3-SR at 8. The one exception, however, was that I&E agrees with OSBA that the rate class with the higher relative rate of return should receive more rate relief. OSBA Stmt. No. 1-R at 9. Accepting OSBA's recommendation, I&E stated that the \$35,830 in excess revenue reallocated from GLP-3 should be allocated based on the percent increase the GLP-1 and OL rate classes are proposed to receive prior to I&E overall recommended scale back. I&E Stmt. No. 3-SR at 18.

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 may 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 Citizens' 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.

Citizens' Main Brief at 107. Revenue allocation is the result of several factors which must be considered and balanced.

After reviewing the various arguments, we find that I&E's proposed revenue allocation best considers and balances these factors. I&E made two recommendations regarding revenue allocation. First, that the GLP-3 rate class be allocated no increase or decrease under proposed rates. Second, that the excess \$35,816 in revenue be reallocated from the GLP-3 rate class and allocated as follows: (1) the first \$10,500 is allocated to the OL class and (2) the remaining \$25,316 be applied to the GLP-1 rate class. I&E Stmt. No. 3 at 30.

I&E 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 GLP-1, GLP-3, and OL rate classes is greater than 1.0 and Citizens' proposes a revenue reduction to the GLP-3 class and rate increases for the GLP-1 and OL classes such that the relative rate of returns are moved closer to 1.0. I&E Stmt. No. 3 at 28. I&E agreed with Citizens' that rate classes GLP-1 and OL should move closer to a relative rate of return of 1.0 but disagreed with the proposed decrease in revenue for the GLP-3 rate class. I&E Stmt. No. 3 at 26.

Instead, I&E argues that GLP-3 should be allocated no increase or decrease, and the excess \$35,816 in revenue be allocated as follows: (1) the first \$245 is allocated to the OL class, which results in an increase \$717 and a relative rate of return of 1.00 for that class, and (2) the remaining \$25,316 be applied to the GLP-1 rate class, resulting in an overall GLP-1 class increase of \$113,715 and a relative rate of return 1.33.

We agree with I&E that the OL and GLP-1 classes should be credited the revenue from the GLP-3 class because they are the only two other rate classes whose relative rate of return were above 1.0. We also agree that decreasing the rates of the GLP-3 now – only to increase rates again in a future rate proceeding – is an issue. I&E's proposal to not increase rates for the GLP-3 class offers additional rate stability for customers and allows costs to "catch up" to rates more gradually. I&E Stmt. No. 3 at 31. In addition, any excess revenue can be credited to the GLP-1 and OL classes which will serve to 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 GLP-3, GLP-1, and OL 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 GLP-3 class towards a relative rate of return of 1.0 as aggressively as Citizens' proposal. However, we agree that the movement from 4.81 under present rates to 2.28 still represents a significant movement and provides relief to the only two rate classes whose relative rates of return are above 1.0. I&E is correct that OCA's recommendation should be rejected because 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 spent to serve those classes. I&E Stmt. No. 3-SR at 16-17.

Under OSBA's proposal, additional revenue would be allocated from the RS and SH rate classes to the GLP-1 and OL rate classes. We again agree with I&E that it is not reasonable to allocate additional increases to rate classes that are already proposed to experience two of the three highest percent increases. OSBA Stmt. No. 1-R at 8-9. I&E Stmt. No. 3-SR at 8. We do, however, agree with OSBA that the rate class with the higher relative rate of return should receive more rate relief. OSBA Stmt. No. 1-R at 9. I&E also accepted OSBA's recommendation. We agree that the \$35,830 in excess revenue reallocated from GLP-3 should be allocated based on the percent increase the GLP-1 and OL rate classes are proposed to receive prior to I&E overall recommended scale back. I&E Stmt. No. 3-SR at 18.

Therefore, we recommend that the Commission find that 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 in reaching a fair determination.

C. Rate Design

Citizens' proposed rates for each rate class are set forth in Schedules B6-3 and B7 (in table format). Citizens' Stmt. No. 1, Exhibit__ (HSG-1), Schedules B6-3 and B7.

Citizens' Position

Citizens' 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 \$2.06 of demand costs in a \$15.00 customer charge for Residential Customers and \$6.04 of demand costs in a \$24.00 customer charge for Residential Heating Customers. Citizens' argues that this proposed rate design reflects several developments since Citizens' last rate case in 2016.

1) Citizens' has been functioning for some time with its entire system operating with advanced metering infrastructure and is now 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.

2) In 2018, the General Assembly passed 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).

Citizens' proposes to include the minimum per-customer demand-related costs in the fixed monthly charges for its Residential customers – Classes RS (Residential) and SH

(Space Heating) and 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. Citizens' 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. Citizens' also asserts that its proposal aligns with the Commission's enumerated policy factors established in its Final Policy Statement. 52 Pa. Code § 69.3302.

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

- **Customer-related costs.** These are costs, based on the ACOS, that have historically been included in the fixed monthly charge. This totals to \$12.94 of the \$15.00 customer charge and is set forth in Schedule E1-C, line 21.
- **Demand-related costs.** The demand-related costs total to \$2.06 of the \$15.00 and represent a portion of Residential demand costs. Specifically, \$2.06 represents the cost of 0.38 kW-month per user, based on the \$5.40 per kW-month demand costs for the Residential Class set forth in the ACOS (Schedule E1-B).

Citizens' Stmt. No. 1 at 32.

Citizens' 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. Citizens' Stmt. No. 1 at 37-38. Citizens' found that 96.8% of Residential monthly customer bills reflected demand of 0.38 kW or higher in 2018. *Id.* Additionally, more than 99% of Residential customers experienced demand of 0.38 kW or more at least once in 2018. *Id.* Citizens' argues that its proposal to allocate the cost for 0.38 kW-demand (\$2.06 per month) to the Residential customer charge shifts only the minimum demand costs to the fixed charge. *Id.*

Citizens' indicated that for Space Heating Customers the structure would be similar. Citizens' proposes to increase the monthly fixed charge from \$18.57 to \$24.00, structured as follows:

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

Citizens' Stmt. No. 1 at 38.

Citizens' indicated that on a bill basis, 81% of Space Heating customers experienced 1.0 kW of demand every month. *Id.* However, over 95% of Space Heating customers reached demand of 1.0 kW at least once in 2018. *Id.* Citizens' argues that its proposal to allocate the cost for 1.0 kW-demand (\$6.04 per month) to the Space Heating customer charge shifts only the minimum demand costs to the fixed charge. *See id.* at 37-38.

Citizens' also argues that its proposal moves toward cost of service-based rates while honoring gradualism, rate simplicity and customer protection. It asserts that moving the residential rate design towards cost of service would require addition of a demand billing element and Citizens' believes that incorporating minimum demand costs into the monthly customer charge will be easier for residential customers to understand. Citizens' Stmt. No. 1 at 37. To recognize cost of service in the proposal, Citizens' chose a demand level annually met by 99% of the residential accounts in the service territory. *Id.* at 37-38. Citizens', therefore, argues that its proposal balances many ratemaking goals – cost of service, simplicity, and gradualism and will also enhance revenue stability. By including only the portion of demand charges constituting the minimum demand for customers, Citizens' argues that this reasonably aligns customer rates with costs.

Citizens’ 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 Citizens’ believes that its proposed rate design addresses each are set forth in Citizens’ Main Brief Table 9.

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

9	Impact on utility revenue	Does not materially impact this factor.
10	Impact on the frequency of rate case filing and regulatory lag.	The Company's proposal promotes revenue stability and thus may reduce the frequency of rate cases.
11	Interaction with other revenue sources, such as Section 1307 automatic adjustment surcharges.	Does not materially impact this factor.
12	Inclusion of appropriate consumer protections.	The Company's proposal is based on cost causation principles, which protects customers from unreasonable rates.
13	Understandability to consumers.	The Company's proposal does not introduce a new surcharge or other rate mechanism but serves as a first step to developing rates that fully reflect demand-based costs, which will likely require customer education.
14	Support of improvements in utility reliability.	By aligning rates with costs, the Company's proposal supports the Company's ongoing efforts to invest in reliability projects.

Citizens' 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.

Citizens' noted that both OCA and I&E 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 Stmt. No. 3 at 34-35. OCA argued that the costs of Citizens' distribution system varies with demand, that volumetric energy charges offer meaningful price signals to customers, and that volumetric charges are more consistent with energy conservation policies. *See*, OCA Stmt. No. 4 at 26. However, Citizens' asserts that both OCA and I&E ignore the fact that Citizens' 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. Citizens' argues that including \$2.06 in the fixed monthly charge for Residential Customers, equal to the

monthly cost of 0.38 kW of demand, is a reasonable balance between aligning more closely with costs on the one hand, and the principle of gradualism on the other hand. Citizens' Stmt. No. 1 at 38. Citizens' further argues that the same rationale applies to the proposal to allocating \$6.04 of demand costs to the fixed monthly charge for Space Heating customers and that both of these proposed changes further the goals of Act 58 by aligning the fixed nature of minimum demand costs with fixed rates. *See*, 52 Pa. Code § 63.3302(1). Citizens' asserts that this is consistent with cost-causation principles, retains price signals, and respects the principle of gradualism.

OCA's Position

OCA summarized Citizens' proposed rate design. Citizens' has one residential rate class, Schedule RS, which Citizens' proposes to increase the residential RS customer charge from \$11.24 to \$15.00 per month, or a 33.5% increase. OCA Stmt. No. 4 at 23. Citizens' also proposes to increase the volumetric energy charge from \$0.02184 per kWh to \$0.02658 per kWh energy charge, or a 21.7 % increase in the energy charge. The customer-related cost component calculated by Citizens' is \$12.94. OCA Stmt. No. 4 at 24. As part of its increase to a residential customer charge of \$15.00 per month, Citizens' also proposes to include a demand-related cost component in addition to the traditional customer-related charge. *Id.*

OCA indicated that it does not dispute the customer-related components that Citizens' has included which would result in a customer charge of \$12.94 per month. OCA Stmt. No. 4 at 28. However, OCA argues that demand charges should not be included in the residential customer charge. OCA does not support Citizens' inclusion of demand-related costs in the monthly customer charge or agree that the demand-related amounts should increase over time. OCA argues that Citizens' 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 also argues that Citizens' 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 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. OCA notes that 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 Citizens' 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.

Moreover, Mr. Mierzwa argued that following Citizens' recommendations to the final steps and logical conclusion would result in the entire cost of service for Citizens' being recovered through monthly customer charges. As OCA witness Mierzwa testified:

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

OCA 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 Citizens' proposed inclusion of demand charges as a part of the customer charges fails to meet the necessary criteria to be approved. In response to testimony presented by I&E, Citizens' witness Gorman had responded 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." Citizens' Stmt. No. 1-R at 8. Citizens' argued that it 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.” Citizens’ Stmt. No. 1-R at 9. OCA responds by indicating that Citizens’ arguments cannot overcome the fact that customers would not receive any price signals that are relevant to the distribution system cost structure and that 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 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 Position

OSBA did not take issue with Citizen’s proposed rate design and stated that the proposed GLP-1 customer charge of \$15.00 per month is consistent with Citizens’ customer cost benchmark analysis. OSBA Stmt. No. 1 at 10. However, in the event that the Commission assigns a lower increase than proposed by Citizens’, OSBA recommended that (i) the proposed GLP-1 customer charge remain unchanged at \$15.00 per month, and (ii) the current GLP-1 energy and demand charges receive a uniform (residual) increase so as to recover the final class revenue target. OSBA Stmt. No. 1 at 11.

I&E Position

I&E outlined Citizens’ proposed increases to the customer charges:

Citizens' Proposed Class Customer Charges

Rate	Pres Cust Chrg	Prop'd Cust Chrg	% Increase
RS	\$11.24	\$15.00	33.5%
SH	\$18.57	\$24.00	29.2%
GLP-1	\$14.17	\$15.00	5.9%
GLP-3	\$50.83	\$51.00	0.3%

I&E argued that Citizens' 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. I&E Stmt. No. 3 at 33. I&E also noted that Citizens' believed it was appropriate to recover demand-related costs in customer charges because it 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.* 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 should be limited to what can be supported by Citizens' customer cost analysis:

I&E Proposed Class Customer Charges

Rate	Pres Cust Chrg	Cust Cost Anly	Prop'd Cust Chrg	I&E Proposed
RS	\$11.24	\$12.94	\$15.00	\$13.00
SH	\$18.57	\$17.96	\$24.00	\$18.57
GLP-1	\$14.17	\$14.87	\$15.00	\$15.00
GLP-3	\$50.83	\$50.75	\$51.00	\$51.00

I&E's recommendation is based on Citizens' customer cost analysis which shows that there is no cost basis for increasing the SH class from its existing customer charges and supports a smaller increase in the RS class than Citizens' has proposed. I&E Stmt. No. 3 at 41. I&E also disagrees with Citizens' argument that the proposed adjustment to the customer charge should be considered "alternative ratemaking" and accepted by the Commission. Citizens' Stmt. No. 1 at 33-37. I&E witness Cline disagreed with Citizens' 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 Citizens' 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 Exhibit No. 3, Schedule 15. 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, Citizens' 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 Stmt. No. 1 at 38-40.

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 40. I&E submits that the Commission has maintained certain core utility ratemaking principles that Citizens' 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.”²⁷

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 Citizens’ proposal violates its cost of service study by assigning demand charges to the customer charge and its proposal contains no specific customer protections. I&E Main Brief at 64.

Last, I&E argues that Citizens’ primarily justifies its proposal by reference to reliability. While reliability may have some bearing on the Commission’s analysis, I&E argues that there are multiple concerns that should outweigh this singular consideration. Therefore, I&E requests the Commission to reject Citizens’ proposal to assign a portion of demand charge to customer charge and instead adopt I&E’s recommendations in accord with Citizens’ cost of service study. *Id.*

Disposition

We agree with OCA and I&E that demand charges should not be included in the residential customer charge. Therefore, we reject Citizens’ 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. Adhering to cost of service principles, we agree that Citizens’ proposal violates its cost of service study by assigning demand charges to the customer charge and its proposal contains no specific customer protections. I&E Main Brief at 64.

²⁷ 52 Pa. Code § 69.3301. The 14 factors considered by I&E witness Cline and Citizens’ witness Gorman are now found at 52 Pa. Code § 69.3302.

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 also agree with I&E that customer charges should be limited to what can be supported by Citizens' customer cost analysis. That analysis shows that there is no cost basis for increasing the SH class from its existing customer charges and also supports a smaller increase in the RS class than Citizens' has proposed. I&E Stmt. No. 3 at 41. We also disagree that Citizens' proposed adjustment to the customer charge constitutes "alternative ratemaking" which should be accepted by the Commission. Citizens' Stmt. No. 1 at 33-37. Citizens' 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 Citizens' proposal.

As discussed in relation to OCA's position, we agree that Citizens' 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 customers receives via their bills. 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 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 Citizens' proposal than under traditional Commission-approved rate making. I&E Exhibit No. 3, Schedule

15. Citizens' argues that its proposal is based on cost causation principles which protect customers from unreasonable rates. Citizens' has however failed to fully explain or support this argument.

With respect to cost causation, we agree that Citizens' proposed rate design does not align revenues with cost causation principles. Citizens' 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 acknowledge that Citizens' 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 40.

We reject Citizens' 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, Citizens' 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. Citizens' cost analysis shows that there is no cost basis for increasing the SH class from its existing customer charges and also supports a smaller increase in the RS class than Citizens' has proposed.

For all of the reasons discussed above, we recommend that the Commission reject Citizens' proposal to assign a portion of demand charge to customer charge in customer rates classes RS and SH. Instead, we recommend that the Commission adopt I&E's proposed customer class charges which are in accord with Citizens' cost of service study.

D. Scale Back

In the event the Commission ultimately approves a revenue requirement for Citizens' that is less than its full requested increase, Citizens' recommends that rates for each class be scaled-back rates based on the cost of service study approved by the Commission in a proportional manner. Citizens' Stmt. 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." This includes a proportional scale back of both increases and decreases. *Id.* Citizens' argues that it has proposed to move each class closer to its actual cost to serve. To preserve this movement, Citizens' believes a proportionate scale back, including to rate decreases, is appropriate and requests that any scale back of rates should be proportionate based on the allocated cost of service study methodology accepted by the Commission, updated to reflect the revenue requirement authorized by the Commission.

I&E, OCA, and OSBA each proposed modifications to Citizens' scale back proposal.

I&E requests that if the Commission grants less than the Company's requested increase, the Commission should proportionally scale back rates based upon the cost of service study, including customer charges, usage rates, and rate classes only if they received a proposed increase. I&E Stmt. No. 3 at 42. I&E, however, agreed with OSBA that because a scale back would move the MBL rate class farther from cost of service, it should not be included in any scale back of rates. I&E Stmt. No. 3-SR at 18. Therefore, I&E argued that the Commission should adopt its proposal regarding a scale back of rates with the exception of rate class MBL.

OCA recommend a proportionate scale back for each rate class, including the customer charge. OCA Stmt. No. 4 at 21.

OSBA's recommended allocation adopts the same limit on class increases (26.2%) as utilized in Citizens' proposal. OSBA Stmt. No. 1 at 9. Further, OSBA argued that its recommended revenue allocation would (i) move all rate classes closer to their respective cost of service, with the exception of Rate MBL, and (ii) provide for greater movement toward cost of service for Rates RS, SH, GLP-1 and OL than under the Company's proposal. OSBA Stmt. No. 1 at 8. In the event that the Commission awards Citizens' an increase less than the \$0.793 million shown on line 7 of Schedule BK-3(C), OSBA recommends that the class increases shown in column 3 of Schedule BK-3(C), excluding rate MBL, be scaled back proportionally. OSBA argues that Rate MBL should be excluded from any scale back since the class fails to exhibit any movement toward cost of service at its (maximum) assigned increase of 26.2%.

Disposition

All of the parties generally agree that any scale-back which may occur should be proportionate. We agree with Citizens' that, to preserve movement of each class closer to its actual cost to serve, a proportionate scale back is appropriate. We also agree that any scale back should be proportionate based on the allocated cost of service study methodology. We agree with I&E that if the Commission grants less than Citizens' requested increase, the Commission should proportionally scale back rates based upon the cost of service study, however only if the rate classes received a proposed increase. We also agree with both I&E and OSBA that because a scale back would move the MBL rate class farther from cost of service, it should not be included in any scale back of rates. We therefore recommend that the Commission adopt a proportional scale back of rates based upon the cost of service study, only if the rate classes received a proposed increase – with the exception of rate class MBL – as any scale back would only serve to move the MBL rate class farther from cost of service. 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.

VIII. MISCELLANEOUS ISSUES

A. Reporting Requirements

I&E witness Cline recommended in his direct testimony that Citizens' be required to provide, no later than April 20, 2020, an update to its plant in service projections by updating Citizens' Exhibit_(HSG-1), Sch. C3(R) 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. 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 67.

In response, Citizens' 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. Citizens' 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. Citizens' Main Brief at 117. Citizens' further argues that the Commission has not yet adopted regulations that comprehensively address requirements for utilities that utilize the FPFTY. It argues that Citizens' 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. Citizens' Main Brief at 117.

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

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 Citizens' be required to provide, no later than April 20, 2020, an update to its plant in service projections by updating Citizens' Exhibit_(HSG-1), Sch. C3(R) 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 Citizens' Electric Company of Lewisburg shall not place into effect the rates contained in Supplement No. 132 to Tariff Electric - Pa. P.U.C. No. 14, which have been found to be unjust and unreasonable and, therefore, unlawful.

2. That Citizens' Electric Company of Lewisburg 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 \$515,144.00.

3. That Citizens' Electric Company of Lewisburg's tariffs, tariff Supplements or tariff revisions may be filed on less than statutory notice, and pursuant to the provisions of 52 Pa.

APPENDICES

Office of Administrative Law Judge Recommended Decision

TABLE I

Citizens' Electric Company of Lewisburg

INCOME SUMMARY

R-2019-3008212

		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	4,860,408	43,432	4,903,840	515,144	5,418,984
2.	Expenses:					
3.	O & M Expense	2,803,733	(81,330)	2,722,403	0	2,722,403
4.	Depreciation	1,029,328	0	1,029,328	0	1,029,328
5.	Taxes, Other	356,823	2,562	359,385	30,393	389,778
6.	Income Taxes:					
7.	State	49,319	12,294	61,613	48,427	110,040
8.	Federal	111,471	23,263	134,734	91,628	226,362
9.	Total Expenses	4,350,674	(43,211)	4,307,463	170,448	4,477,911
10.	Net Inc. Available for Return	509,734	86,643	596,377	344,696	941,073
11.	Rate Base	12,847,545	(22,485)	12,825,060	0	12,825,060
12.	Rate of Return	3.97%		4.65%		7.3378%
	(1) Company Main Brief					
	(2) From Table II Adjustments					
				Revenue Change (%):	10.50%	
				% of requested Increase	73.51%	

Office of Administrative Law Judge Recommended Decision

TABLE I(A)

Citizens' Electric Company of Lewisburg

RATE OF RETURN

R-2019-3008212

		Structure	Cost	After-Tax Weighted Cost	Effective Tax Rate Complement	Pre-Tax Weighted Cost Rate
		(1)	(2)	[(3)=(1)x(2)]	(4)	[(5)=(3)x(4)]
1.	Total Cost of Debt			2.39743800%		2.39743800%
2.	Long-term Debt	49.33%	4.86%	2.39743800%		2.40%
3.	Short-term Debt	0.00%	0.00%	0.00000000%		0.00%
4.	Preferred Stock	0.00%	0.00%	0.00000000%	0.711079	0.00%
5.	Common Equity	50.67%	9.75%	4.94032500%	0.711079	6.95%
6.		100.00%		7.33776300%		9.3474%
7.	Pre-Tax Interest Coverage	3.90				
8.	After-Tax Interest Coverage	3.06				
9.	Tax Rate Complement (1-(21%+(9.99% X (1-21%)))	71.10790%				

Office of Administrative Law Judge Recommended Decision

TABLE I(B)

Citizens' Electric Company of Lewisburg

REVENUE FACTOR

R-2019-3008212

1.	100%				1.00000000
	Less:				
2.	Uncollectible Accounts Factor (*)				0.00000000
3.	PUC, OCA, OSBA Assessment Factors (*)				0.00000000
4.	(Line 1-(Line 2 + Line 3))				1.00000000
5.	Gross Receipts Tax				0.05900000
6.	Other Tax Factors				-
7.	(Line 5 + Line 6)				0.05900000
8.	Effective GRT/CST (Line 7 x Line 4)				0.05900000
9.	Factor after GRT and CST (Line 4 - Line 8)				0.94100000
10.	State Income Tax Rate (*)				0.09990000
11.	Effective State Income Tax Rate				0.09400590
12.	Factor After Local and State Taxes				0.84699410
13.	Federal Income Tax Rate (*)				0.21000000
14.	Effective Federal Income Tax Rate				0.17786876
15.	Revenue Factor (100% - Effective Tax Rates)				0.66912534
				recipricol/gross up	1.49448831

Office of Administrative Law Judge Recommended Decision

TABLE II

Citizens' Electric Company of Lewisburg

SUMMARY OF ADJUSTMENTS

R-2019-3008212

	<u>Adjustments</u>	<u>Rate Base</u>	<u>Revenues</u>	<u>Expenses</u>	<u>Depreciation</u>	<u>Taxes-Other</u>	<u>State</u>	<u>Federal</u>
	(1)	(2)	(3)	(4)	(5)	(6)	Income Tax	Income Tax
							(7)	(8)
1.	RATE BASE:							
2.	CWC:							
3.	Int. & Div. (Table IV)	0						
4.	Taxes (Table V)	0						
5.	O & M (Table VI)	(5,005)						
6.	EDIT Adj.	(17,480)						
		0						
7.	Other	0						
8.	REVENUES:							
9.	Customer Accounts		28,032			1,654	2,635	4,986
10.	Forfeited Discounts		3,376			199	317	601
11.	Bucknell Solar Adjustment		12,024			709	1,130	2,139
12.								
13.	EXPENSES:							
14.	Eliminate 3% Inflation Factor for 2020 ⁽¹⁾			(78,505)			7,843	14,839
15.	Maint. Overhead Lines/Vegetation Mgmt (Acct 593)			0			0	0
16.	Rate Case Expense Normalization			0			0	0
17.	Operations Supv. & Engineering Exp. (Acct 580)			(2,825)			282	534
18.	Misc. Distribution Exp. (Acct 588)			0			0	0
19.	Customer Records & Collection Exp. (Acct 903)			0			0	0
20.	Outside Services (Acct 923)			0			0	0
21.	Employees Pensions/OPEBs (Acct 926)			0			0	0
22.				0			0	0
23.				0			0	0
24.				0			0	0
				0			0	0
				0			0	0
25.	TAXES:							
26.	Interest Synchronization (Table III)						87	164
27.	TOTALS	<u>(22,485)</u>	<u>43,432</u>	<u>(81,330)</u>	<u>0</u>	<u>2,562</u>	<u>12,294</u>	<u>23,263</u>

(1) Based on Citizens' Statement No. 1-R, Rebuttal Testimony of Howard S. Gorman page 4. Account 928 was adjusted to reflect its removal at the annualized amount. Otherwise, this adjustment reflects all other individual accounts annualized amounts prior to the 3% inflation increase.

Office of Administrative Law Judge Recommended Decision

TABLE III

Citizens' Electric Company of Lewisburg

INTEREST SYNCHRONIZATION

R-2019-3008212

		Amount
		\$
1.	Company Rate Base Claim (UGI Electric Main Brief)	12,847,545
2.	ALJ Rate Base Adjustments (From Table II)	(22,485)
3.	ALJ Rate Base (Line 1 - Line 2)	12,825,060
4.	Weighted Cost of Debt (From Table IA)	2.397438%
5.	ALJ Interest Expense (Line 3 x Line 4)	307,473
6.	Company Claim (1)	308,341
7.	Total ALJ Adjustment (Line 6 - Line 5)	868
8.	Company Adjustment	0
9.	Net ALJ Interest Adjustment (Line 7 - Line 8)	868
10.	State Income Tax Rate	9.99%
11.	State Income Tax Adjustment (Line 9 x Line 10) (Flow to Table II)	87
12.	Net ALJ Adjustment for F.I.T. (Line 9 - Line 11)	781
13.	Federal Income Tax Rate	21.00%
14.	Federal Income Tax Adjustment (Line 12 x Line 13) (Flow to Table II)	164
	(1) Company Main Brief	

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

	Accrued Interest				Preferred Stock Dividends
	(1)	Long-Term Debt (2)	Short-Term Debt (3)		(4)
					(5)
1.	Company Rate Base Claim	\$12,847,545	\$12,847,545	Company Rate Base Claim	\$12,847,545
2.	ALJ Rate Base Adjustments	(\$22,485)	(\$22,485)	ALJ Rate Base Adjustments	(\$22,485)
		\$12,825,060	\$12,825,060		\$12,825,060
3.	ALJ Rate Base	\$12,825,060	\$12,825,060	ALJ Rate Base	\$12,825,060
4.	Weighted Cost of Debt	2.397438%	0.00%	Weighted Cost Pref. Stock	0.00%
5.	ALJ Annual Interest Exp.	<u>\$307,473</u>	<u>\$0</u>	ALJ Preferred Dividends	<u>\$0</u>
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	<u>-45.0</u>	<u>0.0</u>	Net Lag Days	<u>0.0</u>
9.	Working Capital Adjustment				
10.	ALJ Daily Interest Exp.	\$842	\$0	ALJ Daily Dividends	\$0
11.	Net Lag Days	-45.0	0.0	Net Lag Days	0.0
12.	ALJ Working Capital	(\$37,890)	\$0		\$0
13.	Company Claim (1)	\$0	\$0	Company Claim (1)	\$0
14.	ALJ Adjustment	<u>(\$37,890)</u>	<u>\$0</u>		<u>\$0</u>
15.	Total Interest & Dividend Adj.	<u>(\$37,890)</u>			
	(1) Company Main Brief.				

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

		Company Pro forma F.T.Y. Expense	ALJ	ALJ Pro forma Expenses	Lag Days	Lag Dollars
	Description (1)	(2)	(3)	(4)	(5)	(6)
1.	O&M	\$2,803,733	\$0	\$2,803,733	45.63	\$127,920,318
2.	Less: Uncollectibles	(\$20,600)	\$0	(\$20,600)	45.63	(\$939,875)
3.		\$0	\$0	\$0	45.63	\$0
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	(\$81,330)	(\$81,330)	45.63	(\$3,710,681)
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.		<u>\$2,783,133</u>	<u>(\$81,330)</u>	<u>\$2,701,803</u>	<u>0.00</u>	<u>\$123,269,762</u>
17.	ALJ Average Revenue Lag (1)	0.0				
18.	Less: ALJ Avg. Expense Lag	45.6				
19.	Net Difference	-45.6	Days			
20.	ALJ Pro forma					
22.	O & M Expense per Day	<u>\$7,402</u>				
23.	ALJ CWC for O & M	(\$337,716)				
24.	Less: Company Claim (2)	<u>(\$342,721)</u>	C1-6 R			
25.	ALJ Adjustment	<u>(\$5,005)</u>				
	(1) Company Main Brief					
	(2) Table II Adjustments					