BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2019-3008212
	:	
Citizens' Electric Company of Lewisburg, PA	:	

EXCEPTIONS OF CITIZENS' ELECTRIC COMPANY OF LEWISBURG, PA

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I. INTRODUCTION

On July 1, 2019, Citizens' Electric Company of Lewisburg, Pennsylvania ("Citizens'" or "Company") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") Supplement No. 132 to Tariff Electric-Pa. PUC No. 14 ("Supplement No. 132"), proposing to increase annual revenues by $792,246. Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule B6-1. In support of this filing, Citizens' submitted a Statement of Reasons, the supporting information required by 52 Pa. Code § 53.52(a), (b), and (c), and various other information.[1]

The Office of Consumer Advocate ("OCA") filed a Formal Complaint against Citizens' rate increase on July 30, 2019. The Office of Small Business Advocate ("OSBA") and the Bureau of Investigation and Enforcement ("I&E"), thereafter, submitted Notices of Appearance in this proceeding. Pursuant to 52 Pa. Code § 5.61(d), Citizens' elected not to file an Answer to OCA's Complaint.

On December 16, 2019 and December 17, 2019, Administrative Law Judges ("ALJs") Steven K. Haas and Benjamin Myers held an evidentiary hearing for the Citizens', Wellsboro Electric Company ("Wellsboro"), and Valley Energy, Inc. ("Valley") (collectively, "Companies") proceedings.

On January 8, 2020, and January 22, 2020, OCA, OSBA, I&E, and Citizens' submitted a Main Brief and Reply Brief, respectively. On February 28, 2020, ALJs Haas and Myers issued a Recommended Decision ("R.D.") in this proceeding.

For the reasons set forth below, Citizens' hereby files these Exceptions to the ALJs' R.D.

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[1] In Rebuttal Testimony, Citizens' subsequently revised its proposed revenue increase to approximately $701,000, reflecting rate of return and rate base adjustments to the as-filed request. *See* Citizens' Main Brief at 1. Citizens' provided an updated Schedule C1 showing these adjustments. *Id.*

II. EXCEPTIONS

A. <u>Exception No. 1</u>: The R.D. erred in denying the Company's proposed revenue adjustment for lost sales associated with the Bucknell University solar project. (R.D. at 19).

The R.D. erred in approving the $12,024 increase to the Company's Fully-Projected Future Test Year ("FPFTY") revenues proposed by OCA on grounds that the Company failed to demonstrate that the Bucknell University ("Bucknell") solar project would be completed within the FPFTY. In reaching this conclusion, the R.D. finds that "the completion and timeframe for completion of the Bucknell solar project is not a known and measurable change that should be reflected in Citizens' revenue requirement." R.D. at 16. The R.D.'s conclusion fails to account for the totality of record evidence indicating that the solar project will be in-service by December 31, 2020. The outstanding East Buffalo Township ("Township") zoning approval required for completion of the project should not render the project unknown and unmeasurable for purposes of the Company's revenue requirement. Any other finding would prevent Electric Distribution Companies ("EDCs") from taking reasonable steps to account for the financial impacts of the Commonwealth of Pennsylvania's ("Commonwealth") promotion of distributed generation and solar generation expansion.

The chronology of events documented on the record contrasts sharply with the R.D.'s finding that there is no indication of how long the Township review process would take. The R.D. correctly observes that Bucknell withdrew its solar project from consideration by the Township after the Township determined it must adopt a solar zoning ordinance before considering the project. R.D. at 17. Bucknell's solar project cannot move forward until the Township Board of Supervisors approves a local zoning ordinance for solar projects and subsequently reviews Bucknell's solar project. *Id.* However, the R.D. ignored evidence addressing the timeframe for these deliberations. The October 3, 2019, article reporting Bucknell's withdrawal of the project from the Township's process also established that the Township already had drafts of the solar zoning ordinance and would require at least "3 months" to adopt it. OCA Statement No. 4, Schedule JDM-2. Company Witness John Kelchner provided an update at the evidentiary hearing noting that the Township's Planning Commission approved the solar zoning ordinance on December 11, 2019, with a vote by the Township Board of Supervisors anticipated for January 2020. Tr. 140-141. Bucknell has confirmed it will resubmit its plan to the Township following approval of the Zoning Ordinance. In other words, *all* of the available evidence supports the Company's projection that the Bucknell solar project will be in service by December 31, 2020.

On the other hand, the evidence offered to show uncertainty surrounding completion of the solar project amounts to nothing more than conjecture. The R.D. references a series of questions from OCA to Company Witness John Kelchner in which Mr. Kelchner acknowledges the theoretical possibility that the Township could modify or reject Bucknell's plan. R.D. at 17. Because Mr. Kelchner candidly and accurately acknowledged that there is always a theoretical possibility that a future project may not happen, OCA concludes "there is no evidence that this will occur in any part of the FPFTY." *Id.* at 17. However, OCA never offered any plausible basis for this assertion. Their only evidence on record regarding the Township zoning process is that the zoning ordinance was approved by the Township Planning Commission *with a recommendation for approval by the Township Board of Supervisors*. Tr. 140-141.

Unfortunately, the R.D. misstates the record in concluding that "as acknowledged by Mr. Kelchner, Bucknell's proposed plan may be revised or amended, or potentially denied outright, thereby causing further delays." R.D. at 19. As noted above, Mr. Kelchner provided this answer in response to a question asking whether the project could *potentially or in theory* be modified or denied. R.D. at 17. When viewed in the appropriate context, it becomes clear that Mr. Kelchner's testimony as to the uncertainty of the project was limited to theoretical possibilities, while the available facts all support the Company's projection that the project will be in-service by the end of the FPFTY. This is evident from review of the complete discussion as presented below:

> Q. And if the zoning ordinance were approved by the township supervisors, Bucknell's proposed solar installation still needs to be reviewed and – and approved, wouldn't it?
> A. It would, however, they've done most of the [legwork] already. The engineering is complete, the township has already seen the land development proposal, so I would expect it would be a fast track approval.
> Q. But *in theory*, the township supervisors could recommend changes before approving the Bucknell solar installation project?
> A. Sure.
> Q. And they could also deny it *in theory* as we well? Is that correct?
> A. Anything is possible, sure.
> Q. And if the solar installation project is approved by the township supervisors, Bucknell would then need to construct and implement the solar installation project? Isn't that correct?
> A. Right, and I – I want to back up a little bit on that answer that anything is possible. I feel like our responsibility is to plan and accommodate what we best believe is likely to happen. I have no indication that the Township has any reservations about this. I fully expect it to pass. I know that in conversations with Bucknell, they feel that the construction timeframe is very short on this, and the materials available is not a super complicated thing to build, so there's no reason really for us to believe this thing['s] going to drag on forever.

Tr. at 153-154 (emphasis added). Contrary to the conclusion in the R.D., the only uncertainty identified on the record is the zoning approval, which the record indicates is proceeding as expected. While OCA correctly noted that the project was delayed in the fall of 2019 due to the Township's recognition that it lacks a zoning ordinance addressing solar projects, this delay reflects a procedural deficiency on the part of the Township that is being corrected. In light of Mr. Kelchner's testimony affirming that both the Township review process and Bucknell's construction process are speedy processes, the R.D.'s finding that there is too much uncertainty surrounding the project's completion in the FPFTY is unreasonable.

The Commission should further consider that granting this Exception is necessary to preserve the efficacy of the FPFTY and allow EDCs to take reasonable steps to offset the financial impact of Commonwealth policies promoting distributed generation and solar generation. Bucknell submitted its interconnection application to Citizens' in 2019 and has repeatedly reiterated its desire to install a major generation project. Tr. 153. Bucknell has not withdrawn the application, despite the zoning delay. It is reasonable for Citizens' to rely on its customers' indications of whether and when a solar project will be constructed.

The Commission's known and measurable standard has not been interpreted to deny rate recognition on grounds of theoretical happenstance. By way of example, the Commission previously rejected an OCA proposal to disallow a Future Test Year ("FTY") maintenance expense claim on grounds that the proposed expenses had not been incurred by the time the record closed in the proceeding. *Pa. Pub Util. Comm'n v. Philadelphia Suburban Water Company*, 1989 Pa. PUC LEXIS 213, *65 (Pa. P.U.C. December 29, 1989) ("Philadelphia Suburban"). The Commission denied the OCA's adjustment and cited to the following discussion from the ALJ's Recommended Decision in that docket:

> The ALJ continued that to adopt the OCA's stance would wreck [*sic*] havoc on future test year methodology. Mr. Wilson's unrebutted testimony that the two projects at issue have been authorized and will in fact be completed by the end of the future test year is entirely credible and worthy of belief, concluded the ALJ.

Philadelphia Suburban, at *65. Similarly, adoption of the R.D.'s resolution would significantly erode the usefulness of the FPFTY, because many projects planned for construction over a FPFTY period could be subject to local approvals and permits that would be no more or less certain than the Township's process for approving the Bucknell solar project.

For the foregoing reasons, the Company requests that the Commission grant this Exception and deny the OCA's proposed revenue adjustment for the Bucknell solar project.

B. <u>Exception No. 2</u>: The R.D. erred in granting I&E's proposed adjustment to the Company's projected customer count for the FPFTY. (R.D. at 21).

The R.D. erred in approving the $28,032 adjustment to Citizens' FPFTY revenues based on I&E's adjustment to the Company's projected FPFTY customer count. The R.D. finds that both Citizens' and I&E presented outside sources supporting their respective projections, but I&E's reliance on historical changes provided the most persuasive evidence. This finding overlooks logical gaps in I&E's reliance on outside sources and fails to give weight to the firsthand experience of Citizens' company witness.

The R.D. references Citizens' reliance on a Union County Planning Commission Annual Report ("UCPC Annual Report") and I&E's reliance on a Union County Housing Study but unreasonably draws a false equivalency by dismissing both studies as equally credible projections. The R.D. observes that both studies "arguably support the positions put forth by the party citing each study." *Id.* However, the Union County Housing study relied upon by I&E simply does not support the inferences drawn by I&E's witness. I&E's proposal to increase Citizens' customer count stems from I&E's disagreement with Citizens' Witness John Kelchner's projection that Citizens' will experience minimal customer growth due to the lack of available lots for new construction. *Id.* at 20. Citizens' supported this claim with Mr. Kelchner's personal experience and observations in the service territory and the UCPC Annual Report showing plans for just 20 new lots across all of Lewisburg Borough, Buffalo Township, and East Buffalo Township. *Id.* In response, I&E's witness argued that the Union County Housing Study indicates a need for new housing "units," which the report clarifies is not equivalent to a demand for new *construction.* Citizens' Main Brief at 33. Accordingly, the Union County Housing Study does not support I&E's argument and should be disregarded in favor of the directly relevant data in the UCPC Annual Report.

In addition to affording undue weight to the Union County Housing Study, the R.D. failed to appropriately weigh evidence from Company Witness John Kelchner. After improperly dismissing both outside studies as equally supported projections, the R.D. relied heavily on I&E's analysis of historical customer growth and gave little weight to Citizens' Witness Kelchner's testimony explaining the dearth of available lots for construction within the service territory. R.D. at 20-21. Although the ALJs' have discretion in assigning weight to witness testimony, the Company avers that Mr. Kelchner's 17 years of experience working in Citizens' service territory should be afforded significant weight, particularly as his testimony comports with the construction projections in the UCPC Annual Report. *See* Citizens' Statement No. 1, at 1 (describing Mr. Kelchner's employment history with Citizens').

Finally, the R.D. fails to recognize that the historical data referenced by I&E reflects the same declining customer growth observed by Mr. Kelchner. While I&E is correct that an average annual customer growth from 2015-2018 amounts to 47 customers per year, a review of the data shows a declining trend since 2016, from the increase of 70 customers from 2016-2017 to 33 customers from 2017 to 2018. I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 2. In the FTY, Citizens' gained just 7 customers over the period December 2018 – July 2019, *which does not account for the loss* of 32 customers in East Lewisburg transferred to PPL Electric Utilities Corporation on August 8, 2019. *See* R.D. at 20. Despite the data indicating Citizens' will experience a net customer loss in 2019, the R.D. proposes to accept I&E's projection showing a net gain, after accounting for the East Lewisburg losses, of 14 customers. R.D. at 20; *but cf.* I&E Statement No. 3-SR, Exhibit No. 3-SR, Schedule 2. The R.D. acknowledges that the historical customer growth shows a declining trend, but paradoxically finds there is no evidence indicating that the declining customer growth will continue. R.D. at 21 This finding contrasts with the aforementioned construction projections in the UCPC Annual Report and the testimony from Citizens' Witness Kelchner.

On balance, the R.D. gave undue weight to the Union County Housing Study cited by I&E and overlooked the construction projections in the UCPC Annual Report, the declining number of customers from 2016-2019, and the testimony of Company Witness Kelchner. The Commission should grant this Exception and deny I&E's proposed revenue adjustment.

C. <u>Exception No. 3</u>: The R.D. erred in rejecting the Company's 3% FPFTY inflation adjustment as speculative. (R.D. at 26).

The R.D. failed to appropriately recognize the substantial evidence in support of the Company's 3% inflation adjustment, which meets the known and measurable standard as historically applied by the Commission. As described below, the Company provided evidence, including consistent historical expense increases, supporting its projection that total Operations and Maintenance ("O&M") expenses will increase by at least the 3% rate of inflation in the FPFTY. As the Company has only proposed a conservative O&M inflation adjustment supported by historical experience, the Company submits that approval of the proposed 3% inflation adjustment is reasonable and consistent with the Commission's authority to approve FPFTY expenses. Alternatively, the Company submits that particularly strong evidence supporting a 3% FPFTY increase in salaries and benefits warrants approval of the 3% inflation adjustment for the accounts where labor is the primary expense.

1. The "known and measurable" standard does not preclude inflation adjustments.

The R.D. misapplies the known and measurable standard in its rejection of the Company's inflation adjustment. The R.D. asserts that inflation adjustments "are not actually known and measurable because they do not reflect the true cost of expenses [because] the adjustments are 'blanket adjustments' which do not directly relate to the actual costs expected to be incurred." R.D.

at 26. This holding is inconsistent with Commission precedent. Even prior to the Pennsylvania Legislature's authorization of the FPFTY through Act 11 of 2012 ("Act 11"), the "known and measurable" standard was not universally applied to deny inflation adjustments – in fact, it had traditionally been applied in quite the opposite manner. In 1996, the Commonwealth Court of Pennsylvania stated: "PUC decisional law reflects its consistent acceptance of the application of an inflation factor to expenses which are not otherwise adjusted, and has not indicated that there are any inherent flaws in this adjustment procedure." *Nat'l Fuel Gas Distrib. Corp. v. Pa. Pub. Util. Comm'n*, 677 A.2d 861, 865 (Pa. Cmwlth. 1996). Consequently, there is nothing inherently inconsistent between the "known and measurable" standard and an inflation adjustment. The R.D.'s attempt to distinguish the Company's proposed inflation adjustment as a "blanket adjustment" does not invalidate the Company's method because the Company did not apply a blanket adjustment to all FPFTY costs. The Company applied an inflation adjustment solely to O&M expenses, which, as discussed below, is consistent with the Company's historical experience.

By way of contrast, the two cases cited by OCA that involve application by the Commission of the "known and measurable" standard to deny inflation adjustments involved far broader and more speculative adjustments. As stated in the Company's Main Brief, the Commission previously denied an inflation adjustment proposed by PECO Energy Company ("PECO") where PECO proposed to recover a true blanket 2% attrition adjustment to expenses, revenue, and rate base. *See* Citizens' Main Brief at 46 *citing Pa. PUC v. Philadelphia Electric Company*, Docket No. R-822291 (Order Entered Nov. 22, 1983). The Company's adjustment applies only to expenses, and not to revenue or rate base. *See* Citizens' Main Brief at 37. Similarly, OCA's reliance on the Commission's decision in a 2007 Philadelphia Gas Works ("PGW") case as a rejection of an inflation factor misconstrues the Commission's decision in that case. *See* R.D.

at 24. There, PGW proposed a 2% annual attrition adjustment to expenses as part of a broader proposal to set rates based on a five-year forecast. *See* Citizens' Main Brief at 46; *see* also *Pa. PUC v. Philadelphia Gas Works*, Docket No. R-00061931 *et al.* (Order Entered Sept. 28, 2007) (PGW Order), at 14.[2] As clearly stated in the PGW Order, the Commission rejected the proposal based not on the inflation factor component, but rather the speculative nature of five-year projections. *See* PGW Order, at 17. Here, Citizen's used the inflation adjustment solely for one year, the FPFTY. Therefore, the R.D. erred in concluding that OCA's cited cases support rejection of Citizens' proposal. *See* R.D. at 24. While the Commission has rejected certain inflation adjustments in the past, it has not categorically denied inflation adjustments as contrary to the known and measurable standard. In fact, the Commission has accepted inflation adjustments as consistent with the known and measurable standard. Citizens' Main Brief at 45.

2. ***The Company's claim is supported by the record and meets the "known and measurable" standard as historically applied by the Commission.***

The R.D. fails to recognize the substantial evidence in support of the Company's 3% inflation factor. The Company's inflation factor is supported with Company-specific historical experience, the 2020 budget increases, and other information, and meets the known and measurable standard as historically applied by the Commission.

First and foremost, the historical O&M expense increases demonstrate a consistent and verifiable trend of increased expenses. In fact, as seen in Schedule C1-1, actual historic O&M expenses show a greater than 3% increase *every year* from 2012 to 2018 (the last year full expense data is available). Citizens' Main Brief at 43; *see also* Citizens' Statement No. 1, Exhibit__(HSG-1), Schedule C1-1 at 2. In other words, regardless of which year is used as a baseline (2012, 2013,

[2] The Company's Main Brief incorrectly referenced a November 28, 2007, entry date for the PGW Order instead of the correct September 28, 2007, entry date.

2014, 2015, 2016, or 2017), the Company's O&M expenses have increased over 3% year-over-year through 2018. It is clear that, historically, 3% is a reasonable and conservative projection of the Company's FPFTY increase in O&M costs. This approach parallels OCA witness Sherwood's statement that historical expense trends should be considered along with known and measurable increases when setting rates. Citizens' Main Brief at 46-47.

Second, the Company's 2020 Budget indicates the proposed 3% expense adjustment represents a conservative estimate of FPFTY costs. On Rejoinder, Citizens' CEO John Kelchner described the Company's budgeting process, stating, "We attempted to make the most accurate budget we could, period... [We] included what we believe is a reasonable estimate of inflation. We also included any known increases or decreases." Tr. 144. Mr. Kelchner further testified that "On an overall basis, we expect expenses to increase by over 3% from 2019 to 2020, with significantly higher increases in some areas (e.g. health insurance costs) being offset by management's efforts to manage costs." *Id.*

Third, the Company testified to vendor and labor expense increases justifying the 3% inflation adjustment for FPFTY expenses. Mr. Kelchner testified on Rejoinder that the Company anticipated increases to health insurance costs, employee salaries, and vendor costs – specifically referencing a notice from the Company's sole source of meter reading hardware and software support that prices would be increasing by 4-6%. Citizens' Main Brief at 44. In fact, Mr. Gorman testified that the Premium Summary provided by Highmark points to increases of as much as 9.79% for health care. *See id.* at 43; *see* Tr. 78-79. As to labor costs, Mr. Kelchner also testified that the oversight committee at Citizens' parent company, which employs the staff at Citizens', recommended a 3% across the board increase for employee salary. Citizens' Main Brief at 44 *citing* Tr. at 144; *see* Joint Statement No. 3 (explaining relationship between Citizens' staff and the parent company).

Most of the evidence above, which had been summarized in the Company's Main Brief, was not addressed by the R.D. Instead, the R.D. rejected the Company's inflation adjustment for being a "blanket" adjustment unrelated to the actual costs to be incurred. R.D. at 26. However, as described above, the Company supported the proposed adjustment by presenting evidence of actual costs to be incurred. The Company has demonstrated that labor costs will rise by approximately 3%, and certain vendor and overhead costs such as health insurance will escalate by much greater amounts. The Company has established, by a preponderance of the evidence, that its O&M expenses will increase by 3% from 2019 to 2020. This evidence is sufficient to warrant acceptance of the Company's proposed adjustment.

3. *The R.D.'s decision, if adopted, would frustrate the purpose of Act 11 and the FPFTY.*

The Company's approach to projecting 2020 costs aligns with the purpose of the FPFTY. The General Assembly enacted Act 11 to establish the FPFTY as a ratemaking tool to "reduce regulatory lag due to the use of rate case inputs that are outdated by the time new base rates become effective and, further, to provide more ratemaking flexibility for the timely recovery of prudently incurred infrastructure costs." *Implementation of Act 11 of 2012*, 2012 Pa. PUC LEXIS 1223 (2012), *4-5. While the R.D. correctly states that Act 11 did not abolish the "known and measurable" standard, it also does not preclude reliance on well-founded projections. To the contrary, Section 315 of the Public Utility Code explains that there will be "estimates" included with the FTY and the FPFTY. 66 Pa. C.S. § 315 ("[T]he utility shall provide, as specified by the commission in its final order, appropriate data evidencing the accuracy of the *estimates* contained in the future test year or a fully projected future test year" (Emphasis added)). The R.D., by denying the Company's well-supported 3% increase for FPFTY O&M expenses, would erode the benefits of Act 11 and the FPFTY as an authorized ratemaking tool for the Company.

Contravening the clear purpose of Act 11, the R.D. relies on 2019 data for FPFTY expense allowances, despite substantial evidence that 2020 costs will increase at or above the 3% rate proposed by the Company. Where historical O&M expenses confirm the Company experiences annual expense increases in excess of 3%, denying a modest 3% expense adjustment for the FPFTY directly conflicts with the forward-looking policy basis underlying Act 11 and the introduction of the FPFTY.

4. At minimum, the 3% inflation adjustment should be applied to expense categories consisting primarily of labor and benefits expense, as the record demonstrates the Company's employee labor and benefits expense will increase by 3%.

Although the Company maintains that the proposed 3% inflation adjustment should be granted in full, the R.D.'s rejection of the proposed inflation adjustment is particularly unjust as applied to the various expense accounts consisting primarily of labor and overhead expenses. As discussed above, the record shows that the Company will experience a 3% increase from the FTY (2019) to the FPFTY (2020) for employee salary and benefits. These expense increases are not conditional – for every hour worked, the Company will experience higher employee labor and overhead costs.

As an alternative to applying the proposed 3% inflation adjustment to total O&M expense, the 3% inflation adjustment should be applied to the following expense accounts, which are comprised of a majority of labor and overhead expenses:

- Operations Supervision and Maintenance Expense (Account 580). The R.D. recommended an allowance of $119,532 based on annualization of the 9-month, September 30, 2019, data. However, this did not include a labor-related expense adjustment for the FPFTY.

Because this account is primarily labor and overhead, a 3% adjustment should be added to the final amount approved by the R.D. *See* I&E Exhibit No. 1, Schedule 2.

- Miscellaneous Distribution Expense (Account 588). The R.D. recommended an allowance of $268,967 based on annualization of the 9-month, September 30, 2019, data. However, this did not include a labor-related expense adjustment for the FPFTY. Because this account is primarily labor and overhead, a 3% adjustment should be added to the final amount approved by the R.D. *See* I&E Exhibit No. 1, Schedule 4.
- Customer Records and Retention Expense (Account 903). The R.D. recommended an allowance of $437,188 based on annualization of the 9-month, September 30, 2019, data. However, this did not include a labor-related expense adjustment for the FPFTY. Because this account is primarily labor and overhead, a 3% adjustment should be added to the final amount approved by the R.D. *See* I&E Exhibit No. 1, Schedule 5.

As indicated above, to ignore these known and measurable increases for employee salary and benefits is inconsistent with the weight of the evidence and inconsistent with the forward-looking purpose of the FPFTY under Act 11. Even in denying the well-supported proposal to increase total O&M expense by 3% for the FPFTY, the R.D. maintains that FPFTY cost increases that are demonstrated and explained should be accepted. Accordingly, at minimum, the Commission should apply the 3% expense adjustment to the FPFTY for the above-referenced accounts with predominant labor and overhead components.

D. <u>Exception No. 4:</u> The R.D. erred in denying the Company's proposal to increase its FPFTY Operations and Maintenance Expense based on an annualization of 9-month FTY expense data. (R.D. at 27).

The Company proposed to project its FPFTY expenses by compiling all individual expense accounts based on annualized 9-month FTY actuals and applying a 3% inflation adjustment to derive total 2020 expenses. R.D. at 37. The R.D. rejected this approach, stating that the public utility must evaluate each individual cost claim under 66 Pa. C.S. §§ 1308(d), 315(a). However, this conclusion assumes that the Company's approach does not adequately address individual accounts. In fact, Section 315(a) requires only that the public utility meets its burden of proof to show that the rate involved is just and reasonable. It does not prescribe the methods used to demonstrate the justness and reasonableness of a proposed rate, or how individual expenses may be justified.

Here, the Company's approach to projecting its costs is based on the most recent available data for each individual account. Citizens' Main Brief at 38-39. Citizens' actual FTY expenses as of September 30, 2019, closely track its projected FTY expenses and demonstrate that the Company has very effectively managed to its budget. *Id.* This approach is consistent with the operations of a small public utility with limited staff. *See id.* at 41. As described by Witness Kelchner, the Company's smaller size requires flexibility for labor assignments because "the Company shifts resources and priorities during the year as operational needs arise." *Id. citing* Citizens' Statement No. 4-R at 3-4.

In contrast, I&E and OCA's approach to reviewing Company expenses penalizes the Company for effectively managing its budget. Citizens' Main Brief at 41. This selective approach focused on accounts where expenses ran below budget in the FTY without recognizing the commensurate increases in other accounts, despite the fact that movement between accounts is required for a small company like Citizens' to operate effectively. *Id.*

The R.D. erred by rejecting the Company's approach. R.D. at 27. Contrary to the R.D.'s conclusion, the Company's use of the most recent available data to develop its FPFTY projection is consistent with Section 315(a) because it reflects the actual FTY data for each expense account.

For the reasons set forth above, the Commission should grant this Exception and approve the Company's proposed FTY expense based on the annualized 9-month FTY expense plus the 3% inflation adjustment.[3]

E. Exception No. 5: The R.D. erred by adjusting the Company's claim for Operations Supervision and Maintenance Expense. (R.D. at 31-32).

The Company's Account No. 580, Operations Supervision and Maintenance Expense includes employee salaries, wages, and overhead (employee benefits) expenses. *See* I&E Exhibit No. 1, Schedule 2. In approving I&E's proposed $13,650 adjustment to Operations Supervision and Maintenance Expense, the R.D. failed to recognize the preponderance of the evidence demonstrating that employee retirements will be a significant and ongoing issue for the Company. R.D. at 32.

The Company met its burden of showing employee retirements as a known and measurable expense. The R.D. stated that the ALJs "agree that employee overlap based off anticipated employee retirements is speculative in nature" and risks the Company overcollecting on its claim, as there is "no guarantee" that the anticipated retirements will take place. However, the Company should not be held to a standard of guaranteeing that retirements will occur. Rather, the Company has a burden to show by a preponderance of the evidence that retirements will occur. The Company has demonstrated that more than half of its staff is expected to retire within the next 5-10 years. Citizens' Main Brief at 51. This is sufficient to demonstrate that the overlap expenses removed from the Company's claim by I&E are not one-time expenses and will continue on a recurring basis as the Company trains new employees to replace the outgoing retirees. Citizens' Main Brief at 51.

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[3] In the event that the Commission denies this Exception, Exception Nos. 6-8 address individual expense accounts.

Additionally, as discussed above, the R.D. did not apply a FPFTY adjustment to its $119,532 allowance, which was based on the annualization of the 9-month, September 30, 2019, data for Account 580. R.D. at 32. As explained in Exception No. 3, labor expenses are increasing by 3% based on the recommendation of the C&T Enterprises Oversight Committee, and health care expenses are increasing by more than 9%. Tr. 78-79, 144. Because this account consists primarily of labor and overhead expense, it is reasonable to apply the Company's proposed 3% adjustment to the expense approved for this account. *See* I&E Exhibit No. 1, Schedule 2.

F. <u>Exception No. 6</u>: The R.D. erred in excluding the 3% FPFTY adjustment from the Miscellaneous Distribution Expense account. (R.D. at 33).

The Company's Account No. 588, Miscellaneous Distribution Expense, includes employee salaries, wages, and overhead (employee benefits) expenses. *See* I&E Exhibit No. 1, Schedule 4. The R.D. recommended a reduction of the Company's claim for Miscellaneous Distribution Expense from $275,814 to $268,967. R.D. at 33. This allowance was based on annualization of the 9-month, September 30, 2019, data. However, the R.D. did not include a FPFTY adjustment. As explained in Exception No. 3, labor expenses are increasing by 3% based on the recommendation of the C&T Enterprises Oversight Committee, and health care expenses are increasing by more than 9%. Tr. 78-79, 144. Because this account consists of primarily labor and overhead expense, it is reasonable to apply the Company's proposed 3% adjustment to the expense approved for this account. *See* I&E Exhibit No. 1, Schedule 4.

G. <u>Exception No. 7</u>: The R.D. erred in excluding the 3% FPFTY adjustment from the Customer Records and Collection Expense account. (R.D. at 34).

The Company's Account No. 903, Customer Records and Collection Expense includes employee salaries, wages, and overhead (employee benefits) expenses. *See* I&E Exhibit No. 1, Schedule 5. The R.D. recommended a reduction of the Company's claim for Customer Records & Collection Expense from $469,626 to $437,188. This allowance was based on annualization of the 9-month, September 30, 2019, data. However, the R.D. did not include a FPFTY expense adjustment. As explained in Exception No. 3, labor expenses are increasing by 3% based on the recommendation of the C&T Enterprises Oversight Committee, and health care expenses are increasing by more than 9%. Tr. 78-79, 144. Because this account consists primarily of labor and overhead expense, it is reasonable to apply the Company's proposed 3% adjustment to the expense approved for this account. *See* I&E Exhibit No. 1, Schedule 5.

H. Exception No. 8: The R.D. erred in referencing Historic Test Year legal expense as "imprudently incurred." (R.D. at 36).

The R.D. erred in its characterization of the Company's outside service expenses (Account No. 923) as "imprudently incurred." In addition to reducing this claim from $81,370 to $62,900 based on 9-month actuals, the R.D. references the Company's Historic Test Year ("HTY") legal expense as "imprudently incurred." R.D. at 36. While the R.D. reviewed evidence indicating that certain accounting and legal expenses in 2018 may be non-recurring in the future, there exists nothing in the record suggesting, supporting, or alleging that the Company acted imprudently when incurring the HTY expense for legal services. The Company respectfully excepts to the R.D.'s characterization of the HTY legal expense as imprudently incurred.

I. Exception No. 9: The R.D. erred in declining to consider multiple methods to establish the ROE where data shows DCF results to be unreliable based on a market-to-book analysis. (R.D. at 52).

The R.D. recommended a 9.74% Return on Equity ("ROE") for the Company. R.D. at 74. To arrive at its recommendation, the R.D. averaged the mean and median proxy group ROE from the Company's Discounted Cash Flow ("DCF") analysis and set the base ROE at one standard deviation above that average (9.49%). *Id.* The R.D. additionally approved a 0.25% performance adjustment to arrive at the final recommended 9.74% ROE. *Id.*

By developing a recommended ROE based solely on the Company's DCF analysis, the R.D. erred in declining to consider multiple methods to determine the appropriate ROE for the Company. The record in this case presents credible evidence demonstrating that primary reliance on the DCF method in the current market environment will understate the appropriate ROE. The Commission should consider this evidence and incorporate the multiple models presented by Company witness Mr. Dylan D'Ascendis in determining the appropriate ROE for the Company.

The R.D. reviews prior Commission decisions and concludes that the Commission has historically relied on the DCF as the preferred method for determining an appropriate ROE, with the Capital Asset Pricing Model ("CAPM") method serving as a check. R.D. at 52. However, although the ALJ quoted select material from the Commission's decision in *Pa. Pub. Util. Comm'n v. UGI Utilities, Inc. – Electric Division* ("UGI Order"), the R.D. omits language from the UGI Order demonstrating that the Commission will consider other methods where appropriate. As noted in the Company's Main Brief, the Commission clarified this point as follows:

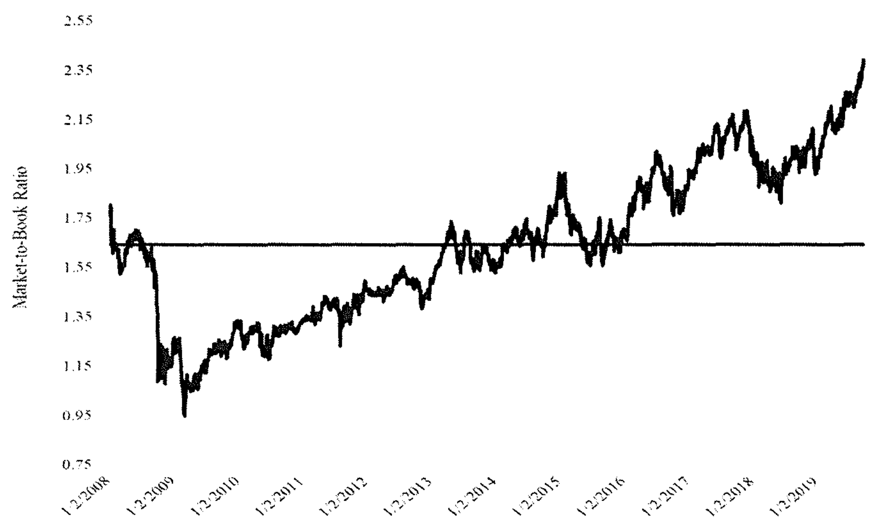
> Initially, we note that UGI has presented a valid argument that sole reliance on one methodology without checking the validity of the results of that methodology with other cost of equity analyses does not always lend itself to responsible ratemaking. As such, where evidence based on other cost of equity methods indicates that the DCF-only results may understate the utility's current cost of equity capital, we will consider those other methods, to some degree, in evaluating the appropriate range of reasonableness for our equity return determination.

Citizens' Main Brief at 74 *citing* UGI Order at 104-105. The Company submits that the Commission's comments in the UGI Order clarify that the DCF is the preferred method, but other methods will be considered where reliance on the DCF would lead to unreasonable results.

The record in this proceeding presents evidence that relying on DCF results will understate the appropriate rate of return for the Company. Mr. D'Ascendis analyzed the market-to-book ratios of the combined I&E and OCA electric utility proxy groups and observed that the market-to-book value for the combined proxy group has significantly exceeded the 1.65 ten-year average, with particularly high market-to-book ratios since 2018. Citizens' Main Brief at 75. The below table evidences the results of Mr. D'Ascendis' analysis:

Main Brief Table 6

<u>M/B Ratios of the Combined Electric Utility Proxy Group Compared with Ten-Year Average</u>



Citizens' Main Brief at 75. As explained by Mr. D'Ascendis, the DCF model assumes a market-to-book ratio of 1.0, which means that the model will overstate or understate the required ROE if the actual market-to-book value of the proxy group deviates from 1.0. *See id.* This is due to incongruent methods by which investors and regulators assess value; investors evaluate returns based on market value, while regulators authorize returns based on book value. Citizens' Main Brief, at 75. This effect is mitigated when the market-to-book ratio is at or close to 1.0. *Id.* Thus, in the current environment where the market-to-book ratio more than doubles 1.0, and even significantly exceeds the ten-year average of 1.65, the DCF model will understate the appropriate return for the Company.

In addition to presenting this analysis, Mr. D'Ascendis also provided extensive supporting evidence corroborating his findings. Mr. D'Ascendis reviewed financial literature concluding that "application of the standard DCF model to utility stocks understates the investor's expected return when the market to-book (M/B) ratio of a given stock exceeds unity." Citizens' Main Brief at 76. He further demonstrated the unreasonable results of the I&E and OCA ROE recommendations by applying the I&E and OCA cost rates to book value instead of market value, which reduced the I&E and OCA growth rates from 4.69% and 5.15% at market value, to just 0.23% and 0.81% at book value. Citizens' Main Brief at 76. Finally, to further illustrate the impropriety of using a DCF model where the market-to-book ratio exceeds unity (1.0), Mr. D'Ascendis applied the I&E and OCA DCF models to the book value capital structure of the respective proxy group. *Id.* This adjustment corrects the apples-to-oranges result of the R.D., which relies on a DCF model with a market value capital structure to develop an ROE that will ultimately be applied to book value. Correcting this imbalance by a running the I&E and OCA DCF models with a book value capital structure increases the respective ROEs by over 100 basis points (8.10% to 9.19% for the I&E DCF ROE and 8.38% to 9.45% for the OCA DCF ROE). Citizens' Main Brief at 76.

While the R.D. partially addresses the shortcomings of the I&E and OCA ROE recommendations by establishing the recommended ROE at the high end of a standard deviation range based on the average of Citizens' mean and median constant growth DCF results, the R.D. justified this recommendation as reflecting a size adjustment, rather than reflecting an adjustment due to understated DCF results. R.D. at 73-74. As detailed above, Mr. D'Ascendis established the inaccuracy of the DCF model in the current market environment where the market-to-book ratio far exceeds unity (1.0). While the R.D. does apply the CAPM model as a check on the DCF, it declines to consider the full multiple model analysis proposed by the Company, despite the

Commission's indication in the UGI Order that consideration of other models is appropriate in circumstances where the results of such models show the DCF results may be understated. R.D. at 52; *but cf.* Citizens' Main Brief at 74. The result of this omission is that the R.D. applies a size adjustment to a base ROE of 8.27, where the appropriate result would be to apply the size adjustment to the base ROE of 9.05, as justified by the multiple model approach proposed by Mr. D'Ascendis. *See* R.D. at 74; *but see* R.D. at 50-51.

Consistent with the above analysis of the market-to-book ratio, each of the alternative analyses developed by Mr. D'Ascendis show an ROE higher than the DCF method. R.D. at 50. These results reinforce the necessity to view DCF results with skepticism when running the model in an environment where market values far exceed book value. Although the Commission has used the standard deviation range around the DCF results in determining the quarterly Distribution System Improvement Charge ("DSIC") ROEs, it is more precise to examine and consider multiple models. In this environment, the Commission should carefully consider the alternative models proposed by Mr. D'Ascendis, as detailed in the Company's Main Brief. Citizens' Main Brief 65-71.

To ensure the Company has an opportunity to earn a reasonable rate of return, the Company requests that the Commission grant this Exception and develop an unadjusted ROE recommendation based on the multiple models proposed by Mr. D'Ascendis.

J. <u>Exception No. 10</u>: The R.D. erred in failing to apply the Company's 100 basis point adjustment for size risk to the ROE. (R.D. at 72).

As explained previously, the R.D. developed a recommended ROE for the Company using the high end of a standard deviation range based on the average of Citizens' mean and median constant growth DCF results. R.D. at 74. The R.D. set the ROE at the high end of the standard deviation range in recognition of the evidence affirming that Citizens' faces size risk. *Id.* While the Company appreciates the R.D.'s acknowledgement of size risk, the Company submits that the methodology developed by the R.D. results in an ROE that is commensurate with the ROEs established for much larger EDCs and thus not truly reflective of the Company's size risk. To accurately account for the Company's size risk, the Commission should approve the Company's proposed size adjustment, subject to the maximum proposed ROE of 10.30%.

The R.D. reasonably finds that an ROE based on the average mean and median DCF results on the record would produce an unreasonable result for the Company. However, the R.D. erred in attributing its use of the standard deviation method solely to the Company's size. As discussed in the Company's brief, the Commission applies the standard deviation method (setting an ROE within a standard deviation range of median or mean DCF results) in developing the ROE for purposes of calculating electric utility DSICs. Citizens' Main Brief at 85. As the DSIC is applicable primarily to large EDCs, this suggests that the process of setting an ROE within a standard deviation of the mean or median DCF results does not reflect size risk. Accordingly, to ensure the authorized ROE reflects the Company's risk, the Commission should apply a size adjustment to the result of the standard deviation method approved by the R.D. To the extent this result would exceed the Company's proposed ROE, the Company submits that the authorized ROE should be capped at the proposed 10.30%.

The Commission should also consider the conservative nature of the proposed 100 basis point size adjustment in comparison to the size adjustment supported by Mr. D'Ascendis' analysis of the Company's size risk relative to the proxy group companies. As detailed in the Company's Main Brief, Mr. D'Ascendis conducted a market capitalization analysis showing Citizens' has a market capitalization of $26.840 million compared to an average company market capitalization of $16.7 billion for the companies in Mr. D'Ascendis' electric utility proxy group ("Electric Utility

Proxy Group"). Citizens' Main Brief at 96. After determining the market capitalization of the Company and the Electric Utility Proxy Group companies, Mr. D'Ascendis relied on published data ranking publicly listed companies into size deciles grouped by ranges of minimum and maximum market capitalizations. *Id.* The $16.7 billion market capitalization of the Electric Utility Proxy Group companies ranks in the 2nd decile while the Company's $26.8 million market capitalization ranks in the 10th decile. *Id.* The size decile rankings translate to a size premium spread of 4.70% between the Company and the Electric Utility Proxy Group Companies. *Id.*

The calculated 4.70% or 470 basis point size premium spread between the Company and the Electric Utility Proxy Group companies corroborates the reasonableness of Mr. D'Ascendis' proposed 100 basis point size adjustment. Accordingly, the Commission should apply the 100 basis point size adjustment to any ROE that it would otherwise award to a larger EDC. Since the ROE method applied in the DSIC Quarterly Reports indicates the standard deviation method is generally deployed to calculate an appropriate ROE for larger utilities, the R.D.'s use of that method does not obviate the necessity to apply a further adjustment to account for size risk. Therefore, while the Company concurs in the R.D.'s finding that Citizens' faces size risk, it respectfully requests that the Commission grant this Exception and apply the 100 basis point size adjustment to the ROE resulting from the R.D.'s standard deviation method, subject to a cap at the 10.30% maximum proposed ROE.

K. <u>Exception No. 11</u>: The R.D. erred in approving a revenue allocation that fails to adequately move all customers towards cost-of-service. (R.D. at 105).

The R.D. erred in rejecting the Company's proposed revenue allocation, including a rate decrease for rate schedule GLP-3 customers. The R.D. correctly rejected the arguments from I&E, OCA, and OSBA suggesting the general proposition of rate decreases for any class should be rejected where other classes will experience rate increases. R.D. at 104. While agreeing with the

Company on the general principle that rates may decrease where justified by cost-of-service and other ratemaking factors, the R.D. denied the proposed rate decrease to Rate GLP-3 on the grounds that two other rate schedules, GLP-1 and OL, would receive rate increases resulting in relative rates of return above 1.0 at proposed rates. *Id.* at 105. This result fails to sufficiently move rate schedule GLP-3 towards cost-of-service and should be denied.

As set forth in the Company's Main Brief, the Company's proposed revenue allocation moves all classes closer to cost-of-service and avoids extreme rate impacts. Citizens' Main Brief at 105-107 *citing Lloyd v. Pa. PUC,* 904 A.2d 1010, 1015 (Pa. Cmwlth. 2006). The R.D. rejects this approach primarily on the grounds that it would impose rate increases on rate schedules GLP-1 and OL and result in relative rates of return above 1.0. R.D. at 105. However, the R.D. overlooks that the relative rates of return for rate schedules GLP-1 and OL, 1.43 and 1.32 under the Company's proposed revenue allocation, represent significant progress from the respective 1.87 and 2.07 relative rates of return under present rates. *Id.* at 102. Under the Company's proposed revenue allocation, rate schedules GLP-1 and OL receive rate increases of 15.2% and 14.9%, below the system average increase of 16.5%. While the R.D. is correct that other factors can justify deviating from the cost-of-service study results, these circumstances do not justify further adjustments. With a relative rate of return of 4.81 under present rates, rate schedule GLP-3 should receive as much rate relief as reasonably possible. *See id.* at 106. The Company's proposal brings rate schedule GLP-3 as close to cost-of-service as possible without subjecting other rate schedules to rate shock. Accordingly, the Company's proposed revenue allocation should be approved.

L. <u>Exception No. 12</u>: The R.D. erred in denying the Company's proposal to recover minimum demand costs through the fixed monthly charge. (R.D. at 120-121).

The R.D. erred in rejecting the Company's proposal to increase the fixed monthly charges for Residential customers to include a small portion of demand charges equal to the minimum demand for residential customers. As set forth in the R.D., the Company recognizes that the Commission, with limited exceptions, has allowed for recovery only of direct customer costs through fixed monthly charges. However, consistent with the Commission's adoption of its Statement of Policy on alternative ratemaking ("Final Policy Statement"), the Company proposed to include minimum demand costs in the proposed fixed monthly charges for Residential customers in order to reflect the Company's fixed costs more closely. R.D. at 107; *see also* 52 Pa. Code §§ 69.3301-3302. The R.D. adopted arguments from I&E and OCA and denied the Company's proposal as contrary to established ratemaking principles and the Final Policy Statement. R.D. at 121. The Company submits that the R.D.'s analysis misstates both the Commission's discretion to approve exceptions to its traditional ratemaking policies and the flexibility afforded by the Final Policy Statement. The Company's proposal reflects a careful balancing of policy objectives, including cost-of-service principles and energy efficiency, and should be approved by the Commission.

As summarized in the R.D., Citizens' proposed to increase the fixed monthly customer charge from $11.24 to $15.00, with $2.06 of the increase attributable to a shift of minimum demand costs into the fixed monthly charge. R.D. at 108. The minimum demand costs that the Company proposes to include equal the monthly cost of 0.38 kW of demand, which is met or exceeded by 99% of the Company's Residential customers. *See id.* at 108. Similarly, the Company proposed to increase the Space Heating fixed monthly charge from $18.57 to $24.00, with $6.04 of the increase attributable to a shift of minimum demand costs into the fixed monthly charge. *Id.* at 109. This minimum demand that the Company proposes to include equals the monthly cost of 0.95 kW of demand, which is met or exceeded by over 95% of the Company's Space Heating customers. *See id.* at 109.

The R.D. argues that Citizens' proposal should be denied as contrary to cost-of-service principles and devoid of customer protections. R.D. at 119. This finding is in error. The Company acknowledges that its proposal to recover minimum demand costs through the fixed monthly charge expands the costs generally recovered through such charges. However, the Company reasonably relied on the Commission's authority to deviate from the traditional ratemaking guidelines. Specifically, the Company's Reply Brief referenced a 2004 decision where the Commission determined that indirect costs such as "employee benefits, local taxes and other general and administrative costs... are costs which may be considered for inclusion in the customer charge, but *such claims are subject to scrutiny on a case-by-case basis*." Citizens' Reply Brief at 41 *citing Pa. PUC v. Aqua Pennsylvania Inc.*, 2004 Pa. PUC LEXIS 39 (Order entered Aug. 5, 2004) (emphasis added). Here, the Company provided a reasonable basis for its proposed fixed monthly charge by demonstrating that the demand costs to be collected through the fixed monthly charge represent the minimum demand costs incurred by the vast majority (99%) of residential customers. R.D. at 108-109. These are not variable costs that could be eliminated or reduced by customer behavior. *Id.* The R.D. overlooks the Company's intentional design in shifting only the minimum demand costs as a customer protection to ensure that only those demand costs that are not variable are shifted to the fixed monthly charge. The remaining demand costs would continue to be recovered through the company's variable (volumetric) rates. *Id.*

The R.D.'s rejection of the Company's proposed fixed monthly charge as a violation of cost-of-service principles ignores the fact that recovery of demand charges through volumetric per-kWh rates is also inconsistent with a strict application of cost-of-service principles. *See* Citizens' Reply Brief at 43. I&E acknowledged that the Company's existing rate structure omits a Residential demand charge and thus recognized that "the energy charge does not perfectly reflect demand-related costs imposed on the system." R.D. at 116. I&E appears to oppose recovery of the demand costs through the fixed monthly charge because the physical infrastructure necessary to support the Company's demand is not correlated or "fixed" to the number of customers. R.D. at 116. This is a distortion of the Company's reference to fixed costs, as the Company uses the term in reference to the cost of each customer's fixed demand, not the total cost of the Company's existing demand-related infrastructure. *See* Citizens' Main Brief at 108 (stating that the proposal to recover demand costs through the fixed monthly charge is "based on demand levels that the vast majority of the accounts experience each month."). While a demand charge could be developed to recover these minimum demand costs, the Company believes its proposal reasonably reflects the fixed nature of the minimum demand costs while preserving a familiar and simplified rate structure for the Residential customers. *See* Citizens' Main Brief at 111.

While the Company believes its proposed fixed monthly charge is reasonable under the Commission's traditional process, the recent enactment of Act 58 further supports approval of the Company's proposed customer charge. The R.D. takes a misguided approach in finding that the Company's proposal is not an alternative ratemaking proposal under the Final Policy Statement because it allegedly fails to promote efficient use of energy sources or reflect cost-of-service principles. R.D. at 121. The above discussion addresses the cost-of-service argument. With regard to the Final Policy Statement, the R.D. adopts an overly narrow view of the policy initiatives underlying alternative ratemaking. The R.D. finds that the Company's proposal "fails to promote efficient use of energy sources as its inclusion of demand charges in the fixed customer charge prevents customers from seeing price signals that would otherwise encourage conservation and the efficient use of electricity."[4] R.D. at 121. This conclusion arises from a misperception that alternative ratemaking mechanisms are intended to unilaterally promote energy efficiency. The plain language of the Commission's Final Policy Statement and Section 1330 of the Public Utility Code demonstrate otherwise.

The R.D. oversimplifies the purpose of the alternative ratemaking mechanisms under the Commission's Policy Statement in finding that alternative ratemaking mechanisms must directly promote efficient use of energy sources. *See* R.D. at 121. The Final Policy Statement identifies several policy objectives of alternative ratemaking proposals, including "the objectives of 66 Pa.C.S. § 1330 (relating to alternative ratemaking for utilities)." Section 1330 of the Public Utility Code provides as follows:

> It is the policy of the Commonwealth that utility ratemaking should encourage and sustain investment through appropriate cost-recovery mechanisms to enhance the safety, security, reliability or availability of utility infrastructure and be consistent with the efficient consumption of utility service.

66 Pa. C.S. § 1330. Importantly, Section 1330 of the Public Utility Code clarifies that a policy objective of alternative ratemaking is to sustain investment in utility infrastructure. *Id.; see also* Citizens' Main Brief at 113 (stating that "[b]y aligning rates with costs, the Company's proposal supports the Company's ongoing efforts to invest in reliability projects."). The R.D. concurs that the Company's proposal "promotes revenue stability and provides some insulation for reduction in usage that may be caused by efficiency efforts," but the R.D. never recognizes that the true purpose of the Company's proposal is not to directly promote energy efficiency, but to develop a cost recovery mechanism that ensures that continued support of energy efficiency will not compromise the Company's ability to recover its fixed minimum demand costs. R.D. at 121. Accordingly, the

[4] The R.D.'s approach would suggest that implementing default hourly-priced service for Residential customers is necessary to promote energy efficiency by sending market price signals.

Company's proposal indirectly supports energy efficiency by removing disincentives existing in the current rate structure.

The R.D.'s finding that the Company's proposal prevents customers from seeing price signals that would otherwise encourage conservation is inconceivable. R.D. at 121. As detailed above, the Company has only proposed to shift minimum demand costs to the fixed monthly charge. The R.D. at no point explains how shifting minimum demand costs to the fixed monthly charge would distort price signals to customers as the proposal ensures that demand costs above the minimum baseline would continue to be recovered through variable per-kWh rates. The Commission should also consider that the vast majority of price signals encouraging conservation come from the generation component of a customer's bill, which would remain unchanged by the proposal to shift the minimum demand costs for the distribution system to the fixed customer charge. Citizens' Reply Brief at 42-43. Accordingly, the R.D.'s suggestion that shifting minimum demand costs to the fixed monthly charge would discourage customers from purchasing energy-efficient equipment should be rejected. *See* R.D. at 120. The Company's proposal preserves appropriate price signals supporting conservation by limiting the demand costs recovered through the fixed charge to the costs of customers' minimum demand.

For the above reasons, the Commission should grant this Exception and approve the Company's proposed fixed monthly charges, including the proposal to assign minimum demand costs for recovery through the fixed Residential monthly charges.

III. CONCLUSION

WHEREFORE, Citizens' Electric Company of Lewisburg, PA respectfully requests that the Pennsylvania Public Utility Commission grant these Exceptions, approve the Company's recommendations therein, and otherwise adopt the Recommended Decision.

Respectfully submitted,

McNEES WALLACE & NURICK LLC

By ______________________

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