PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105

PA PUC *et al.* v. Wellsboro Electric Company,
PA PUC *et al.* v. Valley Energy Inc., and
PA PUC *et al.* v. Citizens Electric Company of Lewisburg

Public Meeting: April 16, 2020
3008208-OSA
3008209-OSA
3008212-OSA
Docket Nos. R-2019-3008208, R-2019-3008209 and R-2019-3008212, *et al.*

STATEMENT OF COMMISSIONER ANDREW G. PLACE

Before the Pennsylvania Public Utility Commission (Commission) for consideration and disposition are the base rate cases filed on July 1, 2019 of Wellsboro Electric Company (Wellsboro), Valley Energy Inc. (Valley), and Citizens Electric Company of Lewisburg (Citizens), collectively "Companies" in the above captioned dockets. Each of the Companies are wholly owned by C&T Enterprises, Inc. (C&T), which is both a holding and management services company. C&T has presented nearly identical testimony for many of the issues in the cases before us. Because of the great similarity and with efficiency in mind, I have consolidated my statement on particular issues shared between these three operating subsidiaries.

Wellsboro Polling Issue #12, Valley Polling Issue #6, Citizens Polling Issue #6g

As to the normalization period for rate cases, the Companies sought a 3-year amortization period for recovery of rate case expenses. In each case, the average historical period between rate cases ranged from 45-48 months for Wellsboro and Citizens, to 60 months for Valley. The use of historical data regarding rate case timing has often been the bellwether for future normalization periods, but the Commission has strayed from this standard occasionally. Previously the Commission has examined this issue in *Pa. Pub. Util. Comm'n v. PPL Electric Utilities Corp*., Docket No. R-2012-2290597 (Order entered December 28, 2012) and *UGI Utilities, Inc. – Electric Division,* Docket No. R-2017-2640058 (Order entered October 25, 2018). In the PPL case, the Company was granted a 2-year normalization period, despite a 3-year historical average. In actuality, the length of time to the next rate case was three years. In addition, although the UGI case was disposed of in October 2018, the actual period between rate cases has yet to be determined. Regardless, I agree that base rate case amortization periods should be decided on the merits of each Company's arguments, including any record evidence provided by the various parties to the proceeding. In addition, the Companies carry the burden of proof to clearly provide evidence on future projected spending, especially capital spending, use of mitigation methods, such as a distribution system improvement charge (DSIC), and sufficient, reasonably quantified evidence to support the need for higher spending sufficient to drive a shorter amortization period. As to the cases before us, I believe only Citizens presented sufficient evidence to stray from the use of average historical time periods between rate cases. Citizens submitted its 5-year financial projections, including future capital budgets which provided a reasonable case for using a 3-year amortization period. Both Wellsboro and Valley provided no such documentation resulting in a finding that these two Companies did not sustain their burden of proof regarding this issue. Moreover, Valley has completed its capital-intensive at-risk pipe replacement.

Wellsboro Polling Issue #14, Valley Polling Issue #18, Citizens Polling Issue #8

As to a size adjustment to Return on Equity (ROE), the ALJs' support for the Companies' position is particularly worrisome since the proposed premium adjustment is clearly not supported by the record in their respective cases. The Companies argued for a 100-basis point adder as an adjustment to their respective ROEs related to the alleged higher risk of each being a small company. In evaluating this issue in the proceedings, the ALJs properly identified and narrowed the discussion to that of small utility companies. As the Bureau of Investigation and Enforcement (BI&E) testified, none of the technical literature the Companies cite supporting small company risk premiums is specific to the electric and natural gas utility industries; therefore, such an adjustment is not appropriate.[1] BI&E witness Henkel cites an article stating a size adjustment for risk is not applicable to utility companies. The article concluded: "After controlling for equity values, there is some weak evidence that firm size is a missing factor from the Capital Asset Pricing Model (CAPM) for the industrial but not for utility stocks. This implies that although the size phenomenon has been strongly documented for the industrials, the findings suggest that there is no need to adjust for the firm size in utility rate regulation."[2]

The Companies' response cites to two articles on small water utilities, espousing small water company risk premiums. However, these studies were limited to the water utility industry, one of which was not properly documented for review, and the other examined only four small water companies. Lastly, the Companies' witness ran a linear regression by calculating the 10-year coefficient of variation ("CoV") of net profit (a measure of risk) and current market capitalization (a measure of size) for each company. After ranking the companies by size (largest to smallest) and risk (least risky to most risky), the Companies' witness made a scatter plot of the data, seeking to establish a relationship between the size of a company and risk. The Companies' argument notwithstanding, the results indicate that there is, in fact, no such relationship, given the R-squared of 0.09. The ALJs, after reviewing the results, noted with evident contradiction: "Thus, we are unable to conclude whether size is or is not a risk for utilities although, generally, we agree that size does seem to be a risk factor for companies."[3] The ALJs note that the Companies are "significantly smaller than the Proxy Group companies, and it is reasonable to conclude that … [they] … would face proportionally greater financial and business risk than much larger utilities."[4] This conclusion is perplexing at best, given the evidence.

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[1] In UGI Utilities, Inc. – Electric Division, the Commission rejected use of technical literature not specific to the regulated utility industry to support a size adjustment. *See Pa. Pub. Util. Comm'n v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Order Entered October 25, 2018), p. 100.

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

[3] Wellsboro, RD at pp. 74,75, Valley, RD at pp. 73,74, and Citizens, RD at p. 72.

[4] Wellsboro, RD at p. 76, Valley, RD at p. 74, Citizens, RD at p. 73.

The ALJs also recommend that the Companies' ROEs be based upon the higher end of the DCF range for each of these base rate cases.[5] The ALJs indicate that this ensures that a market-based result is adopted, while acknowledging the risk of a smaller utility. This ALJ conclusion has no foundation on the record. Moreover, DCF generated returns of large companies have no relationship at all to an alleged small company ROE risk premium.

Wellsboro Polling Issue #15, Valley Polling Issue #19, and Citizens Polling Issue #9

As to an Effective Management Performance adder, the Companies requested a 25-basis point increase for their respective ROEs. In principle, I believe such adders are appropriate, when earned. However, each of the Companies should demonstrate not mere compliance with regulatory requirements, but that they have clearly and consistently exceeded such requirements.[6] Secondly, they must provide a *comprehensive analysis* of their high performance over a *reasonable historic period* – not just selective criteria, over limited periods of time.

As to the customer care performance claims, the Companies only provided information on complaint rate data and thirty second call response data, which were excellent, yet they provided no information on meter read and billing statistics, and no busy out rate data or call abandonment rate data. Thus, it is difficult to conclude that their respective competence or effective management performance extends to these other important customer care performance categories.

As to operational performance, the electric operating Companies claim excellent reliability metrics in 2018. When examining the latest comprehensive 2018 Electric Service Reliability in Pennsylvania Report, assertions of excellent reliability performance by both Citizens and Wellsboro are not proven for the historical period of 2016 through 2018. Although there are various quarterly and annual statistics in the Commission's Report, it is concluded that:

> "Beginning in 2004, Citizens' CAIDI [Customer Average Interruption Duration Index] and SAIFI [System Average Interruption Frequency Index] benchmark performance has been erratic and frequently outside of acceptable tolerances and Citizens' has achieved CAIDI benchmark performance 65% of the time and SAIFI benchmark performance 32% of the time. Citizens' has failed to achieve CAIDI benchmark performance from 2016 until the last quarter in 2018. More management attention is needed in the future to sustain the trend line below the 'green' benchmark performance upper-control-limit-line. Citizens' SAIFI performance trend is poor, and more management attention is needed to address the performance and sustain the trend line below the 'green' benchmark performance upper-control-limit-line."[7]

[5] The ROEs were based on BI&E's constant growth DCF recommendation for Valley at RD p.75, and the Company's mean and median constant growth DCF results for Citizens at RD p.74 and Wellsboro at RD p.76.
[6] Public utilities that operate under a cost-of-service rate base and rate of return method of regulation are presumed to operate in the most efficient manner.
[7] Electric Service Reliability in Pennsylvania, p. 55.

> “It should also be noted that Major Events had a significant negative impact on Citizens’ customers that is not reflected in CAIDI and SAIFI performance metrics.”[8]

Even more importantly, Citizens failed to achieve CAIDI, SAIDI (System Average Interruption Duration Index), and SAIFI 3-year standards – some by substantial amounts. Indeed, one would more likely conclude that Citizens should not receive basis points for their historical operational performance prior to filing this rate case.

As to the operational performance of Wellsboro, the report concludes: “Wellsboro has sustained CAIDI benchmark performance from 2004 through 2017 and is considered an excellent CAIDI benchmark performer. However, Wellsboro failed to achieve CAIDI benchmark performance in 2018. More management attention is needed to sustain CAIDI performance below the ‘green’ benchmark performance upper-control-limit-line. Beginning in 2015, Wellsboro’s SAIFI performance has been inconsistent and frequently above the ‘green’ benchmark performance upper-control-limit-line. More management attention is needed to ensure consistent SAIFI performance is sustained below the ‘green’ benchmark performance upper control-limit-line.”[9] Moreover – Wellsboro failed to achieve the 3-year SAIFI standard by 5.7%.[10]

As it relates to operational performance of electric companies, meeting 3-year reliability standards and consistent operational performance above annual reliability benchmarks should be the hallmark of any earned performance bonuses. Electric utilities need not be below benchmark performance every quarter – normal bad weather variations can preclude that level of performance – but consistent performance below benchmark paves the way for meeting and exceeding standards over the historical period.

The Companies also seek a performance bonus for spending significantly on capital projects. I believe rewards simply for high capital spending should not drive high performance bonuses. First, utility companies, in general, receive just and reasonable compensation for capital spending in the form of return on and of capital through DSIC charges as well as in base rate proceedings. Second, a more appropriate incentive would be for demonstrating efficient deployment of capital, in the form of enhancements to operational performance from deployed capital, and low per unit spending in the form of cost control that reveals itself in rate efficiency over the long term. In these cases, the Companies presented no information on their respective rate efficiency or capital deployment efficiency. The electric Companies also presented some information related to increased pole attachment revenues but provided no information on their respective performance relative to other electric utilities. Therefore, it cannot be determined that Citizens and Wellsboro are top performers in this category of efficient operations.

Valley argued that it should be rewarded for its fast emergency response times to emergency calls during the 2016-2018 period – with a response time of sixty minutes or less. This is an example where the utility is meeting expectations, not exceeding expectations. If the

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[8] Electric Service Reliability in Pennsylvania, p. 58.
[9] Electric Service Reliability in Pennsylvania, pp. 73-74.
[10] Electric Service Reliability in Pennsylvania, p. 79.

Company had provided information on consistently exceeding the 60 minutes requirement, I would have found this documentation more persuasive. Also, Valley claims it should be rewarded because it did not file a DSIC. I note that there are many reasons for not filing a DSIC from a historical perspective, including being in an over-earnings position. Lastly, while it is of substantive value that Valley has removed all of its at-risk cast iron and bare steel pipe, it is already receiving a return on its investment in the form of a return on and of capital herein, as noted above.

Therefore, the record in the proceeding does not provide sufficient evidence to approve the Companies' positions on these delineated issues in the proceedings before us.

DATE: April 16, 2020 **Andrew G. Place, Commissioner**