100 Pine Street • PO Box 1166 • Harrisburg, PA 17108-1166
Tel: 717.232.8000 • Fax: 717.237.5300

Adeolu A. Bakare
Direct Dial: 717.237.5290
Direct Fax: 717.260.1744
abakare@mcneeslaw.com

March 23, 2020

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

VIA ELECTRONIC FILING

RE: Valley Energy, Inc.; Docket No. R-2019-3008209

Dear Secretary Chiavetta:

Please find attached for filing with the Pennsylvania Public Utility Commission the Reply Exceptions of Valley Energy, Inc. ("Valley") in the above-referenced proceeding.

As shown by the attached Certificate of Service, all parties to this proceeding are being duly served with a copy of this filing. Due to the current state of emergency in effect throughout the Commonwealth, Valley has notified all parties that it will provide only electronic service of the Reply Exceptions and has received no objections. Thank you.

Sincerely,

McNEES WALLACE & NURICK LLC

By
Adeolu A. Bakare

c: Administrative Law Judge Steven K. Haas (via E-Mail)
Administrative Law Judge Benjamin Myers (via E-Mail)
Office of Special Assistants at ra-OSA@pa.gov
Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true copy of the foregoing document upon the participants listed below in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

VIA E-MAIL

Sharon E. Webb, Esq.
Daniel G. Asmus, Esq.
Office of Small Business Advocate
Forum Place
555 Walnut Street, 1st Floor
Harrisburg, PA 17101
swebb@pa.gov
dasmus@pa.gov

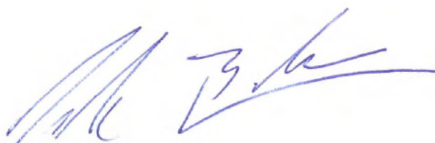
Brian Kalcic
Excel Consulting
225 South Meramec Avenue, Suite 720
St. Louis, MO 63105
Excel.consulting@sbcglobal.net
OSBA Consultant

Christy M. Appleby, Esq.
Aron J. Beatty, Esq.
Darryl A. Lawrence, Esq.
Santo G. Spataro, Esq.
Office of Consumer Advocate
555 Walnut Street
Forum Place - 5th Floor
Harrisburg, PA 17101-1921
CAppleby@paoca.org
ABeatty@paoca.org
DLawrence@paoca.org
SSpataro@paoca.org

John Coogan, Esq.
Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement
Commonwealth Keystone Building
400 North Street, 2nd Floor West
Harrisburg, PA 17120
jcoogan@pa.gov

Jonathan P. Foster, Sr., Esq.
Foster Law Office
303 South Keystone Avenue
Sayre, PA 18840
Jonathan.Sr@fosterslawfirm.com
Solicitor for South Waverly Borough
Solicitor for Borough of Athens

Larry E. Cole
74 E. Laurel Street
Bradford, PA 18832
Larryc41@frontier.com



Adeolu A. Bakare
Counsel to Valley Energy, Inc.

Dated this 23rd day of March, 2020, at Harrisburg, Pennsylvania.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2019-3008209
	:	
Valley Energy, Inc.	:	

REPLY EXCEPTIONS
OF VALLEY ENERGY, INC.

Pamela C. Polacek (PA I.D. No. 78276)
Adeolu A. Bakare (PA I.D. No. 208541)
Matthew L. Garber (PA I.D. No. 322855)
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Phone: (717) 232-8000
Fax: (717) 260-1744
ppolacek@mcneeslaw.com
abakare@mcneeslaw.com
mgarber@mcneeslaw.com

Counsel to Valley Energy, Inc.

Dated: March 23, 2020

TABLE OF CONTENTS

Page

I. INTRODUCTION 2

II. REPLY EXCEPTIONS 3

A. Reply Exception No. 1: The Commission should deny OCA's Exception No. 1 and approve the Company's proposed rate base. 3

B. Reply Exception No. 2: The Commission should deny OCA's Exception No. 3 and adopt the R.D.'s recommendation to approve the Company's proposed revenue projections. 4

C. Reply Exception No. 3: I&E's Exception No. 3 and OCA's Exception No. 7 fail to account for record evidence supporting the Company's proposed rate case normalization period. 6

D. Reply Exception No. 4: The R.D. correctly recommended rejection of I&E's adjustment for C&T Allocation Expense (I&E Exception No. 2). 7

E. Reply Exception No. 5: The R.D. correctly recommended rejection of I&E's adjustment for General Advertising/Miscellaneous General Expense in I&E Exception No. 3. 8

F. Reply Exception No. 6: The ALJs correctly recommended that the Commission approve the Company's claim for Customer Installations Expense (OCA Exception No. 5). 10

G. Reply Exception No. 7: The R.D. correctly adopted Valley's claims for Meters and House Regulators Expense and Meter Reading Expense (OCA Exception No. 4). 11

H. Reply Exception No. 8: OCA's proposed reduction to the R.D.'s recommended allowance for Office Supplies and Expenses should be denied (OCA Exception No. 6). 12

I. Reply Exception No. 9: The Commission should deny I&E's Exception No. 4 and OCA's Exception No. 8 as inconsistent with the record evidence of size risk. 13

J. Reply Exception No. 10: I&E's Exception No. 5 and OCA's Exception No. 9 should be rejected in favor of the R.D.'s well-reasoned recommendation to approve a 25-basis point performance adjustment for the Company 18

K. Reply Exception No. 11: I&E's Exception No. 6 should be discarded as the R.D. correctly denied I&E's recommendation that Valley be required to provide certain accounting reports. 20

L. Reply Exception No. 12: The Commission should deny OSBA's Exception No. 1 and adopt the R.D.'s recommendation to approve the Company's revised Facilities Extension Policy. 21

III. CONCLUSION 23

I. INTRODUCTION

On July 1, 2019, Valley Energy, Inc. ("Valley" or "Company") filed with the Pennsylvania Public Utility Commission ("PUC" or "Commission") Supplement No. 49 to Tariff Gas-Pa. PUC No. 2 ("Original Supplement No. 49"), proposing an annual increase in revenue of $1,034,186. In support of this filing, Valley submitted a Statement of Reasons, the supporting information required by 52 Pa. Code § 53.52(a), (b), and (c), and various other information.[1]

A procedural history for this proceeding was provided in Valley's Main Brief, which was filed on January 8, 2020. The Bureau of Investigation and Enforcement ("I&E"), Office of Consumer Advocate ("OCA"), and Office of Small Business Advocate ("OSBA") also filed Main Briefs on that date, with Reply Briefs being filed on January 22, 2020.

On February 28, 2020, ALJs Haas and Myers issued a Recommended Decision ("R.D.") in this proceeding. On March 13, 2020, Valley filed Exceptions to the ALJs' R.D., asking that the Commission reverse or modify several elements of the R.D., and otherwise accept the R.D. in its Final Order. I&E, OCA, and OSBA also filed Exceptions in response to the R.D.[2]

Valley hereby files the following Reply Exceptions in response to the Exceptions filed by I&E, OCA, and OSBA. The Company respectfully requests that the Commission reject the Exceptions of I&E, OCA, and OSBA, grant Valley's Exceptions, and otherwise adopt the ALJs' Recommended Decision.

---

[1] In its Rebuttal Testimony, Valley subsequently revised its proposed revenue increase to approximately $745,000. Valley Main Brief at 1.

[2] I&E filed Exceptions on March 12, 2020; OCA and OSBA filed Exceptions on March 13, 2020.

II. REPLY EXCEPTIONS

A. <u>Reply Exception No. 1</u>: The Commission should deny OCA's Exception No. 1 and approve the Company's proposed rate base.

Despite recent Orders from both the Commission and the Commonwealth Court affirming the end-of-test-year rate base methodology applied by the Company, OCA continues to propose the average-year rate base methodology for purposes of calculating the Company's rate base. OCA Exceptions at 2. OCA attempts to ignore the extensive litigation on this issue and argues that the prior decisions have no bearing on the Commission's actions in this docket. However, as OCA has failed to present new evidence or arguments that would merit revisiting the Commission's decision in *Pa. PUC v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Order entered Oct. 25, 2018) ("UGI Order"), the Commission should uphold its prior ruling. Any other outcome would produce inequitable and discriminatory outcomes.

OCA's argument rests on a mistaken conclusion that the R.D. misunderstood the impact of the Commonwealth Court Order affirming the Commission's approval of the end-of-year methodology in its UGI Order. OCA Exceptions at 2-3. OCA alleges that the R.D. erred in deeming the Commonwealth Court's decision to be binding on the parties. *Id*. While the Company agrees with OCA that the Commission reserves discretion to overturn its own Orders, the Company avers that the R.D.'s use of "binding" was intended to refer to the Commission's obligation when reviewing a legal question addressed in a prior docket. While the Commission is not bound by the rule of *stare decisis*, it has a duty to "render consistent opinions and should either follow, distinguish, or overrule [its] precedent." *See Joint Petition of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company for Approval of their Default Service Programs,* 2014 Pa. PUC LEXIS 552, *85 (Pa. P.U.C.

July 24, 2014); *Bell Atlantic -- Pennsylvania, Inc. v. Pa.* PUC, 672 A.2d 352, 354 (Pa. Cmwlth. 1995).

Here, OCA has failed to distinguish the facts at issue from the facts addressed in the UGI Order. As set forth in the Company's briefs, the arguments offered by OCA in opposition to the end-of-test-year rate base methodology duplicate the arguments offered and rejected in the Commission's UGI Order. *See* Valley Reply Brief at 4; *see also* Valley Main Brief at 16-21. As the facts remain unchanged, a decision to apply Act 11 to bar use of the end-of-test-year rate base method would generate a discriminatory outcome for the Company. To avoid this scenario, the Commission should deny OCA's Exception No. 1 and uphold the R.D.'s acceptance of the end-of-test-year methodology for developing the Company's rate base.

B. Reply Exception No. 2: The Commission should deny OCA's Exception No. 3 and adopt the R.D.'s recommendation to approve the Company's proposed revenue projections.

OCA excepts to the R.D.'s recommendation to approve Valley's revenue projection, which Valley Witness Gorman developed using a standard regression analysis incorporating weather normalization and adjustment for customer count. R.D. at 17. As discussed in Valley's Main Brief and the R.D., the alternative revenue projection developed by OCA Witness Mierzwa is entirely unsupported. R.D. at 18 *citing* Valley Reply Brief at 17. Consistent with the R.D., the Commission should deny OCA's Exception and approve the Company's proposed revenue projection.

OCA claims its revenue projection should be approved because the Company's revenue projection would understate revenues for the Fully-Projected Future Test Year ("FPFTY"). OCA Exceptions at 8. The sole basis for OCA's conclusion that FPFTY revenue would be understated is that Future Test Year ("FTY") revenues exceeded projections due to a particularly cold 2019 winter. See *id*. This is not a reasonable basis for departing from the Company's generally accepted

methods, where Valley Witness Gorman confirmed the "Company's projection of sales is based on a regression analysis for weather sensitive classes." Valley Main Brief at 26. By way of contrast, OCA's proposed revenue projection is rife with critical flaws. These flaws were summarized in Valley's Main Brief as follows:

> In his oral rejoinder testimony, Mr. Gorman discussed the many flaws in OCA's analysis, including: 1) relying on a single year of sales data; 2) taking the usage over the full year instead of the well-supported approach of taking usage by month; and 3) inexplicably omitting certain classes from weather normalization.

Valley Main Brief at 26; see also R.D. at 18. OCA offers no explanation for these departures from Mr. Gorman's analysis other than its circular conclusion that Mr. Gorman's analysis must be incorrect because the FTY revenues are higher than the projected revenues. OCA Exceptions at 8-9.

Further, OCA is incorrect in asserting that Mr. Gorman's analysis does not account for the colder 2019 winter. See *id.* at 8. As described in Valley's Main Brief, Mr. Gorman's analysis incorporated weather-normalized data for all weather sensitive classes, thereby accounting for year-to-year weather fluctuations. *See* Valley Main Brief at 26. The incorporation of weather-normalized data accounts for the reality that one year in the analysis may be colder than normal, while the next year is warmer than normal (resulting in lower revenues). Mr. Gorman's analysis is not "wrong"; rather, it includes internal controls to prevent overreliance on a warmer than normal or colder than normal test year.

As determined by the R.D., OCA failed to present valid reasons for rejecting Valley's revenue projections. R.D. at 18. The Company's regression analysis is a standard industry practice when developing rate case revenue projections for a weather-sensitive utility. *See id.* at 19. Accordingly, the Commission should deny OCA's Exception, adopt the R.D.'s recommendation, and approve the Company's proposed revenue projection.

C. Reply Exception No. 3: I&E's Exception No. 3 and OCA's Exception No. 7 fail to account for record evidence supporting the Company's proposed rate case normalization period.

The ALJs recommended that the Commission accept Valley's expense claim for rate case expense to be normalized over three years. R.D. at 29. I&E and OCA contend that the ALJs' decision to approve the Company's request to normalize the rate case expense for a 36-month period instead of their proposed 60-month period is an error and a deviation from the Commission's practice of setting a normalization period based on historic filing frequency. I&E Exceptions at 4-5; OCA Exceptions at 14-15. I&E also contends that the Company provides no specific support for the appropriateness of a 36-month normalization period. I&E Exceptions at 5.

The Company presented more than adequate evidence to support the requested 36-month normalization period for rate case expense. Valley Main Brief at 41-43. Company Witness Gorman noted that the filing intervals for the last three rate cases have been "33 months, 36 months, and 110 months." *Id.* at 42. The typical filing frequency is therefore 36 months or less.

I&E and OCA both focus on the average of the Company's filing intervals as grounds for contending that a 60-month normalization period is proper here. I&E Exceptions at 4-5; OCA Exceptions at 14-15. However, Valley Witness Rogers explained the abnormal circumstances contributing to the 110-month stay out since the 2010 rate case as follows:

> The circumstances allowing Valley to avoid a rate increase since 2010 are not likely to recur following this rate case. Valley was fortunate to connect a very large new contract customer shortly after the 2010 rate case. The additional contract revenues helped the company offset rising operational costs that otherwise would have resulted in a request for a rate increase. The Company should not be penalized for effectively managing the additional revenues to avoid burdening customers with rate increases. The fact is, there is no anticipated scenario where Valley would avoid filing a rate increase for a 60-month period.

Valley Main Brief at 42-44 *citing* Valley Statement No. 4-R at 5. The Company has demonstrated that the 110-month period following the 2010 rate case was not a normal occurrence and is an

outlier in comparison to the prior 33-month and 36-month intervals between rate cases. Thus, both historic frequency and future expectations support the 36-month period used by the Company and adopted in the R.D. *See* Valley Main Brief at 42-43.

I&E and OCA's assertions are also incorrect because, as discussed in the Company's Main Brief, historic filing frequency is one factor that the Commission considers in determining rate case normalization, but it is not the only factor. Ratemaking is prospective in nature and the goal of ratemaking is to reasonably reflect future conditions when new rates are in effect. Valley Main Brief at 42; *see e.g., Columba Gas v. Pa. Pub. Util. Comm'n*, 613 A.2d 74, 76 (Pa. Cmwlth. 1992), *aff'd*, 636 A.2d 627 (Pa. 1994). As such, the Commission may consider other factors to ensure that its final decision reasonably reflects future conditions when new rates take effect. The Company, therefore, urges the Commission to accept the R.D.'s recommendation and approve Valley's claim for rate case expense to be normalized over a 36-month period.

D. <u>Reply Exception No. 4:</u> The R.D. correctly recommended rejection of I&E's adjustment for C&T Allocation Expense (I&E Exception No. 2).

The R.D. recommended that the Commission approve a total claim of $233,704 for C&T Allocation Expense. R.D. at 45. I&E argues for a downward adjustment of $44,429 to this expense, contending that "substantial evidence does not exist to support an expense claim of more than $189,179." I&E Exceptions at 6. I&E's claim should be rejected.

In its Exceptions, I&E argues that Valley has improperly claimed that the East Athens project impacts C&T Allocation Expense for the first time in Main Brief. *Id.* This claim is misleading. The Company presented no new evidence in the briefing stage. Rather, the Company simply relied on evidence already on record to support its argument that record evidence shows the annualized FTY expense will understate the Company's C&T Allocation Expense for the FPFTY. Valley Main Brief at 48. The Company had previously explained, on the record, that the

C&T Allocation Expense is determined by the Company's revenue and meter count. *See* I&E Statement No. 1, Exhibit No. 1, Schedule 9 at 1. Similarly, projected customer growth due to the East Athens Project is also established in the record. Valley Statement No. 4 at 11.

Using the Main Brief to clarify the connection between facts established on the record is not a late "claim" as posited by I&E. I&E Exceptions at 6. I&E has cited to no legal authority indicating that the Company, in its briefs, cannot rely on the existing evidentiary record to support its claims made on Direct. I&E cites to 52 Pa. Code § 5.243(e)(2)-(3), but neither these provisions nor cases interpreting them bar the Company from presenting arguments in its brief supporting its claims. *See, e.g., Pa. PUC et al. v. UGI Util., Inc.*, 1994 Pa. PUC LEXIS 138 ("The clear purpose of [52 Pa. Code s 5.243(e)] is to avoid trial by ambush and the prevention of surprise can only be achieved if the parties are confined to the scope of their direct case.") The Company has remained within the scope of its Direct and relied on evidence in the record. *See City of Lancaster (Sewer Fund) v. Pa. PUC*, 793 A.2d 978, 984 (Pa. Cmwlth. 2002) (determining that the City of Lancaster's claimed 4 percent increase in wages was improperly proffered direct evidence in the rebuttal phase of the rate case proceeding pursuant to 52 Pa. Code § 5.243(e)). I&E has not identified improper evidence presented by the Company. *Id.*

While the Company agrees that it would be improper to present new evidence in the briefing stage, the ALJs' recommendation relied on *existing* evidence in the record. As a result, the ALJs reasonably concluded that Valley provided sufficient evidence to justify its claim. The ALJs' recommendation should be adopted by the Commission.

E. Reply Exception No. 5: The R.D. correctly recommended rejection of I&E's adjustment for General Advertising/Miscellaneous General Expense in I&E Exception No. 3.

The ALJs recommend that the Commission approve a total claim of $69,484 for General Advertising/Miscellaneous General Expense (Account No. 930), a reduction of $14,415 to Valley's

original claim of $73,373. R.D. at 42. I&E excepts to this recommendation, arguing that substantial evidence does not exist to support an expense allowance greater than $58,958. I&E Exceptions at 7. This claim is in error.

Specifically, I&E argues that there should be two separate downward adjustments to the Company's claim. I&E Exception at 7. First, I&E states that Valley itself made a $7,351 downward adjustment in Rebuttal Testimony based on annualized year-to-date data for that account. *Id.* Second, I&E agrees with the ALJs' removal of expenses for volunteer labor but argues the removal of $3,889 based on Valley's accounting of volunteer labor expenses for 2019 is insufficient. *Id.* I&E's approach on both issues is inconsistent and should be rejected.

First, characterizing the $7,351 downward adjustment as "uncontested" is inaccurate. *See id.* at 7-8. The presentation of individual expense data by Valley Witness Gorman did not modify the initial claim for the individual expense item. Valley Main Brief at 29-31, 35-36; *see also* Valley Statement No. 1-R at 4-6. Mr. Gorman proposed an overall approach to total Operations and Maintenance ("O&M") expenses of annualizing the most updated available year-to-date data (as of September 30, 2019) and adding an inflation adjustment to convert FTY expenses to FPFTY projections. Valley Statement No. 1-R at 4-6. However, this was an across-the-board proposal in response to the fact that small companies must often shift resources as needs arise, not a limitation on the Company's individual claims following rejection of the across-the-board proposal. Valley Main Brief at 29-31.

Second, the R.D. correctly adopted OCA's proposal to adjust for 2019 volunteer expenses ($3,889), because the R.D.'s expense allowance is based on annualized 2019 data. I&E argues that the R.D. should disallow projected 2020 volunteer expense instead ($7,064). This approach would be reasonable if the R.D. accepted the Company's 2020 projection for this account. However, the

R.D. uses 2019 data, not the Company's 2020 projection. R.D. at 43. As a result, the R.D. reasonably deducted the annualized year-to-date 2019 volunteer expense and applied its adjustments consistently. The R.D.'s recommendation for Account No. 932 should be approved by the Commission, subject to the inflation adjustment addressed in the Company's Exceptions.

F. Reply Exception No. 6: The ALJs correctly recommended that the Commission approve the Company's claim for Customer Installations Expense (OCA Exception No. 5).

In its Recommended Decision, the ALJs adopted the Company's original request of $132,269 regarding Account No. 879 for Customer Installations. R.D. at 32. The Company projected an increase from Historic Test Year ("HTY") to FTY increase of $13,352. Despite year-to-date 2019 data tracking well above the Company's original projection, OCA recommends a reduced allowance of $117,396. OCA Exceptions at 12. Specifically, OCA states that overhead costs can vary from year to year and recommends a 2016-2018 average to estimate FPFTY Account No. 879 expenses. *Id.* at 11.

OCA's recommendation should be rejected as unsupported. OCA argues that "[a]cceptance of the Company's claim based solely upon the actual data provided for the [FTY] ignores historical changes to expenses." *Id.* at 12. The Company avers that OCA's reliance on the 2016-2018 average does not accurately account for labor and overhead costs that are trending upward. *See* Valley Main Brief at 3-4. The Company reasonably projected increases to this account, and the 2019 year-to-date data bears out the Company's expectations. *Id.* In fact, the data shows Account No. 879 tracking substantially ahead of projections for the FTY. Valley Main Brief at 33. This is, in large part, due to a 3% increase in wages effective January 1, 2019 – an expense that will continue to increase. Valley Reply Brief at 14-15.

The ALJs reasonably found that Valley provided sufficient evidence to justify its projected FPFTY costs. R.D. at 32. The Commission should approve the ALJs recommendation.

G. <u>Reply Exception No. 7</u>: The R.D. correctly adopted Valley's claims for Meters and House Regulators Expense and Meter Reading Expense (OCA Exception No. 4).

The ALJs recommended that the Commission approve the Company's claims for Meters and House Regulators Expense (Account No. 878) and Meter Reading Expense (Account No. 902). R.D. at 32. In the R.D., the ALJs addressed both accounts together because the Company explained that work shifted between the two accounts. *Id.* at 32; Valley Main Brief at 44.

OCA opposes the ALJs' recommendation based on OCA Witness Sherwood's disagreement with the Company's underlying forecast. OCA argues that the Company's proposed expenses for Account No. 902 and Account No. 878 are 20% and 17% higher than the HTY expense, respectively. OCA Exceptions at 10. OCA points to 6-month (as of June 30, 2019) FTY data to argue that "the Company through the first half of 2019 has not experienced this level of forecasted expenses." *Id.*

The ALJs correctly rejected OCA's argument based on 6-month FTY data. Using the updated 9-month data provided in Rebuttal Testimony, the Company showed Account No. 878 running $14,010 above FTY projections, with Account No. 902 tracking $15,272 below FTY projections. R.D. at 31. Based on record evidence provided by the Company, the ALJs correctly treated these accounts as interrelated. R.D. at 32. OCA's Exceptions do not provide a reasonable basis for rejecting this recommendation of the R.D., particularly as OCA based its own argument for Account No. 902 on the actual 6-month FTY expense and the R.D. accepted the shift in expense reflected in the actual annualized 9-month FTY expense. R.D. at 31. The Company therefore respectfully requests that the Commission adopt the R.D.'s recommendation for these accounts.

H. Reply Exception No. 8: OCA's proposed reduction to the R.D.'s recommended allowance for Office Supplies and Expenses should be denied (OCA Exception No. 6).

The ALJs adjusted the Company's $74,701 claim for Office Supplies and Expenses (Account No. 921) to $59,934, the annualized year-to-date figure as of September 30, 2019. *See* R.D. at 40. The Company did not except to this adjustment.

In its Exceptions, OCA seeks a further reduction to $55,191. OCA argues that the R.D. overemphasized the Company's "most recent one-time expenditures." OCA Exceptions at 13. OCA asserts that "there is no indication in the record that the Company's proposed training and travel expenses will continue beyond 2020." *Id.*

This is inaccurate. OCA continues to ignore evidence presented by Valley that the training and travel expenses are ongoing. As explained in the Company's Main Brief, Valley Witness Rogers explained that the Company would be incurring ongoing training costs both to onboard new employees and increase gas safety training. Valley Main Brief at 46. Specifically, Mr. Rogers testified that Valley will continue to incur training expenses "to address increasing regulatory obligations for certified Operators and employee training for continually evolving human resources issues." *See id. citing* Valley Statement No. 4-R at 9. The ALJs appropriately recognized this and denied OCA's attempt to ignore the ongoing expenses and set costs at an amount lower than projected by year-to-date data. R.D. at 40.

Accordingly, OCA's proposed adjustment should be denied, and the Commission should accept the ALJs' recommendation for this account.

I. <u>Reply Exception No. 9</u>: The Commission should deny I&E's Exception No. 4 and OCA's Exception No. 8 as inconsistent with the record evidence of size risk.

1. Introduction

As discussed in the Company's Exceptions, the R.D. recommended approval of a 9.93% Return on Equity ("ROE") for the Company, representing the higher end of one standard deviation from the average of the mean and median of the Company's Discounted Cash Flow ("DCF") plus a 0.25% performance adjustment. R.D. at 79. The R.D. determined that the standard deviation method was necessary to account for the Company's size risk. *Id*. I&E and OCA filed Exceptions opposing the R.D.'s use of the standard deviation method. I&E argues that the R.D. erred in applying the standard deviation method because the Company failed to meet its burden of proving the existence of size risk. I&E Exceptions at 8. OCA argues that size merits no adjustment and the R.D.'s result violates the maximum DCF result established by its CAPM analysis. OCA Exceptions at 18-20. Both arguments are misguided and should be rejected. As described in the Company's Exceptions, even the R.D.'s analysis fails to fully reflect the Company's size risk. Valley Exceptions at 18-19. Granting the I&E or OCA Exceptions would improperly result in a historically low ROE for a regulated utility that is not reflective of current market conditions, the Commission's development of a Distribution System Improvement Charge ("DSIC") ROE, or the UGI Order. Valley Main Brief at 69-70.

2. I&E's Exception No. 4 relies on a misstatement of the burden of proof.

I&E claims the R.D. erred in applying the standard deviation method as a size adjustment because the Company failed to meet its burden of showing size risk exists for utilities. I&E Exceptions at 8-9. This is in error. The Company bore the burden of proof only for its argument that size risk exists for small companies. *Pa. PUC v. Duquesne Light Company*, Docket No. R-2018-3000124 (Order entered December 20, 2018) ("Duquesne Order") at 71. I&E bore

the burden of proof to support its counterargument that even if small companies face size risk, utilities do not. The ALJs appropriately determined that I&E failed to adequately support its counterargument. R.D. at 73.

Although I&E is correct that the Company bears the burden of proof as to company size risk, I&E incorrectly claims the Company failed to meet its burden. The Company proposed a size adjustment based on the premise that size risk affects all companies and supported this claim with numerous citations to financial literature and market data. Valley Main Brief at 86-87 *citing* Joint Statement No. 2 at 42-43; *see* R.D. at 73-75. I&E responded to the Company's claim by concurring that the Company provided evidence of general size risk, but alleging that utilities are an exception to the rule. *See* I&E Statement No. 2 at 41. With regards the counterargument that utilities are exempt from the general rule of size risk, I&E bears the burden of proof. Duquesne Order at 71.

Even if the Company additionally bore the burden of proof as to I&E's counterargument, it met its burden by proving, by a preponderance of the evidence, that size risk exists for utilities. Valley Main Brief at 88-91. I&E, without citing to any expert witness testimony or other authority, presents numerous claims purporting to establish factors that mitigate against size adjustments for utilities. I&E Exceptions at 9. However, I&E ignores the basic fact that all of the identified characteristics are uniform between large and small utilities (e.g. both large and small utilities can use a FPFTY and have captive customer bases). *See id.* Accordingly, these factors do not account for relative differences between large and small utility companies such as economies of scale and customer diversity. *See* Valley Main Brief at 86-88. The smaller and less diverse customer base exposes smaller utilities like Valley to higher risks of substantial financial impacts from losing a single large customer or having a significant revenue loss from increased energy efficiency.

Rather than rely solely on published literature, Company Witness D'Ascendis also conducted an unrebutted study demonstrating correlation between utility size and risk. *See* Valley Main Brief at 89-90. All parties acknowledge Mr. D'Ascendis' size study shows an R-Squared of 0.09, meaning that 9% of utility risk is attributable to size. R.D. at 73. While the parties also point out that 0.09 is not generally considered a higher explanatory result, Mr. D'Ascendis clarified that the 0.09 R-Squared is higher in comparison to the R-Squared of the I&E and OCA proxy group companies' beta coefficients, which means that differences in size explain more about utility risk than beta coefficients, which is a measure used by all parties in this proceeding. Valley Main Brief at 90-91. Therefore, Mr. D'Ascendis' size study presents unrebutted evidence of an inverse relationship between utility size and risk in direct contrast to I&E's Exception.

3. OCA's argument is unsupported and not responsive to the R.D.'s recommendation to accept a size adjustment.

OCA opposed both the R.D.'s conclusion that a size adjustment is warranted and the R.D.'s adoption of the standard deviation method to account for the Company's size risk. OCA Exceptions at 17-20. As OCA fails to support either contention, its Exception should be dismissed.

Similar to I&E, OCA claims the ALJs erred in granting a size adjustment for the Company because the record shows that size risk exists for companies in general. OCA Exceptions at 19. OCA contests the Company's quantification of size risk but ignores arguments from the Company refuting OCA's witness. *Id.* at 18-19. OCA additionally argues that the R.D.'s reasoning "conflicts with solid ratemaking principles," but provides no citations for this proposition or explanation of which ratemaking principles are purportedly violated. *Id.* at 19. OCA further argues that the R.D.'s finding of size risk is inconsistent with the Company's status as a natural monopoly. *Id.* This argument was addressed above in response to I&E's Exception and fails here for the same reasons.

In a final misguided effort to discredit size risk, OCA continues to assert that the Company's reliance on size premiums published in the *Duff and Phelps Valuation Handbook*, does not support a size adjustment. *See* OCA Exceptions at 18. As discussed in the Company's Main Brief and Exceptions, the Company used the *Duff and Phelps* size deciles to assess the difference in size risk (the size premium spread) between the Gas Utility Proxy Group companies and the Company. Valley Main Brief at 87-88. Based on the Company's market capitalization and the average Gas Utility Proxy Group company market capitalization, the Company falls within the tenth size decile and Gas Utility Proxy Group Companies fall within the fourth size decile. *Id.*

OCA runs the same analysis except that: (1) OCA inexplicitly uses 2017 *Duff and Phelps* data where the Company used the 2019 handbook; and (2) OCA uses Ordinary Least Squares (OLS) betas to assign size deciles instead of market capitalization. OCA Exceptions at 18. OCA thus argues that under its analysis, the Company remains under size decile 10, but the Gas Utility Proxy Group moves to the first size decile instead of the fourth. OCA Exceptions at 18. Because this first decile has a negative value, OCA concludes the Gas Utility Proxy Group companies have no size risk and extrapolates this observation to argue that adjusting for size risk for the Company is inappropriate. OCA Exceptions at 18-19. As concluded in the Company's Main Brief, this argument defies logic as the size adjustment is intended to reflect the size premium spread or the *difference* between the Company's size decile and Gas Utility Proxy Group size decile. *See* Valley Main Brief at 90-91. Even under OCA's analysis, the size premium spread supports the Company's proposed 100 basis point size adjustment. *See* OCA Exceptions at 18-19.

OCA also claims that the R.D.'s application of the standard deviation method to account for size risk violates the OCA's CAPM/Risk Premium limits. OCA Exceptions at 20. This argument relies on a completely unfounded and counterintuitive assertion that a size adjustment

cannot exceed the range of reasonableness determined by a standard DCF analysis. Of course, this would subvert the very purpose of a size adjustment, which is to award an ROE higher than the result of the standard analysis because small utilities face greater risk than larger utilities.

Company Witness D'Ascendis addressed the principles underlying a size adjustment in testimony. Mr. D'Ascendis explained that "[c]onsistent with the financial principle of risk and return discussed above, increased *relative risk due to small size* must be considered in the allowed rate of return on common equity." Joint Statement No. 2 at 43 (Emphasis added). Because the risk recognized through a size adjustment is the risk relative to a similarly situated larger utility, OCA's proposition to apply a model developed to determine a reasonable ROE irrespective of size cannot serve as the ceiling for a size adjustment.

Even if the Commission were to accept OCA's premise (which it should not) that the size adjustment should fall within the range of reasonableness supported by the unadjusted ROE analysis, OCA's flawed CAPM/Risk Premium model should not be applied as the upper limit. As discussed in the Company's Main Brief, OCA's CAPM/Risk Premium model is an unfounded analysis that, among other deficiencies, fails to utilize a risk-free rate based on a forecast period. *See* Valley Main Brief at 80; *see* Joint Statement No. 2-R at 56-57.

Moreover, as additionally emphasized by the Company throughout this proceeding, use of the median and average of OCA's CAPM/Risk Premium analysis as an upper limit would understate the appropriate return for any utility, much less a utility subject to size risk. OCA's CAPM/Risk Premium analysis results in median and average ROEs of 9.54% and 9.61%, respectively. OCA Exceptions at 20. As detailed in the Company's Main Brief, the Commission calculated a DSIC ROE for gas utilities of 10.00% as of November 14, 2019. *See* Valley Main Brief at 53. This is the proxy return that is used for the DSIC mechanism for any utility that did

not fully litigate ROE in its rate case, so it is meant to reflect what the Commission would decide in a litigated case. *Id.* at 77 *citing* 66 Pa. C.S. § 1357(b)(2). This benchmark illustrates the illogical premise of OCA's assertion; a model producing ROE results below market expectations for general gas utilities cannot be held up as an upper limit for a size adjustment meant to recognize the higher risk faced by smaller utilities.

4. Conclusion

The Company's Exceptions addressed the deficiencies in the R.D.'s ROE determination and detailed the necessity of ensuring that an appropriate size adjustment be applied to the ROE that would otherwise be approved for a larger gas utility. Valley Exceptions at 17-19. The I&E and OCA Exceptions seeking to reduce the ROE approved in the R.D. would deprive the Company of an opportunity to earn a reasonable rate of return and would frustrate the Company's efforts to continue furnishing reliable public utility service to customers. For the reasons set forth above, the Commission should deny I&E's Exception No. 4 and OCA's Exception No. 8.

J. Reply Exception No. 10: I&E's Exception No. 5 and OCA's Exception No. 9 should be rejected in favor of the R.D.'s well-reasoned recommendation to approve a 25-basis point performance adjustment for the Company.

I&E and OCA oppose the R.D.'s award of a 25-basis point performance adjustment. OCA argues only that the performance adjustment is unjustified; but rather than addressing the specific circumstances of the Company's activities, OCA recounts testimony from witnesses opposed to the general concept of performance adjustments. OCA Exceptions at 21-22. I&E similarly opposes the R.D.'s award of a 25-basis point performance adjustment as arbitrary, and alternatively argues that a 5-basis performance adjustment is sufficient. I&E Exceptions at 10. The R.D. correctly weighed the numerous indicators of exemplary and innovative service and found merit in awarding a substantial performance adjustment. R.D. at 78. The OCA and I&E arguments to the contrary should be rejected.

OCA and I&E continue to mount policy arguments against a performance adjustment based on their witnesses' belief that utilities should not receive performance adjustments for meeting their obligations. I&E Exceptions at 10; OCA Exceptions at 21-22. These arguments were comprehensively addressed in the Company's Main Brief. *See* Valley Main Brief at 81-84. Therein, the Company clarified that its efforts to provide customer service and innovation above and beyond its regulatory obligations include, but are not limited to: (1) rolling out Smarthub use to customers; (2) achieving response times to emergency calls from 2016-2018 of 60 minutes or less; (3) receiving 0 formal complaints the last 3 years from customers; (4) replacing all cast iron mains, bare steel mains, and services without use of a DSIC; and (5) applying for and receiving grant funding from the Pennsylvania Department of Community and Economic Development's Pipeline Investment Program in order to extend the East Athens main at reduced customer cost. Valley Main Brief at 82-83. In particular, Valley pursued a highly innovative approach to secure the PIPE grant by allowing customers to pay back Contributions in Aid of Construction ("CIAC") over ten years in order to overcome a conflict between a PIPE grant matching funds requirement and limits on Company investments in Valley's tariff. Valley Statement No. 4 at 10-11. These efforts were acknowledged by PUC Chairman Brown as beneficial towards extending natural gas service to the public. *Id.* at 7-8. The R.D. appropriately concluded that Valley's efforts warrant a substantial performance adjustment. R.D. at 78.

I&E alternatively suggests that the Commission reduce the awarded performance adjustment from 25 basis points to 5 basis points. I&E Exceptions at 10. I&E alleges that Valley provided no basis for its requested 25-basis point performance adjustment. *Id*. The Company's requested size adjustment is commensurate with the 22-basis point size adjustment awarded by the Commission in *Pa. PUC et. al v. Aqua Pennsylvania Inc.,* Docket No. R-00072711 (Order entered

July 31, 2008) at 50. Valley Reply Brief at 36. While the Commission awarded a smaller performance adjustment in its UGI Order, the Company submits that the record in this proceeding reflects a significantly greater degree of innovation, particularly with regards to the Company's creative pursuit of the PIPE grant and efforts to adopt new technologies (Smarthub) to improve customer service.

The Company has met its burden of providing substantial evidence to support the proposed 25-basis point performance adjustment. The Commission should recognize the Company's efforts towards providing its customers with exemplary and innovative service by denying the I&E and OCA Exceptions and adopting the 25-basis point performance adjustment recommended by R.D.

K. <u>Reply Exception No. 11</u>: I&E's Exception No. 6 should be discarded as the R.D. correctly denied I&E's recommendation that Valley be required to provide certain accounting reports.

The ALJs recommended that the Commission deny I&E's request for Valley to be required to provide an update to its plant in service projections by updating Valley Exhibit_(HSG-1), Schedule C3(R) no later than April 20, 2020. R.D. at 86. I&E contends, in its Exceptions, that the ALJs should have directed the Company to provide the aforementioned updates. I&E Exceptions at 11-12. The Company previously stated, in its Main Brief, that it must already make numerous filings with the Commission including Annual Reports, which entail detailed year-end plant, expense, and sales data, and the Company-provided quarterly updates following the initial rate filing in this proceeding. Valley Main Brief at 93. Additional reporting requirements would impose an unfair regulatory burden on a small utility such as Valley. *Id*. Lastly, in light of the fact that the Commission has not adopted regulations that comprehensively address requirements for public utilities utilizing the FPFTY, the Company requests that it not be singled out for compliance with unique and additional reporting requirements that are not applicable to all

NGDCs. *Id*. The Company, therefore, respectfully requests that the Commission approve the ALJs' recommendation and deny I&E's Exception.

L. Reply Exception No. 12: The Commission should deny OSBA's Exception No. 1 and adopt the R.D.'s recommendation to approve the Company's revised Facilities Extension Policy.

The R.D. approved Valley's proposal to modify its Facilities Extension Policy. R.D. at 8790. As summarized in the R.D., Valley proposed changes to: (1) clarify its right to adjust cost estimates; (2) implement a third method for calculating the Company's portion of service line extension costs; and (3) allow customers to request a review of Company records to explore potential refunds for connection fees based on greater-than-anticipated customer connections. *See* R.D. at 87. OSBA excepted to the R.D.'s approval of Valley's revised Facilities Extension Policy on the grounds that Valley failed to meet its burden of proof that the third method for calculating the Company's portion of service line extension costs is reasonable or appropriate. OSBA Exceptions at 6. Contrary to OSBA's Exceptions, Valley provided extensive testimony addressing the public interest benefits supporting approval of the proposed tariff modification. *See* Valley Main Brief at 96-98. In contrast, OSBA failed to articulate a credible basis for denying the change. Consistent with the R.D., the Commission should approve Valley's proposed tariff change.

OSBA argues that Valley failed to offer an economic or cost justification in support of its proposed modification to the Facilities Extension Policy. OSBA Exception at 6. This assertion overlooks the economic and public interest considerations addressed by Valley and supported by OCA. *See* Valley Main Brief at 96-98; OCA Main Brief at 70-74. Valley's testimony discussed the necessity to correct economic inequities resulting from the current policy. Valley Main Brief at 96-97. Under the current policy, the total Company contribution to a customer's requested service extension may (under the 200-foot rule) depend solely on the length of the extension rather than the actual cost to the Company. *Id.* at 96. Currently, customers can receive a Company

contribution for service line extensions of up to $6 per additional dollar of anticipated annual revenues or, under what it referred to as the "200-foot rule," the total cost of a 200-foot line extension. *See id*.

The 200-foot rule creates inequities between customers. As discussed in Valley's Main Brief, there is no rational reason why a customer requesting a 200-foot extension costing $6,557 should be eligible for a 100% Company contribution while a customer requesting a 300-foot extension costing $6,400 receives only the costs of the first 200 feet. *See id*. The Company's proposal corrects this inequity by preserving the 200-foot rule as the critical cost threshold but allowing the Company to approve a contribution equal to the average cost of a 200-foot main or service line extension in cases where a customer requests a longer extension that happens to cost less than the average 200-foot extension. *See id*. As summarized by Valley Witness Rogers, this proposal "allows all customers to access, if needed, the same minimum dollar investment available to any customer with an average 200-foot extension." Valley Main Brief at 97.

OCA agreed that Valley's proposal resolves an inequity under the current rule. As illustrated by OCA, under the current rule, a customer with a lower unit price ($26/foot) and a longer extension (250 feet) would be responsible to pay the portion of the total cost ($6,500) associated with the excess 50 feet. R.D. at 89-90. However, a customer with a higher unit price ($34/foot) and a shorter extension (200 feet) would receive a full Company contribution for the total cost ($6,800). *Id.* Contrary to OSBA's unsubstantiated and conclusory allegations that the policy change is uneconomic or financially unsound, OCA recognizes that Valley's proposal preserves the protection of the 200-foot rule by capping Company contributions at the average cost of a 200-foot installation. Valley Main Brief at 97 *citing* OCA Statement No. 4-R at 9. OCA

further concurs that this policy change advances the Commission's public policy goals of extending natural gas service to underserved populations. R.D. at 90.

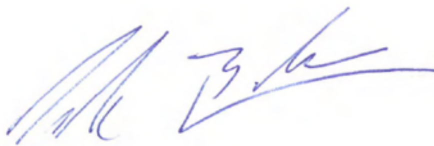
As stated in the R.D., Valley met its burden of proof in justifying the proposed modifications to the Facilities Extension Policy. R.D. at 90. Accordingly, the Commission should deny OSBA's Exception, adopt the R.D.'s recommendation, and approve the Company's proposed tariff change.

III. CONCLUSION

WHEREFORE, Valley Energy, Inc. respectfully requests that the Pennsylvania Public Utility Commission grant these Reply Exceptions approve the Company's recommendations therein and in its Exceptions, and otherwise adopt the Recommended Decision.

Respectfully submitted,

McNEES WALLACE & NURICK LLC



By ______________________________

Pamela C. Polacek (PA I.D. No. 78276)
Adeolu A. Bakare (PA I.D. No. 208541)
Matthew L. Garber (PA I.D. No. 322855)
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
Phone: (717) 232-8000
Fax: (717) 260-1744
ppolacek@mcneeslaw.com
abakare@mcneeslaw.com
mgarber@mcneeslaw.com

Counsel to Valley Energy, Inc.

Dated: March 23, 2020