**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17120**

Public Meeting held April 16, 2020

Commissioners Present:

Gladys Brown Dutrieuille, Chairman, Dissenting in part, Statement

David W. Sweet, Vice Chairman

Andrew G. Place, Dissenting in part, Statement

John F. Coleman, Jr.

Ralph V. Yanora

Pennsylvania Public Utility Commission R-2019-3008212

Office of Small Business Advocate C-2019-3011849

 v.

Citizens’ Electric Company of Lewisburg, PA

**OPINION AND ORDER**

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**BY THE COMMISSION:**

Before the Pennsylvania Public Utility Commission (Commission) for consideration and disposition is the Recommended Decision (R.D.) of Administrative Law Judges (ALJs) Steven K. Haas and Benjamin J. Myers, issued on February 28, 2020, and the Exceptions and Reply Exceptions filed thereto, in the above-captioned proceeding.

Exceptions to the Recommended Decision were filed by the Commission’s Bureau of Investigation and Enforcement (I&E) on March 12, 2020, and by Citizens’ Electric Company of Lewisburg, PA (Citizens’ or the Company) and the Office of Consumer Advocate (OCA) on March 13, 2020.[[1]](#footnote-2) Reply Exceptions were filed by Citizens’, I&E, the OCA, and the Office of Small Business Advocate (OSBA) on March 23, 2020.

For the reasons stated, *infra*, we shall grant, in part, and deny, in part, the Exceptions filed by Citizens’, I&E and the OCA, and adopt the ALJs’ Recommended Decision, as modified, consistent with this Opinion and Order.

As discussed below, Citizens’ proposed a base rate change that would have increased its total annual operating revenues by $792,246, or approximately 16.5%, based on a fully projected future test year (FPFTY) ending December 31, 2020.[[2]](#footnote-3), [[3]](#footnote-4) In this Opinion and Order, we shall approve an annual revenue increase of $494,749 to the Company’s pro forma revenue at present rates of $4,903,840, or approximately 10.1%.

# Background

Citizens’ is a public utility and an investor-owned electric distribution company (EDC), as those terms are defined in the Pennsylvania Public Utility Code (Code), 66 Pa. C.S. §§ 102 and 2803, providing service in and around Lewisburg, Pennsylvania. Citizens’ is wholly owned by C&T Enterprises, Inc. (C&T). C&T is a holding and management services company that also owns Wellsboro Electric Company (Wellsboro) and Valley Energy, Inc. (Valley). Citizens’ service territory encompasses an area of approximately 55 square miles in and around Lewisburg, Pennsylvania. As of December 31, 2018, Citizens’ served approximately 7,043 customers, of which approximately 5,871 were residential and 1,172 were commercial, industrial or lighting.

Citizens’ seeks approval of an increase in its annual jurisdictional distribution operating revenues. The Company’s original request, Supplement No. 132 to Tariff Electric Pa. P.U.C. No. 14 (Supplement No. 132), filed on July 1, 2019, sought an increase in annual distribution operating revenues of approximately $792,246, based on a FPFTY ending December 31, 2020. Subsequently, the Company filed replacement base rate schedules and tariff sheets by which it revised its requested increase to $701,000, which is designed to provide the Company with an opportunity to earn a 7.62% overall rate of return, including a 10.30% return on common equity, on a claimed rate base of $12.8 million. In its request, Citizens’ proposed to increase the monthly customer charges for its Residential customers – Class RS (Residential) and SH (Space Heating) from $11.24 to $15.00 and from $18.57 to $24.00, respectively, including a demand charge component.

Citizens’ asserts that the increase requested, if granted, will allow the Company to earn a return of approximately 7.62%, which is in line with the current expectations of investors in the marketplace, particularly for investors in smaller utilities, such as Citizens’, which are generally viewed as carrying more risk because of their susceptibility to larger revenue fluctuations due to weather-related usage variations, loss of customer load, and other factors. Citizens’ further asserts that the requested rate increase reflects its experienced increases in operating and capital costs since its 2016 base rate proceeding, occurring as Citizens’ faces declining sales and preventing it from earning a fair rate of return on its investment, at present rate levels.

# History of Proceeding

On July 1, 2019, Citizens’ filed Supplement No. 132, to become effective August 30, 2019, containing proposed changes to rates designed to produce a net increase in Citizens’ annual distribution revenue of approximately $792,246, or 16.5%, above existing distribution revenues.

By Order entered August 29, 2019, the Supplement No. 132 was suspended by operation of law pursuant to Section 1308(d) of the Code, 66 Pa. C.S. § 1308(d), for up to nine months, or until March 30, 2020, unless permitted by Commission Order to become effective at an earlier date. The Commission also initiated an investigation of Citizens’ proposed general rate increase.

On September 9, 2019, Citizens’ filed a tariff supplement voluntarily extending the suspension period until April 29, 2020. On October 2, 2019, Citizens’ filed an updated tariff supplement voluntarily extending the suspension period until May 1, 2020.

A Prehearing Conference was held on September 13, 2019, before ALJs Haas and Myers, at which time a litigation schedule was developed. The Prehearing Conference was held jointly with rate cases filed by Wellsboro and Valley at Docket Nos. R-2019-3008208 and R-2019-3008209, respectively. Prior to the Prehearing Conference, on August 2, 2019, Citizens’ provided the Parties with its Direct Testimony. In accordance with the procedural schedule, on October 15, 2019, the OCA, I&E and the OSBA submitted Direct Testimony and associated exhibits. On November 14, 2019, Citizens’, the OCA and the OSBA submitted Rebuttal Testimony. On December 4, 2019, the Parties submitted Surrebuttal Testimony.

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

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

In their Recommended Decision issued on February 28, 2020, the ALJs recommended that Citizens’ be permitted to file tariffs, tariff supplements or tariff revisions designed to produce an increase in annual operating revenues of no more than $515,144 or approximately 10.5%. R.D. at 1, 125. As previously noted, I&E filed Exceptions on March 12, 2020, and on March 13, 2020, Citizens’ and the OCA filed their Exceptions. On March 23, 2020, Citizens’, I&E, the OCA, and the OSBA filed their Replies to Exceptions.

# Legal Standards

At issue here is the Company’s general rate increase filing governed by Section 1308(d) of the Code, which provides the procedures for changing rates, the time limitations for the suspension of the new rates, and the time limitations on the Commission’s actions. 66 Pa. C.S. § 1308(d).[[4]](#footnote-5) “Under traditional ratemaking, utilities may not change rates charged to customers outside of a base rate case.” *McCloskey v. Pa. PUC*, 127 A.3d 860, 863 n.2 (Pa. Cmwlth. 2015).

Section 1301(a) of the Code mandates that “[e]very rate made, demanded, or received by any public utility ... shall be just and reasonable, and in conformity with [the] regulations or orders of the [C]ommission.” 66 Pa. C.S. § 1301(a). Pursuant to the just and reasonable standard, a utility may obtain “a rate that allows it to recover those expenses that are reasonably necessary to provide service to its customers[,] as well as a reasonable rate of return on its investment.” *City of Lancaster (Sewer Fund) v. Pa. PUC*, 793 A.2d 978, 982 (Pa. Cmwlth. 2002). There is no single way to arrive at just and reasonable rates, and “[t]he [Commission] has broad discretion in determining whether rates are reasonable” and “is vested with discretion to decide what factors it will consider in setting or evaluating a utility’s rates.” *Popowsky v. Pa. PUC*, 683 A.2d 958, 961 (Pa. Cmwlth. 1996) (*Popowsky*).

The Commission is required to investigate all general rate increase filings. *Popowsky*, 683 A.2d at 961. In deciding this or any other general rate increase case brought under Section 1308(d) of the Code, 66 Pa. C.S. § 1308(d), certain general principles always apply. A public utility is entitled to an opportunity to earn a fair rate of return on the value of the property dedicated to public service. *Pa. PUC v.* *Pennsylvania Gas and Water Co.* 341 A.2d 239, 251 (Pa. Cmwlth. 1975). In determining a fair rate of return, the Commission is guided by the criteria provided by the United States Supreme Court in the landmark cases of *Bluefield Water Works and Improvement Co. v. Public Service Comm’n of West Virginia*, 262 U.S. 679 (1923) (*Bluefield*) and *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). In *Bluefield*, the Court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

*Bluefield*, 262 U.S. at 692-693.

The burden of proof to establish the justness and reasonableness of every element of a public utility’s rate increase request rests solely upon the public utility in all proceedings filed under Section 1308(d) of the Code. The standard to be met by the public utility is set forth in Section 315(a) of the Code, 66 Pa. C.S. § 315(a), as follows:

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

In reviewing Section 315(a) of the Code, the Pennsylvania Commonwealth Court interpreted a public utility’s burden of proof in a rate proceeding as follows:

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

*Lower Frederick Twp. Water Co. v. Pa. PUC*, 409 A.2d 505, 507 (Pa. Cmwlth. 1980) (emphasis added). *See also*, *Brockway Glass Co. v. Pa. PUC*, 437 A.2d 1067 (Pa. Cmwlth. 1981).

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

[T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to

demonstrate the reasonable necessity and cost of the installations, and that is the burden which the utility patently failed to carry.

*Berner v. Pa. PUC*, 382 Pa. 622, 631, 116 A.2d 738, 744 (1955).

This does not mean, however, that in proving that its proposed rates are just and reasonable, a public utility must affirmatively defend every claim it has made in its filing, even those which no other party has questioned. As the Pennsylvania Commonwealth Court has held:

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

*Allegheny Center Assocs. v. Pa. PUC*, 570 A.2d 149, 153 (Pa. Cmwlth. 1990) (citation omitted). *See also, Pa. PUC v. Equitable Gas Co.*, 73 Pa. P.U.C. 310, 359-360 (1990).

Additionally, Section 315(a) of the Code, 66 Pa. C.S. § 315(a), cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose. Inasmuch as the Legislature is not presumed to intend an absurd result in interpretation of its enactments,[[5]](#footnote-6) the burden of proof must be on the party who proposes a rate increase beyond that sought by the utility. The mere rejection of evidence contrary to that adduced by the public utility is not an impermissible shifting of the evidentiary burden. *United States Steel Corp. v. Pa. PUC*, 456 A.2d 686 (Pa. Cmwlth. 1983).

In analyzing a proposed general rate increase, the Commission determines a rate of return to be applied to a rate base measured by the aggregate value of all the utility’s property used and useful in the public service. The Commission determines a proper rate of return by calculating the utility’s capital structure and the cost of the different types of capital during the period in issue. The Commission is granted wide discretion, because of its administrative expertise, in determining the cost of capital. *Equitable Gas Co. v. Pa. PUC*, 405 A.2d 1055, 1059 (Pa. Cmwlth. 1979) (determination of cost of capital is basically a matter of judgment which should be left to the regulatory agency and not disturbed absent an abuse of discretion).

As we proceed in our review of the various positions of the Parties in this proceeding, we are reminded that any argument or Exception that we do not specifically address shall be deemed to have been duly considered and denied without further discussion. The Commission is not required to consider expressly or at length each contention or argument raised by the parties. [*Consolidated Rail Corp. v. Pa. PUC*,625 A.2d 741 (Pa. Cmwlth. 1993);](file://C:\research\buttonTFLink?_m=69761b6202cb4178e2a6e6fe02f5751b&_xfercite=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b2000%20Pa.%20PUC%20LEXIS%2067%20%5d%5d%3e%3c\cite%3e&_butType=3&_butStat=242&_butNum=5&_butInline=1&_butinfo=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b625%20A.2d%20741%5d%5d%3e%3c\cite%3e&_fmtstr=FULL&docnum=5&_startdoc=1&_startchk=1&wchp=dGLSzS-lSlbz&_md5=ad2b02d95c2a9216e83b92a3570d4785) *also see, generally,* [*University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984).](file://C:\research\buttonTFLink?_m=69761b6202cb4178e2a6e6fe02f5751b&_xfercite=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b2000%20Pa.%20PUC%20LEXIS%2067%20%5d%5d%3e%3c\cite%3e&_butType=3&_butStat=242&_butNum=6&_butInline=1&_butinfo=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b485%20A.2d%201217%5d%5d%3e%3c\cite%3e&_fmtstr=FULL&docnum=5&_startdoc=1&_startchk=1&wchp=dGLSzS-lSlbz&_md5=9b1cc8319afd12440738bb82d74455ef)

# Review of the ALJs’ Uncontested Recommendations

## Rate Base

### Materials and Supplies

Regarding the issue of Materials and Supplies, the Company agreed to a small Materials and Supplies adjustment proposed by the OCA and I&E, reducing its claim by $4,209 from $178,276 to $174,067. Citizens’ M.B. at 23; Citizens’ St. 1-R at 6. Since no other Parties raised any objection or counterproposal, the ALJs concluded that the small adjustment was reasonable and recommended its approval. R.D. at 10.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall reduce the claim for materials and supplies to $174,067.

### Accrued Pension/OPEB Liability

The Company proposed a reduction to rate base for Accrued Pension / Other Post-Employment Benefits (OPEB) liability. This reduction reflects the excess of amounts charged to expense over amounts paid. Citizens’ M.B. at 23; Citizens’ St. 1 at 14. Neither the OCA nor I&E proposed any adjustments to the Company’s claim. OCA St. 1, Sch. SLS-3; I&E St. 3 at 6. Since no other Parties raised any objection or counterproposal, the ALJs concluded that the small adjustment was reasonable and recommended its approval. R.D. at 11.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall incorporate the Company’s Accrued Pension/OPEB Liability amount of $578,182 as a deduction from rate base.

### Customer Deposits

Regarding the issue of reductions from rate base, the Company noted that the OCA proposed a $209 adjustment to Customer Deposits, which the Company accepted. Citizens’ M.B. at 24; OCA St. 2 at 6; Citizens’ St. 1-R at 13. Since no other Parties raised any objection or counterproposal, the ALJs concluded that the small adjustment was reasonable and should be approved. R.D. at 13.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall incorporate the adjustment to Customer Deposits which reduces the rate base by $209.

### ADIT and EDIT

The Company asserted that accumulated deferred income taxes (ADIT) addresses the difference between actual tax liability for accumulated depreciation paid by Citizens’ and the amount of tax expense for accumulated depreciation paid by ratepayers in the revenue requirement. In contrast, excess deferred income taxes (EDIT) directly addresses the benefit the Company received by taking depreciation expense for tax purposes while the Federal corporate tax rate was 35% and the revaluation of EDIT as of December 31, 2017, when the corporate tax rate changed from 35% to 21%.[[6]](#footnote-7) R.D. at 13‑14. The Company argued that because the EDIT is due to the one-time change in the tax rate established through the Tax Cuts and Jobs Act of 2017 (TCJA), it will not change over time. Citizens’ M.B. at 25; Citizens’ St. 1 at 13-14.

Citizens’ submitted that its claimed rate base includes a reduction for ADIT of $94,708 for the end of the FPFTY. According to the Company, this amount is equal to the difference between accumulated depreciation based on Federal tax expense borne by ratepayers (*i.e.*, based on straight line method) and accumulated depreciation based on Citizens’ actual tax Federal tax expense (*i.e*., based on double declining balance method), times the current Federal income tax rate. Citizens’ St. 1 at 13-14, Exh.\_(HSG-1), Sch. C1-6, lines 27-32 and line 6.

Citizens’ also asserted that the EDIT is calculated by taking the ADIT at December 31, 2017 (the initial effective date of Federal income tax rates under the TCJA), times the reduction in Federal income rates due to the TCJA. The EDIT is computed on Schedule C1-6, lines 34-39 and carried up to Schedule C1-6, line 7. *Id*. The Company is amortizing the balance over the estimated remaining book life of the assets – ten years. *Id*. According to the Company, the EDIT balance included in rate base declines each year during this ten-year period and the annual EDIT accretion (Schedule C1-6, line 40) is carried forward to reduce Income tax expense (Schedule C1‑4, line 28). Citizens’ St. 1 at 14.

The ALJs noted that no Party challenged the Company’s calculation of ADIT; however, the OCA proposed adjustments to the Company’s calculation of EDIT. Since EDIT is fully addressed in another part of Citizens’ Main Brief and was not discussed in the Rate Base Section, the ALJs addressed the rationale for its EDIT recommendation under the Recommended Decision section pertaining to Taxes. R.D. at 14.

Accordingly, we shall also address the OCA’s proposed adjustments to EDIT under the Taxes section of this Opinion and Order, below.

## Revenues: Forfeited Discounts

Regarding the issue of Forfeited Discounts (late payment charges), the Company claimed $27,126.00 in revenue from Forfeited Discounts for 2020. Citizens’ Exh.\_(HSG-1), Sch. B6. I&E proposed that the Company’s claim for revenue from Forfeited Discounts should be increased by $3,376.00, for a total of $30,502.00. I&E asserted that the increase was warranted to reflect the increased revenue due to the percentage of sales the Company may recover through the Commission-approved rates. R.D. at 21 (citing I&E St. 3 at 23).

In response, Citizens’ conceded that the Forfeited Discounts would increase with higher revenues, however, it maintained that Uncollectible Accounts Expense would also increase in a corresponding amount. Therefore, Citizens’ argued that I&E’s proposed adjustment should be rejected. In the alternative, Citizens’ asserted that, if I&E’s proposed increase to revenues is adopted, the Commission should also adopt a corresponding increase in the Company’s claim for Uncollectible Accounts Expenses. R.D. at 22.

The ALJs rejected Citizens’ position and adopted I&E’s proposed increase to the Company’s claim for Forfeited Discounts, to a total claim of $30,502.00. R.D. at 22. The ALJs rejected the Company’s alternative proposal for a corresponding increase to the Company’s Uncollectible Accounts Expense, because the Company had neither raised nor provided support in the record for an adjustment to Uncollectible Accounts Expense associated with Forfeited Discounts. *Id*.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall adopt the increase of $3,376.00 to the Company’s claim for Forfeited Discounts, for a total claim of $30,502.00.

## Fair Rate of Return

### Capital Structure

Regarding the issue of capital structure, the Company proposed a capital structure of 49.33% debt and 50.67% equity. Citizens’ St. 2 at 13-14. The Parties did not dispute the Company’s proposal. OCA St. 3 at 3; I&E St. 2 at 16. The ALJs recommended adoption of the Company’s proposed capital structure. R.D. at 48.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall approve the Company’s proposed capital structure of 49.33% debt and 50.67% equity.

### Cost of Long-Term Debt

Regarding the issue of cost of long-term debt rate, Citizens’ is proposing a rate of 4.86%. The Parties did not dispute the Company’s proposal. OCA St. 3 at 3; I&E St. 2 at 17. The ALJs recommended adoption of the Company’s proposed cost of long-term debt rate. R.D. at 48.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall adopt the Company’s proposal for a cost of long-term debt rate of 4.86%.

### Cost of Common Equity

As discussed in the Review of Exceptions and Replies section of this Opinion and Order, *infra*, the primary dispute among the Parties regarding rate of return is focused around the reliance on differing return on equity (ROE) models in the development of each Party’s respective ROE recommendation. As indicated in Citizens’ Main Brief, its ROE recommendation relied on the analysis of multiple ROE models; the Discounted Cash Flow (DCF) model, the Risk Premium Model (RPM), and the Capital Asset Pricing Model (CAPM), as well as comparison to non-price regulated companies, also called the Comparable Earnings (CE) approach. Citizens’ M.B. at 62-63.

As the Commission has traditionally utilized the DCF method, with the CAPM method being used as a check, the ALJs, accordingly, focused on the DCF and CAPM methods. R.D. at 56. Since no Party challenged the ALJs regarding their recommended barometer group, DCF model, or CAPM, the Parties’ positions and associated recommendations of the ALJs, regarding these designated issues, will be discussed in the following sections. However, the following sections will not address the reasonableness of the ALJs’ reliance on the DCF method with the CAPM as a check, or the ALJs’ recommended size and performance adjustments that were considered in their recommended ROE of 9.74%, but will be reserved for discussion in the Review of Exceptions and Replies section of this Opinion and Order, *infra.*

#### Barometer Groups

Regarding the issue of the makeup of the barometer or proxy group of companies to be used as a benchmark for determining the Company’s appropriate rate of return, the Parties presented arguments regarding the proper makeup of the group of companies which best compare to Citizens’ as similar risk enterprises. Ultimately, the OCA and Citizens’ reached joint agreement on the proxy group proposed by the Company’s witness, Mr. D’Ascendis, as amended in his Rebuttal Testimony by the exclusion of two companies. Citizens’ St. 2-R at 4; Citizens’ R.B. at 20.

The ALJs observed that the main difference between I&E’s selection criteria for its proxy group and the Company’s selection criteria was that the Company’s proxy group excluded companies that did not have 70% or greater total operating income derived from, and 70% of total assets attributed to, regulated electric distribution operations in fiscal year 2017; whereas I&E’s witness claimed that more than 50% of revenue must come from regulated electrical activities and the company must operate in a deregulated state. R.D. at 56. Noting there was minimal discussion regarding the criteria, the ALJs adopted the proxy group as proposed by the Company’s witness because the standard for the grouping appeared to be the more stringent, if only slightly so. *Id*.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall approve the use of the proxy group proposed by Citizens’ witness, Mr. D’Ascendis, as amended in his Rebuttal Testimony.

#### Discounted Cash Flow (DCF) Model

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

Regarding the issue of the appropriate DCF model for purposes of determining the cost of equity, the ALJs noted that the average of the mean and median for each Party’s constant growth DCF model produce similar results. R.D. at 62. On the basis that the Parties’ proposed models produced similar results and each appeared reasonable, the ALJs elected to adopt the Company’s proposed DCF model on the slight strength of Citizens’ proposed proxy group. *Id.*

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall approve the use of Citizens’ proposed DCF model for purposes of determining the cost of equity.

#### Capital Asset Pricing Model (CAPM)

Regarding the issue of the appropriate CAPM, the ALJs noted that the Commission has traditionally utilized the CAPM method as a check on DCF results. The ALJs also expressly noted they would not determine the reasonableness of the Parties’ respective CAPM results. Instead, the ALJs relied upon the CAPM results to verify the reasonableness of each Parties’ DCF calculation. R.D. at 63. The ALJs reviewed the Parties’ respective proposals for a CAPM considering each Parties’ respective proposed DCF model. R.D. at 64-65. Noting that the Company’s witness Mr. D’Ascendis’ proposed calculations resulted in standalone CAPM ROE and DCF ROE which were both 8.27%, the ALJs concluded that the Company’s witness’ proposed DCF model appeared reasonable. R.D. at 65.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall approve the use of Citizens’ proposed CAPM for purposes of verifying the reasonableness of the Company’s proposed DCF calculations.

## Taxes

### Excess Deferred Income Taxes (EDIT)

Regarding the issue of EDIT which resulted from the reduction in the Federal income tax rate for corporations from 35% to 21% due to passage of the TCJA, the Parties agreed that the EDIT should flow back to Citizens’ customers, however, disagreed on the date the flowback should commence. R.D. at 79-82; *Tax Cuts and Jobs Act of 2017*, Docket No. M-2018-2641242 (Order entered May 17, 2018).

Citizens’ argued that in 2018, Citizens’ commenced to flow back the EDIT to customers by amortizing the EDIT balance over a ten-year period. Citizens’ St. 1 at 14. The OCA disagreed that Citizens’ had commenced the flow back of EDIT to its customers in 2018, where the rates did not change in 2018 to reflect the flowback for EDIT. OCA St. 2 at 19. The OCA noted that, instead, the rates were changed to reflect the reduction of the current Federal income tax expense included in rates. OCA St. 2 at 9.

The OCA argued that, since the rates do not appear to have been changed in 2018 to flow back the EDIT, an adjustment should be made on Schedule LKM-5 to reverse the flowback of EDIT reflected in the Company’s filing, thereby increasing the EDIT balance by $17,480 and reducing rate base by the same amount. OCA St. 2 at 10, Sch. LKM-5.

The ALJs agreed with the OCA that Citizens’ had failed to provide any evidence that the 2018 rates had been changed to flow back the EDIT. Therefore, the ALJs recommended an adjustment on Schedule LMK-5 to reverse the flowback of the EDIT reflected in the Company’s filing, thereby increasing the EDIT balance by $17,480 and reducing rate base by the same amount. R.D. at 82.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall approve an adjustment on the Company’s Schedule LMK-5 to reverse the flowback of the EDIT reflected in the Company’s filing, thereby increasing the EDIT balance by $17,480 and reducing rate base by the same amount.

### Deferred Regulatory Liability

Regarding the issue of Deferred Regulatory Liability, the ALJs considered Citizens’ proposal to provide a final reconciliation of the TCJA Voluntary Surcharge within 120 days after new rates take effect, for purposes of compliance with the Commission’s direction to account for tax savings associated with the TCJA. R.D. at 82‑83. Citizens’ argued that the 2019 tax data, which is essential to the reconciliation of the TCJA Voluntary Surcharge, would not be available until March or April of 2020. R.D. at 83. The OCA opposed the Company’s proposal for reconciliation after the rates take effect, and argued that the reconciliation should be required prior to rates taking effect to allow for any over or under recovery to be reflected in the rates, thereby returning any due flowback to customers as soon as possible. OCA St. 2 at 10; R.D. at 84.

The ALJs agreed with Citizens’ regarding the need to conduct a final reconciliation of the TCJA Voluntary Surcharge based upon the 2019 tax data, which would not be available until March or April 2020.[[7]](#footnote-8) Therefore, the ALJs recommended adoption of the Company’s proposal for a final reconciliation of the TCJA Voluntary Surcharge to be completed within 120 days after the new rates take effect.

No Party filed Exceptions on this issue. Finding the ALJs’ recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall adopt the Company’s proposal for a final reconciliation of the TCJA Voluntary Surcharge to be completed within 120 days after the new rates take effect.

## Rate Structure: Scale Back

Regarding the issue of scale back, the ALJs noted that all Parties generally agreed that any scale back which may occur should be proportionate. R.D. at 123-124. Citizens’ argued that, to preserve movement of each class closer to its actual cost to serve, a proportionate scale back is appropriate based on the allocated cost of service study methodology. I&E argued that, if the Commission grants less than the Company’s requested increase, the Commission should proportionally scale back rates based upon the cost of service study, however only if the rate classes received a proposed increase. R.D. at 122 (citing I&E St. 3-SR at 18).

Both I&E and the OSBA argued that because a scale back would move the Municipal Boulevard and Street Lighting Service (MBL) rate class farther from cost of service, it should not be included in any scale back of rates. I&E St. 3 at 42; OSBA St. 1 at 9.

The ALJs agreed with Citizens’ that, to preserve movement of each class closer to its actual cost to serve, a proportionate scale back is appropriate. The ALJs also agreed that any scale back should be proportionate based on the allocated cost of service study methodology. R.D. at 124. Furthermore, the ALJs agreed with I&E that if the Commission grants less than the Company’s requested increase, the Commission should proportionally scale back rates based upon the cost of service study, however only if the rate classes received a proposed increase. The ALJs also agreed with both I&E and the OSBA that because a scale back would move the MBL rate class farther from cost of service, it should not be included in any scale back of rates. *Id*.

Therefore, the ALJs recommended that the Commission adopt a proportional scale back of rates based upon the cost of service study, only if the rate classes received a proposed increase, with the exception of rate class MBL, as any scale back would only serve to move the MBL rate class farther from cost of service. R.D. at 124. Additionally, the ALJs noted their recommendation to adopt I&E’s customer charge adjustment, discussed *infra*, and therefore recommended adjusting the usage rates to meet class revenue requirements.

No Party filed Exceptions on this issue. Accordingly, we shall adopt a proportional scale back of rates based upon the cost of service study, only if the rate classes received a proposed increase, with the exception of rate class MBL, as any scale back would only serve to move the MBL rate class farther from cost of service.

Considering our adoption of the ALJs’ recommended customer charges; specifically, maintaining an $18.57 per month SH customer charge and limiting the monthly RS customer charge to $13.00, we additionally find that a scale back is most appropriately applied to the RS class usage rate until a usage rate revenue level is reached equal to that under present rates, which we note should also include our adoption of I&E’s adjustment to the Company’s claimed present rate revenues, *infra*. Once that level is reached, the $13.00 per month customer charge for the RS class should be scaled back, if required. Our reasoning is based on the fact that the reduction to the Company’s requested RS class customer charge, as found appropriate in this Opinion and Order, has the effect of increasing the usage rates at the full requested revenue increase. Therefore, the RS rate class usage rates should be scaled back prior to any scale back of the RS customer charge. Likewise, since the findings in this Opinion and Order maintain the existing monthly customer charge of $18.57 for the SH class, we find it appropriate to adjust solely the usage rate for the SH class in order to reflect the level of scale back. For the GLP-1 and OL classes we find it appropriate to include the customer, demand, and usage rates in the revenue scale back for those classes. Furthermore, we find that the proportional scale back should be based upon the customer charges granted Citizens’ at the Company’s requested revenue increase, since they are consistent with the customer costs evaluated in the Company’s own customer cost analysis. Rate class GLP-3 is excluded from any scale back since that class will experience an overall bill reduction.

# Review of Exceptions and Replies

## Rate Base

The Company states that its claim for a new rate base is based on data for the FPFTY ending December 31, 2020. Citizens’ M.B. at 16 (citing Citizens’ St. 1-R at 2; Citizens’ Exh.\_(HSG-1R), Sch. C1(R)). In addition, Citizens’ provided data for the HTY ending December 31, 2018. Citizens’ M.B. at 16 (citing Citizens’ St. 1 at 5).

 According to the Company, its final claimed rate base of $12,847,545 reflects all adjustments adopted by the Company in this proceeding, which consists of:

* the original cost of its utility plant in service as of December 31, 2020;
* less: accumulated depreciation; accumulated deferred income taxes (ADIT); excess deferred income taxes (EDIT); and customer deposits; and
* plus: CWIP [Construction Work in Progress]; accrued pension / OBEP liability; materials and supplies; and Cash Working Capital (CWC).

The Company notes that I&E proposed changes to CWIP but did not dispute any other rate base components; and the OCA proposed adjustments to plant in service, CWIP, Materials and Supplies, Customer Deposits, Depreciation Expense, and EDIT. Citizens’ M.B. at 16.

Additionally, the Company explained that its claim for original cost utility plant in service of $26,687,785 is based on projected plant in service at the end of the FPFTY. Citizens’ M.B. at 16-17 (citing Citizens’ Exh.\_(HSG-1), Schs. C1-6, C2, C3, E‑1A).

### Utility Plant in Service and FPFTY

* 1. **Positions of the Parties**

The Company asserted that its rate claim – based on plant projected to be in service at the end of the FPFTY – is consistent with recent Commission direction. Citizens’ M.B. at 17-18 (citing, in part, *Pa. PUC v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Order entered October 25, 2018) (*UGI Order*) at 23-26); and 66 Pa. C.S. § 315(e)). The Company argued that, in the *UGI Order*, the Commission rejected arguments from the OCA based on Section 1315 of the Code, which requires electric utility projects to be “used and useful” before being included in the rate base. Citizens’ M.B. at 18-19. Citizens’ also cited to the Commission’s statement that by using an FPFTY, “a utility is essentially permitted to require ratepayers to pre-pay a return on its projected investment in future facilities.” Citizens’ M.B. at 19 (quoting *UGI Order* at 24).

The Company also contended that the language of Act 11, which amended Section 315 of the Code, fully supports use of end of test year balances. Citizens’ asserted that Act 11 does not contain a separate provision for the FPFTY, but instead adds the FPFTY to the existing statute authorizing use of a FTY. According to the Company, the General Assembly: (1) expressly indicated that the FPFTY may include plant projected to be in service during the FPFTY; and (2) specifically noted that Section 1315, which codified the “used and useful” standard, provides no bar to including in rate base all plant added during the FPFTY. Citizens’ M.B. at 19-20 (citing 66 Pa. C.S. § 315(e)).

Accordingly, the Company contended that the OCA’s proposal to use an average rate base would dramatically weaken the benefits provided by the Legislature in adopting Act 11, by disallowing half of the additions budgeted between the end of the FTY and the end of the FPFTY (*e.g.*, allowing only $592,756 in plant additions in 2020, despite Citizens’ plan to add $1,185,512 of plant additions for the FPFTY). Citizens’ M.B. at 21 (citing OCA St. 2, Sch. LKM-1).

The Company also submitted that the OCA’s proposal would cause first-year rates to become insufficient to cover the used and useful plant placed into service during that year. According to Citizens’, this would effectively convert a fully projected future test year to a “partially projected half test year” which is inconsistent with the policy underlying Act 11. Citizens’ M.B. at 21.

In response, the OCA contended that although Section 315 of the Code permits capital investments that are not used and useful on the first day of new rates to be included in an electric utility’s rate base during the FPFTY period, Act 11 does not remove the requirement under Section 1301 of the Code that rates be just and reasonable. OCA M.B. at 10 (citing 66 Pa. C.S. § 1301).

The OCA argued that the end-of-year method would allow the Company to over-earn on its investment in the FPFTY while the annual average method recognizes that capital investments will be made throughout the first year that new rates are in effect. The OCA submitted that the Company has not met its burden to demonstrate that the use of the end of the test year methodology for rate base results in just and reasonable rates. Thus, the OCA asserted that the Commission should utilize the average rate base method for determining its rate base, resulting in a proposed change from the Company’s filed end of test year rate base to the OCA’s proposed average which would decrease the Company’s rate base by $592,756 from $26,687,785 to $26,095,029. OCA M.B. at 12, 14-15 (citing OCA St. 1 at 4, Sch. SLS-3).

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

* 1. **Recommended Decision**

The ALJs agreed with the Company that using the FPFTY is appropriate and supported by law. The ALJs emphasized the *UGI* *Order*, wherein the Commission allowed the use of an FPFTY even though some of the utility plant in service might not be operational until the latter part of the FPFTY. Additionally, the ALJs noted that the Commonwealth Court recently upheld the *UGI* *Order* on this issue on January 15, 2020, in *McCloskey v. Pa. PUC*, \_\_\_A.3d\_\_\_, 1549 C.D. 2018, 2020 WL 215931 (Pa. Cmwlth. 2020) (*McCloskey*). Thus, the ALJs determined that the Parties to this proceeding, and subsequent rate proceedings, are bound by the Commission’s holding in the *UGI Order*. R.D. at 8.

In addition, the ALJs rejected the OCA’s request to find the rate claims unjust and unreasonable pursuant to Section 1301 of the Code. Reasoning that the

*UGI* *Order* did not otherwise override the provisions of Section 1301, the ALJs found no record evidence to show that the proposed rate base or rates are unjust or unreasonable. In this regard, the ALJs noted that the OCA made no specific factual arguments in support of its contention that use of an FPFTY results in unjust or unreasonable rates. Rather, the OCA merely argues that the Company will be earning interest for the whole FPFTY on an asset that is not put in service until the end of that year, which would constitute overearning on an investment. According to the ALJs, this argument has already been rejected in the Commission’s *UGI Order* and the Commonwealth Court’s *McCloskey* decision. R.D. at 8-9.

The ALJs also noted that none of the other Parties to the proceeding objected to the Company’s use of an FPFTY. Accordingly, the ALJs recommended that the Company be permitted to use an FPFTY in this proceeding. *Id.* at 9.

* 1. **Exceptions and Replies**

In its Exception No. 1, the OCA contends that the ALJs erred by accepting Citizens’ proposal, which will allow the Company to over-earn on investments, resulting in rates that are unjust and unreasonable. Thus, in order to comply with the standard that rates be just and reasonable, the OCA takes the position that rates must be based on the average rate base projected to be used and useful in the FPFTY, which properly reflects the fact that plant is added throughout the year and not all at once on the first day of new rates. OCA Exc. at 2-5.

The OCA argues that the ALJs misstated the Commonwealth Court’s determination in *McCloskey*. According to the OCA, the Court did not conclude that all utilities are bound by the decision or that an average rate base could never be used. The OCA asserts that the Court instead found that the Commission retains the discretion to evaluate the matter and under the record presented in the *UGI Order* it would not disturb the Commission’s determination. Thus, the OCA submits that the Commission retains the discretion to require an average rate base calculation and urges its use here because the record clearly shows an overstatement of earnings if the end-of-test year method is used. OCA Exc. at 2-3.

In addition, the OCA contends that the ALJs erroneously concluded that the OCA’s proposal would prevent the use of the FPFTY. The OCA submits that its average method properly reflects the fact that plant is added throughout the year rather than all at once on the first day of new rates. *Id.* at 3.[[8]](#footnote-9)

Moreover, the OCA objects to the ALJs’ conclusion that the OCA provided no record evidence showing the proposed rate base or rates to be unjust or unreasonable. In support of its contention that the Company would be overearning on the investment, the OCA reiterates the argument that the year-end method would be the equivalent of an individual making a deposit into an interest-bearing account on the 365th day of the year but requiring the bank to pay interest beginning on day one. A bank would deny such an arrangement because the individual would be earning more interest than he or she would be entitled to. OCA Exc. at 3-4 (citing OCA St. 1 at 4-5).

Regarding the ALJs’ finding that the OCA proposal would deny the Company rate recovery, the OCA asserts that its annual average method will not cut Citizens’ earnings but would properly reflect investments as they are made and placed into service during the FPFTY. The OCA also argues that “the purpose of the FPFTY is to mitigate regulatory lag, not eliminate it, which is exactly what the average rate base method does.” OCA Exc. at 4.

The OCA contends that the Commission should deny the Company’s request to recover more than its necessary costs because it would require ratepayers to overpay the revenue requirement. The OCA submits that the Commission should adopt the OCA’s recommendation and approve the use of an average rate base. Further, in adopting the OCA’s proposal, the Commission should adjust the accumulated depreciation, depreciation expense, and CWIP calculations. OCA Exc. at 5.

In its Replies to OCA Exception No. 1, the Company argues that the OCA ignores the prior extensive litigation and decisions on this issue and has failed to present new evidence or arguments that would merit revisiting the *UGI Order*. Citizens’ asserts that the Commission should uphold its prior ruling because any other outcome would produce inequitable and discriminatory outcomes. Citizens’ R. Exc. at 15.

Citizens’ disputes the OCA’s argument that the ALJs misunderstood the impact of the Commonwealth Court Order affirming the Commission’s approval of the end-of-year methodology in its *UGI Order*. Although the Company agrees with the OCA that the Commission maintains discretion to overturn its own Orders, the Company avers that the ALJs’ use of the term “binding” was intended to refer to the Commission’s obligation when reviewing a legal question addressed in a prior docket. Citizens’ submits that while the Commission is not bound by the rule of *stare decisis*, it is required to render consistent opinions by either following, distinguishing or overruling its prior decisions. *Id.* at 16 (citing, in part, *Bell Atlantic - Pennsylvania, Inc. v. Pa. PUC*, 672 A.2d 352, 354 (Pa. Cmwlth. 1995)).

Citizens’ contends that the OCA has failed to distinguish the facts at issue from the facts addressed in the *UGI Order*. According to the Company, the arguments offered by the OCA in opposition to the end-of-test-year rate base methodology duplicate the arguments offered and rejected in the Commission’s *UGI Order*. The Company proffers that because 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 Company requests that the Commission deny the OCA’s Exception No. 1 and uphold the ALJs’ acceptance of the end-of-test-year methodology for developing the Company’s rate base. Citizens’ R. Exc. at 16.

* 1. **Disposition**

Upon review, we agree with the rationale and the recommendation of the ALJs to permit Citizens’ to utilize a year-end rate base methodology. Accordingly, we shall deny the OCA’s Exception on this issue.

The ALJs correctly noted that the OCA’s argument has already been rejected in the *UGI Order*, which has been recently upheld by the Commonwealth Court’s *McCloskey* decision. We agree with the ALJs that the OCA has failed to distinguish the facts at issue from the facts addressed in the *UGI Order*, nor has the OCA presented new evidence or arguments that would merit revisiting the *UGI Order*.

Regarding the OCA’s concern that the utilization of a year-end rate base methodology would allow Citizens’ to over-earn on its investment, we find the Company’s argument compelling that, rather under the OCA’s recommended average rate base methodology, there is the potential for the utility to face an under-recovery of its revenue requirement allowed in the proceeding before the end of the first year that new base rates are in effect. In contrast to the OCA’s concerns, using the average rate base approach proposed by the OCA, would effectively cause the Company’s base rates set in this proceeding to reflect only one-half of its total investment in 2020 plant additions, which would be comparable to setting rates on the basis of the Company’s rate base at approximately mid-year 2020. Setting up rate conditions that require more frequent base rate cases would appear to be contrary to efforts, such as the passage of Act 11, to increase rate stability. It would increase rate case expenses ultimately borne by ratepayers and impose increased demand on the resources of the Commission and other parties associated with more frequent base rate proceedings.

Furthermore, we agree with the ALJs that the OCA has not provided any record evidence to show that the use of rate base established at the Company’s end-of-FPFTY level would produce rates that are unjust or unreasonable. Therefore, we concur with the ALJs’ determination that an FPFTY allows a utility to project revenue requirements and ratemaking components throughout the twelve-month period beginning with the first month that the new rates would be placed in effect, after the expiration of the full nine-month suspension period allowed by law. For these reasons, we shall deny the OCA’s Exception and adopt the ALJs’ decision on this issue.

### Accumulated Depreciation

**a. Positions of the Parties**

In its claim for rate base, the Company included an accumulated depreciation of $13,537,134 for the FPFTY. The Company calculated accumulated depreciation by adding annual depreciation expense at each year-end and subtracting retirements to the previous year-end balance. Citizens’ M.B. at 22 (citing Citizens’ St. 1 at 13; Citizens’ Exh.\_(HSG-1), Sch. C1-6).

The OCA proposed an adjustment to accumulated depreciation based on its arguments that original cost utility plant in service should be based on an average of the beginning-of-year and end-of-year FPFTY plant balances. OCA St. 2 at 4. The OCA’s FPFTY average balance calculation of $26,095,029 resulted in a $378,420 reduction in accumulated depreciation amount, for a total accumulated depreciation of $13,158,754. OCA St. 2, Sch. LKM-1.

The Company contends that original cost plant in service should be calculated based on the FPFTY year-end balance, consistent with the Commission’s holding in the *UGI Order*. Therefore, the Company argues that the OCA’s position regarding accumulated depreciation should be rejected based on the *UGI Order*. Citizens’ M.B. at 22-23.

I&E did not oppose Citizens’ accumulated depreciation claim and the OSBA took no position on the issue. Citizens’ M.B. at 22; I&E St. 3, Exh. No. 3, Sch. 1.

* 1. **Recommended Decision**

The ALJs did not find adequate record evidence to support the OCA’s recommended downward adjustment to accumulated depreciation. Noting their agreement with the Company’s contention that original cost plant in service should be calculated based on the FPFTY year-end balance, the ALJs determined that the OCA’s position regarding accumulated depreciation should also be rejected based on the *UGI Order*. Therefore, the ALJs recommended that the Company’s claim for accumulated depreciation should be approved by the Commission. R.D. at 9-10.

* 1. **Exceptions and Replies**

As discussed above in OCA Exception No. 1, the OCA requests that if the Commission adopts its proposed use of an average method for determining the Company’s rate base, it should also adjust the accumulated depreciation amount. OCA Exc. at 5. Thus, the OCA requests an adjustment to accumulated depreciation based on an average of the beginning-of-year and end-of-year FPFTY plant balances resulting in a $378,420 reduction in accumulated depreciation amount, for a total accumulated depreciation of $13,158,754. OCA St. 2 at 4, Sch. LKM-1.

As discussed in its responses to OCA Exception No. 1, Citizens’ argues that the Commission should uphold the R.D.’s acceptance of the Company’s end-of-test methodology. Citizens’ R. Exc. at 16.

* 1. **Disposition**

Based on its recommended application of the FPFTY concept, the OCA proposes that the Company’s rate base reflect only the annual “average” difference between its plant in service as of December 31, 2019 and December 31, 2020. Correspondingly, the OCA recommends reducing the Company’s claims for annual depreciation expense to reflect a level that corresponds to its “average” plant in service proposals, and the OCA adjusted accumulated depreciation accordingly.

Consistent with our determination with regard to the OCA’s recommended adjustment to rate base, reflective of its advocacy for an average rate base approach, we shall adopt the ALJs’ recommendation to deny this adjustment as well. Accordingly, we shall deny the Exceptions filed by the OCA on this issue.

### Cash Working Capital and Construction Work in Progress

**a. Positions of the Parties**

The Company claimed an increase of $342,049 to rate base for CWC. Citizens’ Exh.\_(HSG-1), Sch. C1-6. The Company derived the CWC by using the formula of 1/8 of non-fuel cash operating costs. Citizens’ St. 1 at 14. Citizens’ noted that I&E and the OCA did not oppose the 1/8 method proffered by the Company, but that I&E and the OCA each proposed to reduce the CWC claim to reflect their respective proposed operating and maintenance (O&M) expense adjustments. Citizens’ M.B. at 24; I&E St. 1 at 23; OCA St. 1 at 9. Citizens’ agreed that CWC should be recalculated if the Commission orders any changes to the Company’s claimed O&M expenses. Citizens’ St. 1-R at 5, 12. If O&M expenses are adjusted, the Commission should use the same 1/8 method utilized by the Company, with removal of non-cash items as proposed by I&E and the OCA, to adjust CWC. Citizens’ M.B. at 24.

I&E noted that the Company’s rate base claim included $70,492 of CWIP based on the December 31, 2018, financial statements and estimated to be the same in the FTY and FPFTY. Citizens’ Exh.\_(HSG-1), Sch. C1-6. I&E also noted that, although CWIP allows a utility to recover costs for plant additions that will be completed and in service within six months of the end of the test year, the Company elected to use a FPFTY ending December 31, 2020, which includes projections of plant in service and depreciation that will be recovered in rates during that twelve-month period. Accordingly, I&E stated there is no reason to include a CWIP claim given that the plant should be included in the Company’s FPFTY plant claim. The Company accepted I&E’s recommended adjustment in rebuttal testimony and conceded that the $70,492 CWIP claim should be removed from the FPFTY rate base as originally filed. I&E M.B. at 9.

I&E also noted that the Company claimed $342,049 for CWC, which was later revised to $342,721. Citizens’ Exh.\_(HSG-1), Sch. C1-6; I&E Exh. No. 1-SR, Sch. 1 at 3. I&E explained that CWC covers the lag between the payment of operating expenses and the receipt of revenues from ratepayers and that all cash-based expenses are included in the Company’s overall CWC claim. I&E contended that any adjustments to the Company’s O&M expense claims impact the CWC allowance and recommended that the O&M expense claims be reduced by $106,623, which reduces the Company’s CWC allowance by $13,328. I&E M.B. at 10-11; I&E St. 1-SR at 24.

1. **Recommended Decision**

The ALJs addressed I&E’s recommended disallowance of CWIP and a reduction to CWC allowance. The ALJs also noted that the tables attached to I&E’s Appendix A only reflect a recommended reduction to rate base of $13,328 for CWC because Citizens’ rebuttal position accepted I&E’s CWIP recommendation. Additionally, the ALJs explained that the OCA recommended an exclusion of CWIP in rate base when using an end-of-test-year or the average rate base test year method because in either case, the plant item will not be completed and placed in service during the FPFTY. According to the OCA, the Commission has historically disallowed the inclusion of CWIP in rate base. The ALJs further noted that the OSBA did not take a position on these issues. R.D. at 12-13.

The ALJs determined that the CWIP and CWC adjustments were reasonable and should be approved. In their rationale, the ALJs cited to the Company’s agreement with the recommendation that CWC should be adjusted based on the level of operating expenses approved in this case and that the 1/8 method be used to adjust the CWC. The ALJs also emphasized that the Company agreed to I&E’s recommended adjustment regarding CWC and that no other Party objected to the Company’s acceptance of such an adjustment. R.D. at 13.

Therefore, based on the ALJs’ O&M recommendations, resulting in a downward adjustment of $81,330 to Citizens’ O&M expenses (Table VI), the ALJs’ Table II reflects a corresponding downward adjustment to CWC of $5,005. R.D. at 11-13, Tables II and VI. Also, the ALJs recommended a deduction of $70,492 from the Company’s claimed rate base in its original filing, reflecting the disallowance of CWIP. R.D. at 15.

1. **Exceptions and Replies**

In I&E Exception No. 1, I&E contends that the ALJs inadvertently miscalculated the flow-through adjustment to CWC based on their O&M adjustments. Therefore, I&E argues that should the Commission accept the ALJs’ O&M recommendations in their entirety, the CWC claim should be adjusted downward by $10,163 ($81,300/8), not $5,005. However, if the Commission modifies the ALJs’ O&M recommendations based on the Parties’ exceptions, the ALJs’ CWC recommendation should be modified consistent with the 1/8 method. I&E Exc. at 4-5.

In its Replies to I&E Exception No. 1, Citizens’ argues that I&E improperly applied the 1/8 method for determining CWC when it multiplied the expense reductions in Table II of the Recommended Decision by 1/8 to obtain the proposed CWC adjustment of $10,163. Citizens’ asserts that the ALJs correctly multiplied the total proposed O&M expense of $2,701,802 by 1/8 for a total CWC of $337,716, which is $5,005 less than the Company’s $342,721 claim. Citizens’ R. Exc. at 2.

Thus, Citizens’ submits that the Recommended Decision’s $5,005 calculation represents the correct CWC adjustment based on the expense recommendations of the ALJs. Accordingly, the Company requests denial of I&E Exception No. 1 and approval of the calculation in the R.D. subject to further adjustment based on the total O&M expense approved in this proceeding. *Id.*

1. **Disposition**

No Party opposed the Company’s use of the 1/8 method for determining its claim for CWC. The Company’s updated computation of rate base, shown on I&E Exhibit No. 1-SR, Schedule 1 at 3, reflects a revised CWC claim of $342,721. This claim was determined by multiplying the cash based operating expenses, totaling $2,741,767, by 1/8, as illustrated in column 1 on the table below.

Although this calculation, known as an iteration, effectively prevents the determination of a precise calculation until such time as all adjustments have been made to the Company’s expense claims, I&E’s Exception No. 1 challenges the ALJs’ adjustment of $5,005 to the Company’s claimed CWC of $342,721 based on the ALJs’ downward adjustment of $81,330 to the Company’s O&M expenses, as shown on Table VI of the Recommended Decision. Upon review of the record and the Recommended Decision, including Table VI of the Recommended Decision, we found that Citizens’ inadvertently miscalculated its CWC claim by applying the cash operating expenses ratio (1/8) to a cash based operating expense claim ($2,741,767) that was mistakenly lowered by $41,366 ($356,823 - $398,189) due to a discrepancy between the amount of Taxes other than income included in the total expenses ($356,823) and the amount which was removed ($398,189).[[9]](#footnote-10) Therefore, based on the ALJs’ expense recommendations, the calculated adjustment to the Company’s revised CWC claim of $342,721 is $5,005 ($337,716 - $342,721). However, based on a corrected calculation of the Company’s CWC claim, as shown in column 2 of the table below, the calculated adjustment, based on the ALJs’ expense recommendations, is approximately $10,176 ($337,716 - $347,892).



Accordingly, finding no error in the ALJs’ calculated $337,716 CWC amount to be included in rate base, based on their expense recommendations, we shall adopt the ALJs’ recommendation and deny I&E’s Exception on this issue.

## Revenues

### Bucknell Solar Project

**a. Positions of the Parties**

Bucknell University (Bucknell) has submitted an interconnection application to Citizens’ by which it is seeking approval to connect a planned solar generation facility to Citizens’ distribution system (Solar Project). Citizens’ proposed to reduce its sales revenue by $12,024 for its FPFTY to reflect an anticipated loss of Kilowatt-hour (kWh) sales and revenues for various Bucknell accounts resulting from installation and operation of the Solar Project. Citizens’ expects the project to be completed in 2020, during its FPFTY. Citizens’ M.B. at 26.

The OCA disagreed with Citizens’ proposal and recommends an upward adjustment to the Company’s FPFTY revenues in the amount of $12,024. OCA St. 4 at 29-30, Sch. JDM-5. The OCA argued that the timeframe for completion of the proposed Solar Project is uncertain and is not a known and measurable change that should be reflected in Citizens’ revenue requirement. OCA St. 4 at 29; OCA M.B. at 18. The OCA refers to a newspaper article noting that the East Buffalo Township Planning Commission tabled discussions about the Solar Project earlier in 2019 due to zoning concerns related to the project. OCA St. 4, Sch. JDM-1 at 1. The article indicated, and Citizens’ acknowledged, a solar zoning ordinance is first needed in East Buffalo Township (Township) before the Township Planning Commission considers Bucknell’s project. OCA St. 4, Sch. 2 at 1; Citizens’ St. 4-R at 9. A second article stated that the Solar Project plan had been withdrawn from consideration from the Township Planning Commission by Bucknell pending resolution of the zoning issues. OCA St. 4 at 14, Sch. JDM-7; OCA M.B. at 19.

**b. Recommended Decision**

The ALJs agreed with the OCA that, in this proceeding, completion of construction of the Solar Project and placing it into service before the end of the FPFTY may certainly be possible; however, it is too speculative and uncertain to recommend approval of Citizens’ proposed adjustment to its revenue calculation. Additionally, the ALJs noted no reason to dispute Citizens’ contention that, once approved, the Solar Project may be constructed within several months. However, the ALJs were more persuaded by the uncertainty surrounding the length of the Township’s ordinance review and approval process and potential timeframe, as well as the process for review and approval of Bucknell’s plans, once submitted. Accordingly, the ALJs recommended that the OCA’s proposed adjustment to Citizens’ revenue calculation in the amount of $12,024 be approved. R.D. at 18-19.

**c. Exceptions and Replies**

In its Exception No. 1, Citizens’ contends the ALJs erred in denying Citizens’ $12,024 proposed revenue adjustment for lost sales associated with the Bucknell Solar Project. Citizens’ Exc. at 2 (citing R.D. at 19). Citizens’ claims the ALJs failed to account for the totality of the record evidence indicating that the Solar Project will be in-service by December 31, 2020. Specifically, Citizens’ states that the outstanding 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. Citizens’ Exc. at 2. Citizens’ argues the ALJs ignored evidence addressing the timeframe for how long the Township review process would take. The Company states the ALJs correctly observed that Bucknell withdrew its Solar Project from consideration after the Township determined it must adopt a solar zoning ordinance before considering the project. Citizens’ Exc. at 2 (citing R.D. at 17).

Citizens’ notes it provided an update at the evidentiary hearing explaining 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. Citizens’ Exc. at 3 (citing Tr. at 140-141). The Company averred Bucknell will resubmit its plan to the Township following approval of the zoning ordinance. Considering the aforementioned, Citizens states all of the available record evidence supports the Company's projection that the Bucknell Solar Project will be in service by December 31, 2020. Citizens’ asserts the only uncertainty identified on the record is the zoning approval, which the record indicates is proceeding as expected. Additionally, Citizens’ asserts adoption of the ALJs’ decision would erode the usefulness of the FPFTY. The Company has many projects planned for construction over the FPFTY period and these could be subject to local approvals and permits that would be no more or less certain than the Solar Project.

In Reply to Citizens’ Exception No. 1, the OCA affirms the ALJs correctly denied the Company’s proposed reduction of its sales revenues to reflect completion of the Solar Project by the end of the FPFTY. OCA R. Exc. at 1 (citing R.D. at 19). The OCA suggests that the ALJs appropriately determined that Citizens’ did not demonstrate that the project is likely to be completed during the FPFTY used in this proceeding. OCA R. Exc. at 2 (citing OCA M.B. at 18-20). Additionally, the OCA states the ALJs correctly recognized the uncertainty of the outstanding zoning approval required for completion of the Solar Project. The OCA specifies the record clearly demonstrates that the project cannot go forward at this time under the existing zoning ordinance. Therefore, the OCA asserts the project could not have been approved by the Township and the Company’s arguments do not change the fact that the solar ordinance would still need to be reviewed and approved by the Township. OCA R. Exc. at 2 (citing Tr. 147). In conclusion, the OCA maintains Citizens’ has failed to meet its burden to show the proposed Solar Project will be known and measurable in the FPFTY. OCA R. Exc. at 2.

**d. Disposition**

Citizens’ projected a decline in sales of 3,681,000 kWh due to the anticipated completion of the Solar Project at Bucknell and has reflected this as a reduction to FPFTY revenues. Specifically, this anticipated decline in sales is reflected as a 1,094,800-kWh reduction in rate class GLP-1 (General Light and Power Service) annual usage and a 2,586,200-kWh reduction in rate class GLP-3 (General Light and Power Service (50 Kilowatts minimum)) annual usage projected for the FPFTY. OCA St. 4, Sch. JDM5.

As the evidentiary record provides, the completion date of the Solar Project at Bucknell is shrouded in uncertainty due to zoning concerns, specifically, the existing zoning ordinance is preventing the project from moving forward at this time. The uncertainty surrounding the zoning approval has been a notable concern of the OCA, recognized by the ALJs in the determination of their recommendation, and has been acknowledged by the Company.

Further, once a final solar zoning ordinance has been adopted by the Township, Bucknell’s Solar Project must then be resubmitted, reviewed, and approved. As acknowledged by Citizens’, Bucknell’s proposal may be revised or amended, or potentially denied outright, thereby causing further delays. Tr. at 148-149; OCA M.B. at 19-20. Given the uncertainty associated with the completion of the Solar Project prior to the conclusion of the FPFTY, we agree that the completion of the proposal is not a known and measurable change which should be reflected in the Company’s rates. Therefore, the Company’s claimed FPFTY revenues should be adjusted to reflect the continuation of historic service levels to Bucknell. Accordingly, finding no error in the OCA’s adjustment to FPFTY revenues in the amount of $12,024 to account for continuing to provide service to Bucknell, we shall adopt the ALJs’ recommendation and deny the Company’s Exception on this issue.

### Present Rate Revenue – Customer Counts

**a. Positions of the Parties**

The Company’s proposed present rate revenue estimate of $4,860,408 is derived from its estimated customer counts for the FPFTY. The Company estimates in this proceeding that its FPFTY will include an average customer count of 7,043. Citizens’ Exh.\_(HSG-1), Sch. B3. This figure represents an increase of only nine customers from the Company’s HTY average number of customers. I&E Exh. 3, Sch. 6. The Company notes that, while it has seen a very modest number of new connections, during its FTY, it lost 32 customers in the East Lewisburg area as part of a transfer of those customers to PPL Electric Utilities Corporation (PPL). Citizens’ St. 4 at 7. Citizens’ noted that the total customer count for the Company rose by only 7 during the 8-month period from December 2018 to July 2019, representing an average of only one customer gained per month (the loss of 32 customers did not occur during this time period). Citizens’ argues that its final 2019 customer growth figure is likely to show a significant loss. Citizens’ M.B. at 32. Citizens’ further supports its position by citing the Union County Planning Commission Annual Report (UCPC Annual Report), which indicated that Lewisburg Borough, Buffalo Township and East Buffalo Township (most of Citizen’s territory) have plans for only 20 new lots as of 2018. Citizens’ St. 4-R at 12‑13, Exh. JK-4R at 6-7; Citizens’ M.B. at 33.

I&E disputed Citizens’ customer count estimates. I&E proposed an average FPFTY customer count of 7,096, resulting in an increase of present rate revenue of $28,032 over Citizens’ projection. I&E St. 3-SR at 13; I&E Exh. 3-SR, Sch. 3. I&E based its projections on the average change in customer counts from 2015-2018 for each rate class. I&E St. 3-SR, I&E Exh. 3-SR, Sch. 2. I&E argued that, rather than a net increase of nine customers from HTY to FPFTY, as proposed by Citizens’, a net gain of 62 new customers is appropriate. I&E’s net increase figure of 62 customers is calculated, “. . . by assuming 47 new customers per year for a 94-customer net gain from HTY to FPFTY (47 x 2 = 94), adjusted for the 32 lost customers in FTY due to the East Lewisburg transfer to PPL (94 – 32 = 62).” Citizens’ M.B. at 30-31. To further support its position, I&E cited a Union County Housing Study projecting demand for housing will increase by 89 units in Lewisburg Borough, 545 units in Buffalo Township, and 885 units in East Buffalo Township through 2050. I&E Exh. 3-SR, Sch. 1 at 32; I&E M.B. at 13.

**b. Recommended Decision**

The ALJs took I&E’s position and recommended adoption of its upward adjustment to Citizens’ present rate revenues in the amount of $28,032. As noted by the ALJs, both Parties cited external studies in support of their respective positions: Citizens’ to the UCPC Annual Report and I&E to the Union County Housing Study. The ALJs remarked both studies arguably support the positions put forth by the party citing each study. However, the ALJs observed both studies represent estimates or projections of what their respective authors anticipate will happen in the future. Distinguished from both studies, the ALJs stated I&E also presented actual figures of customer counts from 2015 through 2018. The ALJs observed that although those figures suggested a downward trend in new customers, there is no certainty that the trend will continue. In conclusion, the ALJs were more persuaded by I&E’s averaging of the actual known figures since 2015 to estimate a reasonable customer count figure for the Company’s FPFTY. Thus, the ALJs recommended adopting I&E’s upward adjustment to Citizens’ present rate revenues in the amount of $28,032. R.D. at 21.

**c. Exceptions and Replies**

In Citizens’ Exception No. 2, the Company declares the ALJs erred in approving the $28,032 adjustment to its FPFTY revenues based on I&E’s adjustment to the Company’s projected FPFTY customer count. Citizens’ notes the ALJs found 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. The Company contends the ALJs overlooked gaps in I&E’s reliance on outside sources and failed to give weight to the firsthand experience of Citizens’ witness. Citizens’ Exc. at 6.

Citizens’ claims the Union County Housing study relied upon by I&E simply does not support the inferences drawn by I&E’s witness. Citizens’ asserts I&E’s proposal to increase Citizens’ customer count stems from I&E’s disagreement with Citizens’ witness Kelchner’s projection that Citizens’ will experience minimal customer growth due to the lack of available lots for new construction. 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.*  The Company notes 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. Therefore, Citizens’ avers 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. Citizens’ Exc. at 6 (citing Citizens’ M.B. at 33).

Finally, the Company asserts the ALJs failed to recognize that the historical data referenced by I&E reflects the same declining customer growth observed by Mr. Kelchner. Citizens’ states I&E is correct that an average annual customer growth from 2015-2018 amounts to 47 customers per year, although 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. Citizens’ Exc. at 7 (citing I&E Exh. 3-SR, Schedule 2). Additionally, in the FTY, the Company claims it gained just 7 customers over the period December 2018 – July 2019, which does not account for the lossof 32 customers to PPL. Citizens’ claims the ALJs acknowledged that the historical customer growth shows a declining trend, but nevertheless find there is no evidence indicating that the declining customer growth will continue. Citizens’ Exc. at 7 (citing R.D.at 20-21). In conclusion, the Company declares the ALJs 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. Citizens’ Exc. at 8.

In I&E’s Reply to Citizens’ Exception No. 2, I&E states the ALJs appropriately accepted I&E’s recommended $28,032 adjustment to Citizens’ FPFTY revenues based on I&E’s adjustment to the Company’s projected FPFTY customer count. I&E notes Citizens’ states it gained seven customers between the eight-months of December 2018 to July 2019, and this amount does not account for the loss of 32 customers in East Lewisburg to PPL. I&E mentions Citizens’ provided no basis for using an eight-month period to demonstrate its experience for the entire FTY. Therefore I&E declares the eight-month period should be rejected as an incomplete data point. I&E R. Exc. at 1. Additionally, I&E states the Company incorrectly claims the ALJs failed to recognize that I&E’s historical data reflects the same declining growth as noted by Citizens’, noting the ALJs incorporated I&E’s recommendation accounting for the 32 customers lost to PPL. I&E R. Exc. at 2 (citing R.D. at 19).

I&E observes that Citizens’ Exceptions cite the UCPC Annual Report, however I&E notes the ALJs rejected both I&E’s and Citizens’ reliance on studies. I&E R. Exc. at 2 (citing R.D. at 21). Further I&E explains this report should not be relied on because it reflects Union County as a whole; not Citizens’ specific service territory. I&E R. Exc. at 2 (citing Tr. at 165). I&E also points out that Citizens’ admits this report does not specifically show a decrease in permitted home construction for Citizens’ actual service territory. I&E R. Exc. at 2 (citing Tr. at 165-166). Additionally, the Union County Annual Report does not actually include any projected data. I&E R. Exc. at 2 (citing Tr. at 166). Citizens’ Exceptions further disagree with I&E’s use of the Union County Housing Study’s projection of new housing units because it does not equate to new construction. I&E explains that, whether the units are new construction or occupancy of existing vacant housing, additional occupancy translates into additional customers for Citizens’. I&E R. Exc. at 2-3. I&E also addresses Citizens’ claim that the ALJs failed to credit proper weight to the testimony of its witness Kelchner. I&E states Citizens’ correctly notes that the ALJs have the discretion to weigh witness testimony, and the ALJs did not find Mr. Kelchner’s testimony persuasive. I&E R. Exc. at 3.

**d. Disposition**

We are in agreement with the ALJs that the reasonable projection of customer growth based on I&E’s calculation, based on the average of actual known figures since 2015 is more persuasive than the Parties’ reliance on studies. In order to reflect the level of customer growth or decline expected to occur during the FTY and FPFTY, I&E considered actual customer fluctuations that have occurred historically over a recent three-year period, as well as the Company’s known changes.

Based on the evidence, we find I&E’s adjustment to the Company’s claimed present rate revenues, based on I&E’s projected customer counts for the FPFTY, to be reasonable. Therefore, the Company’s rates shall be designed based upon the usage billing determinants set forth in Citizens’ Exhibit\_(HSG-1), Schedule B3-1 and upon the customer counts reflected in Schedule 2 of I&E Exhibit No. 3-SR.[[10]](#footnote-11) Accordingly, we shall adopt the ALJs’ recommendation and deny the Exception filed by Citizens’ on this particular issue.

## Expenses

A regulated utility is entitled to recover in its rates all legitimate expenses incurred in the rendition of its public utility service. *UGI Corp. v. Pa. PUC*,410 A.2d 923, 932 (Pa. Cmwlth. 1980). Generally, utilities are permitted to set rates which will recover those operating expenses reasonably necessary to provide service to customers, while earning a fair rate of return on the investment in plant used and useful in providing adequate utility service. *Western Pennsylvania Water Company v. Pa. PUC*, 422 A.2d 906, 908 (Pa. Cmwlth. 1980). The objective evaluation of reasonableness is whether the record provides substantial evidence to objectively determine whether the expense is prudently incurred. *Popowsky v. Pa. PUC*, 674 A.2d 1149, 1153-54 (Pa. Cmwlth. 1996).

### Inflation Adjustment

In developing its expense claims, the Company analyzed HTY actual costs and the FTY budget and developed projected costs for the FPFTY. The Company also added a 3% wage, salary, and benefit inflation adjustment and other known adjustments to the O&M accounts in its FTY budget. Citizens’ M.B. at 37.

**a. Positions of the Parties**

The Company contended that its use of an inflation adjustment is a realistic and conservative projection of its FPFTY increase in O&M expenses. Arguing that growth in costs cannot be known with certainty but can be reasonably estimated, Citizen’s asserted that historic O&M expenses showed a greater than 3% increase every year from 2012 to 2018. Citizens’ Exh.\_(HSG-1), Sch. C1-1 at 2. In preparing its fiscal year 2020 budget, Citizens’ expected expenses to increase by over 3% from 2019 to 2020, with significantly higher increases in some areas being offset by management’s efforts to manage costs. Citizens’ St. 4-R at 4.

Citizens’ argued that its use of the Producer Price Index (PPI) as a guideline in forming its 3% inflation projection was reasonable because the Company’s historical year-to-year O&M expense escalations, projected expense increases, and budgeted 2020 expenses indicate that overall O&M expenses will increase by at least3%. Citizens’ M.B. at 42-47.

Citizens’ asserted that the Commission has recognized the use of inflation factors in projecting costs. The Company also argued that its use of a 3% inflation rate aligns with the Commission’s purposes as set forth in Act 11 in establishing the FPFTY as a ratemaking tool and criticized the OCA’s position of removing the inflation adjustment because it assumed no cost increases from the FTY to the FPFTY. Citizens’ M.B. at 45 (citing, in part, *Pa. PUC v. Pennsylvania-American Water Co.*, Docket Nos. R-00038304, *et al.* (Order entered Jan. 29, 2004) at 35, *aff’d*, *Popowsky v. Pa. PUC*, 868 A.2d 606 (Pa. Cmwlth. 2004)).

The OCA objected to the use of a 3% inflation adjustment arguing that the proposed adjustments are not actually known and measurable. The OCA asserted that such blanket adjustments or increases do not directly relate to actual costs expected to be incurred by the Company in the period in which rates are set. The OCA also proffered that across-the-board inflation factors, or attrition adjustments, should not be used to establish rates because they are speculative in nature. Additionally, the OCA argued that a utility cannot meet its burden of proof, per 66 Pa. C.S. § 315(a), by applying the inflation to all its costs because there is no way to assess the reasonableness of the FPFTY expenses relative to HTY or the FTY expenses. OCA M.B. at 21-24 (citing, in part, *Pa. PUC v. Philadelphia Gas Works*, Docket Nos. R-00061931, *et al.*, 2007 Pa. PUC LEXIS 45 (Order entered Sept. 28, 2007) (*PGW*)).

Regarding the Company’s proposal to use PPI in forming the inflation adjustment, the OCA contended that it is not an appropriate tool to measure the change in costs and a better measure of inflation for ratemaking purposes would be the forecasted Gross Domestic Product-Price Index (GDP-PI). The OCA submitted that if the Commission allows the use of an inflation adjustment, it should be based on the GDP-PI at 2.1%, instead of the PPI the Company used. OCA St. 2 at 8-9.

**b. Recommended Decision**

The ALJs agreed with the OCA, finding it improper to use an inflation escalation in projecting FPFTY expenses. As a preliminary matter, the ALJs noted that the Parties cited to cases in support of their positions on the inflation adjustment but explained that these cases were decided prior to Act 11, which authorized EDCs to use a FPFTY in their Section 1308(d) base rate proceedings. The ALJs reasoned that, although Act 11 allowed for utilities to use the FPFTY to project expenses for the FPFTY, it did not eliminate the “known and measurable” standard. If a company claims that an expense will increase in the FPFTY, the ALJs stated that it must be supported through some known and measurable change in the FPFTY, in order for the Company to meet its burden of proof under 66 Pa. C.S. § 315(a). R.D. at 25-26.

The ALJs reasoned that inflation adjustments are not actually known and measurable because they do not reflect the true cost of expenses. Instead, they are blanket adjustments which do not directly relate to the actual costs expected to be incurred. The ALJs rejected the Company’s position that the Commission should accept the total expense claim without consideration of individual expense adjustments. According to the ALJs, the assumption that all expenses will increase by 3% is not supported in the record and the Company has not met its requisite burden of proof. R.D. at 26.

The ALJs acknowledged that accepting the OCA’s position does not require an assumption that there are no cost increases from the FTY to the FPFTY. Rather, the ALJs highlighted their recommendations that the Commission accept FPFTY projections consisting of cost increases from the FTY to the FPFTY that the Company can demonstrate and explain in the record. However, the ALJs determined that it is not known how the Company specifically calculated its 3% inflation adjustment figure and that Citizens’ should not be permitted to apply such a blanket inflation adjustment to all of its O&M accounts in its FTY budget. *Id.*

**c. Exceptions and Replies**

In its Exception No. 3, Citizens’ asserts that the ALJs erred in rejecting the Company’s 3% FPFTY inflation adjustment. The Company submits that its conservative inflation factor applies solely to FTY O&M expenses which is consistent with its historical experience, the 2020 budget increases, and other information, thus meeting the known and measurable standard as historically applied by the Commission. Citizens’ Exc. at 8-10.

Regarding the known and measurable standard, Citizens’ argues that the Recommended Decision’s holding on this issue is inconsistent with Commission precedent which has consistently permitted inflation adjustments. As an example, the Company cites to *Nat’l Fuel Gas Distrib. Corp. v. Pa. PUC*, 677 A.2d 861, 865 (Pa. Cmwlth. 1996) (*NFGD*), in which the Commonwealth Court stated that “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.” Citizens’ Exc. at 8-9 (citing *NFGD*). The Company submits there is nothing inherently inconsistent between the known and measurable standard and an inflation adjustment. Additionally, Citizens’ argues that it did not apply a blanket adjustment to all FPFTY costs but instead applied an inflation adjustment solely to O&M expenses consistent with the Company’s historical experience. Citizens’ Exc. at 9.

The Company contends that the cases cited by the OCA are distinguishable. Citizens’ proffers that its adjustment applies only to expenses and not to revenue or rate base in contrast with *Pa. PUC v. Philadelphia Electric Company*, Docket No. R-822291 (Order entered Nov. 22, 1983) (*PECO*), which involved an attempt to recover a true blanket 2% attrition rate to expenses, revenue and rate base. The Company also argues that the Commission’s decision in *PGW* is inapplicable because it involved a 2% annual attrition adjustment to expenses as part of a broader proposal to set rates based on a five-year forecast. Citizens’ Exc. at 9-10.

The Company asserts that the ALJs’ recommendation undercuts the purpose of the FPFTY authorized in Act 11 by ignoring historical trends that should be considered along with known and measurable increases when setting rates. In support, Citizens’ submits that the historical O&M expense increases demonstrate a consistent and verifiable trend of increased expenses citing to actual historic O&M expenses showing a greater than 3% increase every year from 2012 to 2018 (the last year full expense data is available). Citizens’ Exc. at 10-11 (citing Citizens’ Exh.\_(HSG-1), Sch. C1-1 at 2). Additionally, Citizens’ argues that the proposed 3% expense adjustment represents a conservative estimate of FPFTY costs and provided testimony to support the vendor and labor expense increases justifying the 3% inflation adjustment for FPFTY expenses. Citizens’ Exc. at 11-12 (citing Tr. at 78-79, 144).

The Company criticizes the Recommended Decision as potentially frustrating the purpose of Act 11 and the FPFTY. According to the Company, the R.D. contravenes the clear purpose of Act 11 by relying on 2019 data for FPFTY expense allowances despite substantial evidence that 2020 costs will increase at or above the proposed 3% rate. The Company contends that denying a modest 3% expense adjustment for the FPFTY directly conflicts with the forward-looking policy basis underlying Act 11 and the FPFTY. Citizens’ Exc. at 12-13.

Moreover, Citizens’ contends that, at a minimum, the 3% inflation adjustment should be applied to expense categories consisting primarily of labor and benefits expense (Accounts 580, 588, and 903), as the record demonstrates the Company’s employee labor and benefits expense will increase by 3%. Citizens’ Exc. at 13-14.

In response to Citizens’ Exception No. 3, the OCA argues that the ALJs appropriately rejected the Company’s across-the-board inflation adjustment because it lacked evidentiary support. The OCA asserts that Commission precedent in *PGW* and *PECO*, which rejected similarly speculative and unsupported adjustments, are relevant to this proceeding. Moreover, the OCA submits that its arguments do not supplant the purpose of Act 11 because the legislation was not simply to increase rates but to provide an opportunity to mitigate regulatory lag for known and supported changes in the FPFTY. OCA R. Exc. at 5-8.

The OCA maintains that the 3% inflation adjustment is not a well-founded projection, and, in addition to the across-the-board inflation adjustment, the Company’s proposed alternative should also be denied. The OCA also reiterates that should the Commission decide that the use of an inflation factor to measure the change in costs is appropriate, the GDP-PI would be a better measure of inflation for ratemaking purposes than the PPI used by the Company. *Id.* at 9.

**d. Disposition**

In considering the record evidence and arguments before us, along with the Exceptions and Reply Exceptions of the Parties, we shall adopt the ALJs’ recommendation to not allow Citizens’ to apply a blanket 3% inflation adjustment to all of its O&M accounts in its FTY to reach its FPFTY projections. We agree with the ALJs that the Company did not meet its burden in demonstrating that its proposed blanket 3% inflation adjustment to all expenses would meet the “known and measurable” standard for increasing each FTY expense claim in the FPFTY. To state it another way, the Company did not demonstrate that making this blanket adjustment to each expense claim directly relates to the actual costs expected to be incurred in each expense account in the FPFTY. R.D. at 23-26. In our view, the ALJs’ recommendation to reject the Company’s position is reasonable and consistent with applicable law. Accordingly, we shall deny Citizens’ Exception No. 3 and adopt the ALJs’ recommendation on this issue.

### Individual Adjustments

#### General

* + - * 1. **Positions of the Parties**

The OCA and I&E proposed individual adjustments to the Company’s expense claims. OCA M.B. 25-33; I&E M.B. at 15-25. Citizens’ argued that the Commission should deny the OCA’s and I&E’s individual expense adjustments and approve the Company’s full expense claim as filed.

Citizens’ stated that the approach of analyzing individual adjustments raises particular problems for a small utility like Citizens’, that shifts resources and priorities during the year as operational needs arises. The Company argued that this approach actually penalizes it for being responsive and for applying resources where most needed and ignores the Company’s success in managing overall costs close to its budgeted costs. Citizens’ submitted that its 9-month annualized expenses, adding a 3% inflation factor, is $2,695,345, which is $279 greater than its FPFTY claim of $2,695,066. The Company proffered that because it has managed its expenses close to budget, and that such expenses are tracking slightly higher than projected for 2019, it is appropriate to approve its expense claim in its entirety. Citizens’ M.B. at 39-41.

* + - * 1. **Recommended Decision**

The ALJs rejected the Company’s approach in projecting its total FPFTY O&M expense, finding it to be inconsistent with 66 Pa. C.S. §§ 315(a) and 1308(d), which provides that a public utility has the burden of proof to establish the justness and reasonableness of every element of its rate increase request. Instead, the ALJs determined that each expense claim should be analyzed to determine the justness and reasonableness of each item. R.D. at 27.

* + - * 1. **Exceptions and Replies**

In its Exception No. 4, Citizens’ objects to the ALJs’ recommendation, maintaining that its primary proposal to approve its FPFTY expense claim based on the annualized FTY O&M expense plus the 3% inflation adjustment is reasonable. The Company submits that the approach of analyzing individual adjustments is contrary to the practical operations of smaller public utilities and penalizes Citizens’ for effectively managing its budget. To the extent that the Company’s general objection to recommendations of specific adjustments to its O&M expense claims is dismissed, the Company has responded to specific adjustments. Citizens’ Exc. at 14-16.

In response, I&E submits that the ALJs correctly rejected the Company’s proposition that individual expense claims not be examined. I&E objects to the Company’s update of its O&M expenses at hearing and during rebuttal testimony because it rendered the non-Company Parties’ review essentially meaningless. In addition, I&E argues that it violates due process principles because it prevents an opportunity to evaluate such late-brought claims. I&E R. Exc. at 3-4.

I&E also contends that the Company’s position that totalO&M costs should be scrutinized, rather than analyzing the merits, rationale, and the basis of each expense claim, would create a dangerous precedent and handicap the Parties’ ability to evaluate individual expense accounts. I&E therefore proceeded to address several individual expense claims that it contended were not reasonable or appropriate for furnishing service to customers. I&E R. Exc. at 4-5.

The OCA echoes I&E’s argument, stating that the Company has an obligation under the law to demonstrate each and every element of its claim is supported under the law. Like I&E, the OCA had also made recommendations pertaining to whether individual expense claims in the FPFTY are just and reasonable. OCA R. Exc. at 9-10.

* + - * 1. **Disposition**

In considering the record evidence and arguments before us, along with the Exceptions and Reply Exceptions of the Parties, we shall adopt the ALJs’ recommendation to evaluate the merits of the Parties’ positions on individual O&M expense claims.

We reject the Company’s position on this issue. Citizens’ avers that Section 315(a) requires only that the public utility meets its burden of proof to show that the rate involved is just and reasonable, but it does not prescribe the methods used to demonstrate the justness and reasonableness of a proposed rate, or how individual expenses may be justified. Citizens’ argues that its 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. Citizens’ Exc. at 15; Citizens’ M.B. at 38-39; Citizens’ St. 4-R at 3-4. Accordingly, Citizens’ argues the ALJs erred in evaluating the merits of the Parties’ positions on the Company’s individual O&M expense claims.  We disagree, and therefore we shall deny Citizens’ Exception No. 4 on this issue.

We agree with the ALJs that, under Section 315(a) of the Code, the Company has the burden of proof to establish the justness and reasonableness of every element of its rate increase request filed under Section 1308(d) of the Code. R.D. at 27 (citing 66 Pa. C.S. §§ 315(a), 1308(d)). Section 315(a) of the Code sets forth the standard for the reasonableness of rates as follows:

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

66 Pa. C.S. § 315(a).

Under this standard, we must reject the Company’s proposal to be relieved of its responsibility to establish the reasonableness of its individual expense claims on the basis that it is a smaller utility. Thus, we agree with the ALJs’ determination that each litigated O&M expense claim must be analyzed to determine the justness and reasonableness of the claim. R.D. at 27. Based on this disposition, we will address below the merits of the Parties’ positions on individual O&M expense claim which were raised in the Parties’ Exceptions.

#### Maintenance of Overhead Lines/Vegetation Management (Account 593)

1. **Positions of the Parties**

Citizens’ made an original claim of $456,019 for maintenance of overhead lines for the FPFTY which includes salaries and wages, overhead, transportation, and material expense, and tree trimming (contractor services). This projection is an increase in costs of $401,475 in the HTY to $456,019 for the FPFTY. Citizens’ Exh.\_(HSG-1), Sch. C1-1. According to Citizens’, the increase in costs is due to maintenance and repair of damage dealt to trees in Citizens’ service territory by the Emerald Ash Borer. Citizens’ claimed that trees damaged by the Borer pose a significant risk to its distribution lines, as the damaged trees are poised to fall onto overhead lines resulting in unnecessary outages and damage to its facilities. The Company contended it will experience increased contractor costs when it comes to contracting with third parties in order to identify and remedy damaged trees, particularly damaged off right-of-way priority trees. Citizens’ St. 4 at 13-14.

The Company provided nine-month data for the FTY (as of September 30, 2019), which showed a FTY amount of $367,362 and an annualized amount of $489,816. Applying a 3% inflation adjustment to the FTY annualized amount, Citizens’ calculated a new claim of $504,510 for the FPFTY. Citizens’ St. 1-R at 4. The Company argued that its claim is conservative and projected future tree trimming costs will be higher, based upon contractor bids and the escalation for contracting services because of the existence of the Borer. Citizens’ St. 4-R at 6.

I&E recommended a downward adjustment of $9,564 to Citizens’ claim, arguing that the Company experienced a fluctuating trend in material expense from 2016 through 2018. I&E asserted that Citizens’ did not support the significant increase of 25.15% from the HTY material expense to the FPFTY material expense. I&E St. 1 at 17‑18. I&E noted that Citizens’ claimed that material and contractor costs are the same, but I&E alleged that there is no clear substantiation or breakdown of material expense to verify this claim. I&E did not dispute the increase to the contractor subcategory or any other subcategory of cost for the FTY and FPFTY. I&E R.B. at 12.

The OCA recommended a downward adjustment of $40,652 to Citizens’ claim, arguing there has been a significant variance in vegetation management costs. The OCA used a three-year average methodology to average the vegetation management contractor costs, concluding with a $40,652 reduction to Citizens’ claim. OCA M.B. at 25-26; OCA St. 1-SR at 5.

1. **Recommended Decision**

The ALJs found that Citizens’ provided sufficient evidence to show that the proposed increase in vegetation management expenses is due to the known and measurable change of the Borer’s impact on this Account. According to the ALJs, the Company provided sufficient evidence to show that its contractor costs will increase in order to combat the Borer vegetation crisis. The ALJs acknowledged the Company’s evidence that demand for contractors have increased in response to combating the Borer, based upon bids it has received from contractors. Regarding I&E’s proposal for an adjustment based off historic material expense costs from 2016-2018, the ALJs found such an approach to be inappropriate because historic costs do not factor in the new threat posed by the Borer. Likewise, the ALJs considered the OCA’s adjustment to be inappropriate because it used historical averages without reflecting the increased expenses the Company will experience in combating the new threat posed by the Borer. R.D. 29-30.

Accepting either I&E’s or the OCA’s positions on this issue would run the risk of under collection of this expense, the ALJs stated. Such under collection of this expense could affect the Company’s ability to provide safe and reasonable service to its customers. R.D. at 30 (citing 66 Pa. C.S. § 1501).

Thus, the ALJs recommended that the Commission approve the Company’s claim for maintenance of overhead lines/vegetation management. The ALJs noted that the Company’s costs will be higher than what Citizens’ initially projected in its filing. Since the Company’s original claim of $456,019 is less than what its new claim would be at $504,510, the ALJs recommended an allowance of $489,816 for Account 593 (the annualized actual costs incurred during the 9-month FTY), which is the new claim minus the 3% inflation adjustment. R.D. at 30.

1. **Exceptions and Replies**

In its Exception No. 2, I&E submits that Citizens’ did not sufficiently demonstrate that its claim for the Material expense subcategory is justified, and therefore, maintains its contention that Account 593 is overstated by $9,564. I&E argues that based on the historical fluctuating nature of the Material expense and the Company’s inability to verify that Material is simply a further breakdown of the Contractor subcategory, the Company cannot support the significant increase of 25.15% from the HTY Material expense to the FPFTY Material expense. I&E Exc. at 5-6 (citing I&E M.B. at 20-21; I&E R.B. at 11-12).

In its Exception No. 2, the OCA excepts to the ALJs’ finding, contending that it fails to account for the fact that vegetation contractor costs have, and will continue to vary by year. The OCA maintains that its recommendation to average the vegetation management contractor costs for three years, 2016 through 2018, is reasonable. The OCA’s proposal would result in a $40,652 decrease to the Company’s original Account 593 expense claim of $456,019. OCA Exc. at 5-6 (citing OCA M.B. at 25; OCA R.B. at 16).

 Citizens’ responds that the Commission should adopt the ALJs’ recommendation as modified by the Company’s Exception No. 3 to include the 3% inflation adjustment for the FPFTY expense. Citizens’ contends that I&E and the OCA ignore the substantial evidence supporting the higher expense projections based on increasing contractor costs and the escalating spread of the Emerald Ash Borer. Citizens’ R. Exc. at 2-4.

1. **Disposition**

Upon review, we shall deny I&E Exception No. 2 and OCA Exception No. 2. We agree with the findings of the ALJs that the Company has provided sufficient evidence to establish that the proposed increase in vegetation management expenses is due to a known and measurable change to combat the Borer vegetation crisis. Indeed, the Company has provided evidence that its claim is conservative and that future tree trimming costs will be higher than the projected amount based on bids received from contractors and on the demand for contractor services which has escalated due to the Borer problem. Citizens’ St. 4-R at 6.

We further agree that the proposals of I&E and the OCA would appear to expose Citizens’ to the risk of under collection for this expense which could affect its ability to provide safe and reasonable service to its customers. Accordingly, we shall adopt the recommended allowance of $489,816 for Account 593.

#### Operations Supervision & Maintenance Expense (Account 580)

**(1) Positions of the Parties**

Citizens’ made an original claim of $144,762 for operations supervision and maintenance expense in the FPFTY. Using nine-month data for the FTY (as of September 30, 2019), the Company showed a FTY amount of $91,768 with an annualized amount of $122,357. Applying a 3% inflation adjustment to the FTY annualized amount, Citizens’ claimed $126,028 for the FPFTY for this account. Citizens’ St. 1-R at 4.

I&E recommended an adjustment of $21,644 to Citizens’ claim. I&E’s recommendation for the FPFTY was based on the annualized FTY expense of $119,532 plus a 3% inflation increase for employee payroll and benefits expense. This reflects removal of a one-time additional payroll cost ($53,998) due to employee overlap (while Citizens’ was training a new Senior Director of Engineering and Operations) incurred in the HTY ended on December 31, 2018. I&E St. 1 at 10-11.

Citizens’ opposed I&E’s adjustment, asserting that the Company is preparing to address a significant number of retirements in the upcoming years. To address the retirements, Citizens’ indicated that it is implementing a long-term and methodical transition strategy that will prevent a lapse in experience and job knowledge. The Company submitted it will incorporate additional short-term staff overlaps during 2019 and beyond. Thus, Citizens’ claimed that the overlap is not “one-time” as it will recur in a variety of transitions. Citizens’ M.B. at 51; Citizens’ St. 4 at 15-16.

In response, I&E argued that Citizens’ witness testimony relating to anticipated retirements does not expressly relate to this expense claim and that I&E’s recommendation is justified because neither the historical nor annualized FTY experience for this expense support Citizens’ claim. I&E St. 1 at 9-11.

**(2) Recommended Decision**

The ALJs agreed with I&E, citing the speculative nature of employee overlap and the associated increase in payroll cost based on anticipated employee retirements. Although generally agreeing with I&E on this issue, the ALJs noted I&E’s recommendation of $123,118 ($144,762 - $21,644) included a 3% inflation adjustment for the FPFTY. Therefore, consistent with their recommendation rejecting the Company’s 3% FPFTY inflation adjustment, the ALJs recommended that the Commission allow Citizens’ to recover $119,532 of its $144,762 claim for Account 580, based on annualization of actual costs incurred during the first 6 months of the FTY (as of June 30, 2019). The ALJs noted that annualizing actual data for the first 9 months of the FTY produces an amount of $122,357. R.D. at 30-32.

**(3) Exceptions and Replies**

In Citizens’ Exception No. 5, the Company submits that the ALJs erred by adjusting the Company’s claim for Account 580, contending that the ALJs failed to recognize the evidence demonstrating that employee retirements will be a significant and ongoing issue for the Company, as well as failing to include a 3% inflation adjustment. Citizens’ claims it should not need to guarantee retirements will occur, rather, the Company has met its burden of proof for this expense, projecting more than half of Citizens’ staff is expected to retire in the next 5-10 years. Citizens’ Exc. at 16-17.

In its replies, I&E submits that the ALJs were correct to agree with its recommendation, as costs for employee overlap based off anticipated employee retirements are speculative in nature. I&E R. Exc. at 6-7.[[11]](#footnote-12)

Consistent with the OCA’s opposition to a 3% inflation factor which Citizens’ proposed be applied to totalO&M expenses, the OCA submits that the ALJs correctly excluded the Company’s proposed 3% inflation adjustment to Account 580 based on an annualization of FTY expense data. OCA R. Exc. at 10.

**(4) Disposition**

We shall deny Citizens’ Exception No. 5 and adopt the ALJs’ recommendation. The Company’s projection of a significant number of retirements in the next 5-10 years is speculative in nature. As the ALJs correctly reasoned, there is no guarantee that such staff members will retire and the Company cannot establish that the proposed retirements can be expressly related to this expense claim. Here, Citizens’ could not establish that employee turnover will occur in a variety of transitions. Since it appears that such expenses would be imprudently incurred and abnormally overstated during the test year, the ALJs appropriately determined that the proposed expense should be disallowed and not recoverable through rates. Accordingly, we shall adopt an allowance of $119,532 for Account 580.

#### Miscellaneous Distribution Expense (Account 588)

**(1) Positions of the Parties**

Citizens’ made an original claim of $275,814 in the FPFTY for the miscellaneous distribution expense which includes employee salaries and wages, overhead (employee benefits), transportation, material, safety material, travel, and retiree health expenses. Using nine-month data for the FTY (as of September 30, 2019), the Company showed a FTY amount of $201,725 with an annualized amount of $268,967. Applying a 3% inflation adjustment to the FTY annualized amount, the Company calculated a new claim amount of $277,036 for the FPFTY. Citizens’ St. 1-R at 4.

I&E recommended a downward adjustment of $9,218 to the Company’s original claim. In making its recommendation, I&E argued that the Company’s significantly increased material expense claim in the FPFTY over the HTY expense was not justified and supported by the most recent three years’ declining expense trend. I&E St. 1 at 13. I&E argued that the Company’s projection of a significant increase in material expense (40.42%) in the FTY over 2018 expense was not explained or supported when Citizens’ experienced a declining trend in material expense from 2016 through 2018. I&E R.B. at 11.

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

**(2) Recommended Decision**

The ALJs concurred with I&E’s position, finding that there was insufficient evidence to support the entirety of Citizens’ original claim of $275,814 for miscellaneous distribution expense in the FPFTY, particularly considering the declining trend in the material expense subcategory experienced by the Company in recent years. Accordingly, the ALJs recommended that the Commission allow Citizens’ to recover $268,967 of its $275,814 claim for Account 588, based on annualization of actual costs incurred during the 9-month FTY, ending September 30, 2019, excluding a 3% inflation factor. R.D. at 33.

**(3) Exceptions and Replies**

In Citizens’ Exception No. 6, the Company submits that the ALJs erred in excluding the 3% FPFTY adjustment from Account 588, maintaining its contention that an inflation adjustment of 3% is reasonably applied to this account because it consists primarily of labor and overhead expense that should reflect the expected increase in labor and health care costs. Citizens’ Exc. at 17.

I&E did not file Replies to this Exception. However, the OCA counters that consistent with the OCA’s opposition to a 3% inflation factor which Citizens’ proposed be applied to totalO&M expenses, the ALJs correctly excluded the Company’s proposed 3% inflation adjustment to Account 588 based on an annualization of FTY expense data. OCA R. Exc. at 10.

**(4) Disposition**

Upon review, we shall deny Citizens’ Exception No. 6. In its Exception, the Company argues that the ALJs incorrectly rejected the proposed 3% increase to Account 588 for the FPFTY, contending that a 3% increase is reasonable, considering the anticipation of a 3% increase in labor expenses by the C&T Enterprises Oversight Committee and the expected increase in health care expenses of at least 9%. In support, the Company simply references its arguments set forth in Citizens’ Exception No. 3, pertaining to its overall inflation adjustment request. Citizens’ Exc. at 17.

However, as discussed above in Section C.1, the Company did not meet its burden in demonstrating that its proposed blanket 3% inflation adjustment to all expenses would meet the “known and measurable” standard for increasing each FTY expense claim in the FPFTY. Specifically, as to this account, Citizens’ did not rebut I&E’s evidence showing a declining trend in material expense from 2016 through 2018. Rather, the Company proposed a significant increase of 40.42% in the FTY over the 2018 expense and an additional 3% increase in the FPFTY. In light of the Company’s inability to provide a detailed explanation and support for this significant projected increase, the ALJs appropriately recommended a reduction of $9,218 to this account. Thus, we shall adopt an allowance of $268,967 for Account 588.

#### Customer Records & Collection Expense (Account 903)

**(1) Positions of the Parties**

Citizens’ made an original claim of $469,626 for customer records and collection expense in the FPFTY, which included employee salaries and wages, overhead (employee benefits), transportation, and material expenses. Nine-month data for the FTY (as of September 30, 2019) showed a FTY amount of $327,891 and an annualized amount of $437,188. Applying a 3% inflation adjustment to the FTY annualized amount, the Company claimed a new amount of $450,304 for the FPFTY. Citizens’ St. 1-R at 4.

I&E recommended a reduction of $13,650 to the Company’s claim. I&E claimed that Citizens’ significantly increased its material expense claim (+13.15%) in the FPFTY over the HTY expense which was not justified and supported by the most recent three years’ declining expense trend. Rather, I&E argued that the Commission should find I&E’s recommended allowance for material expense based on the HTY’s expense to be appropriate because the Company experienced a declining trend in material expense from 2016 through 2018 and it did not support the significant increase in the FTY and FPFTY’s material expense claim included in the customer records and collection expense. I&E St. 1-SR at 14-15.

In response, the Company stated that, if the Commission addresses the proposed adjustments on an account-by-account basis, it will accept I&E’s proposed adjustment to Account 903, acknowledging that the total account expense is tracking below projected amounts. Citizens’ M.B. at 52.

The OCA recommended a reduction of $43,591 to the Company’s claim, submitting that it included costs which are not normal or on-going in its forecast for Account 903. Rather, the costs related to the training of a new employee and employee overlap planned for 2019 and 2020. The OCA asserted that the overlap expense should be removed and replaced with the 2018 labor and average material cost for the years 2016 through 2018. OCA St. 1 at 6.

**(2) Recommended Decision**

The ALJs concurred with I&E’s position, finding that there was insufficient evidence to support the entirety of Citizens’ original claim of $469,626 for customer records and collection expense in the FPFTY, particularly considering the declining trend in the material expense subcategory experienced by the Company in recent years. Accordingly, the ALJs recommended that the Commission allow Citizens’ to recover $437,188 of its $469,626 claim for Account 903, based on annualization of actual costs incurred during the 9-month FTY, ending September 30, 2019, excluding Citizens’ proposed inflation adjustment of 3% for the FPFTY. R.D. at 33-34.

**(3) Exceptions and Replies**

In its Exception No. 7, Citizens’ submits that the ALJs erred in excluding the 3% FPFTY adjustment from Account 903, maintaining its contention that an inflation adjustment of 3% is reasonably applied to this account because it consists primarily of labor and overhead expense that should reflect the expected increase in labor and health care costs. Citizens’ Exc. at 17-18.

In its Replies to Citizens’ Exception No. 7, consistent with the OCA’s opposition to a 3% inflation factor which Citizens’ proposed be applied to totalO&M expenses, the OCA submits that the ALJs correctly excluded the Company’s proposed 3% inflation adjustment to Account 903 based on an annualization of FTY expense data. OCA R. Exc. at 10-11.

In its Exception No. 3, the OCA submits that its recommendation to reduce the Company’s FPFTY expense claim of $469,626 for Account 903 by $43,597 to $426,029 more accurately reflects the expected costs that should be included in rates. The OCA maintains that its proposed adjustment correctly reflects the removal of the labor and material costs associated with the training of new employees and employee overlap planned for 2019 and 2020, which are one-time expenses that are not normal or ongoing, and therefore should be eliminated for ratemaking purposes. OCA Exc. No. 7‑8.

The Company responds to OCA Exception No. 3, opining that its testimony on future retirements supports its claim that employee training expense will continue beyond the FPFTY, and therefore, supports the adoption of the ALJs’ recommendation as modified by the Company’s Exception No. 3 to include the 3% inflation adjustment for the FPFTY expense. Citizens’ R. Exc. at 6.

**(4) Disposition**

Upon review, we agree with the rationale and the recommendation of the ALJs that the Commission allow Citizens’ to recover $437,188 of its $469,626 claim for Account 903, based on annualization of actual costs incurred during the 9-month FTY, ending September 30, 2019, excluding Citizens’ proposed inflation adjustment of 3% for the FPFTY. The ALJs agreed with I&E’s position, finding that there was insufficient evidence to support the entirety of the Company’s original claim of $469,626 for customer records and collection expense in the FPFTY, particularly considering the declining trend in the material expense subcategory experienced by the Company in recent years. Citizens’ also indicated it accepts I&E’s adjustment because Account 903 is tracking below projections. Accordingly, we shall deny the OCA’s and Citizens’ Exceptions on this issue.

Additionally, we agree with the ALJs’ rejection of the OCA’s recommendation to reduce the Company’s FPFTY expense claim of $469,626 for Account 903 by $43,597 to $426,029. The OCA claims this more accurately reflects the expected costs that should be included in rates. However, we find the Company’s argument compelling that employee training expenses will continue beyond the FPFTY, and therefore, supports the adoption of the ALJs’ recommendation.

#### Outside Services (Account 923)

**(1) Positions of the Parties**

Citizens’ made an original claim of $81,370 for outside services in the FPFTY, which included accounting and legal services. Thereafter, the Company utilized nine-month data for the FTY (as of September 30, 2019) for a FTY amount of $47,175, and calculated an annualized amount of $62,900. Applying a 3% inflation adjustment to the FTY annualized amount, the Company claimed a new amount of $64,787 for the FPFTY. Citizens’ St. 1-R at 4.

I&E recommended a reduction of $25,380 to Citizens’ original claim, which reflects the removal of one-time legal expenses incurred in the HTY and is reasonably consistent with the last three years’ expense level. Specifically, I&E noted that the Company’s historic outside services for 2016, 2017, and 2018 (after adjusting the one-time legal expense) were $53,612, $52,217, and $55,762. I&E argued that the Company’s claim for the significant increased level of legal expense in the FPFTY is improper because it has not explained the reason for the large increase in legal expenses in the FTY (after adjusting the one-time legal expense). I&E St. 1 at 19-20; I&E M.B. at 22.

The OCA recommended a reduction of $28,456 to the Company’s original claim arguing that Citizens’ did remove all one-time expenses from its claim. The OCA argued that the Company’s annualized FTY expense amount is $18,470 below the Company’s claim for FPFTY, which indicates that the Company’s claim is likely higher than what will actually be incurred. Instead, the OCA recommended an adjustment reflecting a normalized period for 2016 and 2017, and excluding 2018 to eliminate one-time expenses, which results in a reduction of $28,456. OCA M.B. at 29 (citing OCA St. 1-SR (Revised) at 6).

Alternatively, Citizens’ argued that if the Commission found a downward adjustment to be reasonable, the Company contended that a claim for $64,787 is reasonable because it is the annualized 9-month (as of September 30, 2019) YTD projection, plus an inflation adjustment. Citizens’ M.B. at 52.

**(2) Recommended Decision**

The ALJs concurred with I&E’s position, finding that there was insufficient evidence to support the entirety of Citizens’ original claim of $81,370 for outside services expense in the FPFTY and finding that it was imprudently incurred in the HTY. In particular, the ALJs found that Citizens’ forecast included an unsupported significant increase in legal expenses and that any one-time costs should be removed from its claim. Accordingly, the ALJs recommended that the Commission allow Citizens’ to recover $62,900 of its $81,370 claim for Account 923, based on annualization of actual costs incurred during the first 9 months of the FTY (as of September 30, 2019), excluding Citizens’ proposed inflation adjustment of 3% for the FPFTY. R.D. at 35-36.

**(3) Exceptions and Replies**

In Citizens’ Exception No. 8, the Company objects to the ALJs’ characterization of its HTY legal expenses as imprudently incurred, submitting that, while certain accounting and legal expenses in 2018 may be non-recurring in the future, nothing in the record suggests or supports that the Company acted imprudently when incurring the HTY expense for legal services. Citizens’ Exc. at 18.

In its replies, the OCA submits that the Company’s arguments are confusing and lack merit. The OCA clarifies its understanding of the ALJs’ recommendation, stating that they found the legal expenses in question to be “one-time legal expenses,” therefore it would be imprudent to include them in the HTY as they “will not occur again in the FPFTY.” OCA R. Exc. at 11-12.

In its Exception No. 4, the OCA excepts to the ALJs’ recommendation, contending that its recommendation to reduce the Company’s FPFTY expense claim for Account 923 by $28,456 to $52,914 should be adopted. The OCA submits that, although the ALJs agreed with I&E’s position, I&E’s $25,389 adjustment should also be modified to reflect more up-to-date data. The OCA maintains that its recommended adjustment reflects a normalized period for 2016 and 2017, excluding 2018 to eliminate one-time expenses. OCA Exc. at 8-10.

**(4) Disposition**

We are in agreement with the ALJs’ finding that there was insufficient evidence to support the entirety of Citizens’ original claim of $81,370 for outside services expense in the FPFTY, concurring with I&E’s position. The ALJs correctly recognized that the Company’s forecast included an unsupported significant increase in legal expenses and that any one-time costs are appropriately removed from its claim. I&E based its adjustment on the annualized FTY expense as of June 30, 2019, however the ALJs noted data as of September 30, 2019, is available. Thus, the ALJs used the data as of September 30, 2019, recommending that the Commission approve an allowance of $62,900 for Account 923, which is the annualized 9-month YTD projection, minus the 3% inflation adjustment. Accordingly, the ALJs recommended that the Commission allow Citizens’ to recover $62,900 of its $81,370 claim for Account 923, based on annualization of actual costs incurred during the first 9 months of the FTY (as of September 30, 2019) and excluding Citizens’ proposed inflation adjustment of 3% for the FPFTY.

We note that the ALJs appropriately rejected the OCA’s contention that its recommendation to reduce the Company’s FPFTY expense claim for Account 923 by $28,456 to $52,914 should be adopted. The OCA submitted that, although the ALJs agreed with I&E’s position, they chose to modify I&E’s $25,389 adjustment, in order to reflect more up-to-date data. The OCA maintains that its recommended adjustment reflects a normalized period for 2016 and 2017, excluding 2018 to eliminate one-time expenses. We disagree with the OCA using a normalized period for 2016 and 2017, excluding 2018, as the FTY, ending September 30, 2019, is the most recent data. Additionally, using the annualized period ending September 30, 2019, eliminates the OCA’s concern about one-time expenses in the projected FTY. Consequently, we shall deny the OCA’s Exceptions on this issue and will allow Citizens to recover $62,900 of its $81,370 claim for Account 923, based on annualization of actual costs incurred during the first 9 months of the FTY (as of September 30, 2019) and excluding the Company’s proposed inflation adjustment of 3% for the FPFTY.

#### Employee Pension & Benefits (Account 926)

**(1) Positions of the Parties**

Citizens’ made an original claim of $10,300 for employee pension and benefits in the FPFTY. The Company then used nine-month data for the FTY (as of September 30, 2019) showing a total of $11,931 and an annualized amount of $15,908. Applying a 3% inflation adjustment to the FTY annualized amount, Citizens’ submitted a new claim amount of $16,385 for the FPFTY. Citizens’ St. 1-R at 4.

The OCA recommended a reduction of $8,039 to the Company’s original claim. The OCA noted that this account includes employee appreciation expenses such as employee gifts, Christmas parties, picnics, and retirement parties. Noting that in 2018, the Company spent $1,150 on a retirement party and $3,270 on a Christmas party, the OCA proposed to disallow such expenses, claiming that they do not enhance service to customers and should not be supported by rates. After eliminating such expenses, and leaving expenses such as coffee, equipment lease, national night out, and a safety breakfast as the remaining employee appreciation expenses, Citizens’ claim should be set at $2,261 for the FPFTY. OCA St. 1 at 8.

The OCA argued that the Commission has consistently disallowed entertainment expenses for parties because they are not necessary for the provision of public utility service. OCA M.B. at 30 (citing *Pa. PUC v. Pennsylvania-American Water Co.*, Docket No. R-922428, 1993 WL 854381 (Order entered April 21, 1993) (*PAWC 1993*); and *Pa. PUC v. Citizens’ Utilities Water Co. of Pa.*, Docket No. R-953300C0001-0072, 1996 WL 350828 (Order entered March 29, 1996) (*Citizens’ 1996*)).

In response, Citizens’ argued that the employee activity expenses relate to employee recognition events which the Commission has permitted. The Company emphasized that the special events are to recognize the employees’ hard work and dedication, as well as to boost employee engagement and the morale of the overall workforce. Citizens’ M.B. at 53-54 (citing *UGI Order* and Citizens’ St. 4-R at 7).

**(2) Recommended Decision**

The ALJs agreed with Citizens’, finding that the Company’s approach is consistent with the precedent upheld in the *UGI Order.* Specifically, the ALJs found that there was sufficient evidence to show that the employee activity costs in question are employee recognition costs and can therefore be claimed as an expense. Therefore, the ALJs recommended that Citizens’ be permitted to recover the cost of employee pension and benefits in the amount of $15,908, based on annualization of actual costs incurred during the first 9 months of the FTY (as of September 30, 2019) excluding Citizens’ proposed inflation adjustment of 3% for the FPFTY. R.D. at 38-40.

**(3) Exceptions and Replies**

In OCA Exception No. 5, the OCA criticizes the ALJs’ recommendation, contending that it is an unnecessary departure from Commission precedent. OCA Exc. at 11 (citing *PAWC 1993* and *Citizens’ 1996*). The OCA submits that its proposal to disallow $8,039 of the Company’s original $10,300 FPFTY claim for Account 926 properly eliminates expenses related to certain events (retirement and holiday events) because they do not serve to enhance service to customers and should not be supported by rates. OCA Exc. at 11-12.

Citizens’ replies that, corroborated by Commission precedent in the *UGI Order*,the ALJs properly approved the employee activity costs in question, which have been proven by the Company to be costs of recognition events intended to recognize the achievements of the Company’s staff in order to bolster morale and, ultimately, incentivize high levels of customer service. Accordingly, Citizens’ submits that the Commission should deny the OCA’s Exception on this issue and adopt the ALJs’ recommendation as modified by the Company’s Exception No. 3, to include the 3% inflation adjustment for the FPFTY expense. Citizens’ R. Exc. at 6-7.

**(4) Disposition**

Upon review, we agree with the ALJs’ finding that the Company’s approach is consistent with the precedent upheld in the *UGI Order.* By finding that there was sufficient evidence to show that the employee activity costs in question are employee recognition costs and can therefore be claimed as an expense, the ALJs properly approved the employee activity costs in question. Further, Citizens’ proved costs of the recognition events intended to recognize the achievements of the Company’s staff in order to bolster morale and, ultimately incentivize high levels of customer service.

The OCA contends that the ALJs’ decision is an unnecessary departure from Commission precedent. However, the OCA does not substantiate its claim that the Company’s employee recognition costs do not serve to enhance service to customers and should not be supported by rates. Therefore, we adopt the ALJs’ recommendation that Citizens’ be permitted to recover the cost of employee pension and benefits in the amount of $15,908, based on annualization of actual costs incurred during the first 9 months of the FTY (as of September 30, 2019) excluding Citizens’ proposed inflation adjustment of 3% for the FPFTY. Accordingly, we shall deny the OCA’s Exceptions on this issue.

#### Rate Case Expense – Normalization Period

**(1) Positions of the Parties**

Citizens’ claimed a Rate Case Expense of $326,000, to be normalized over 36 months resulting in a normalized claim of $108,667. Citizens’ acknowledged that the average filing interval for its last three rate cases is 48 months but explained that 48 months is neither the most typical filing frequency nor the Company’s anticipated time frame before the next base rate filing. Citizens’ noted that its filing intervals have been 37 months, 75 months and 34 months, and asserted that rejecting its claim to normalize the Rate Case Expense over 36 months would penalize it for being able to forego a rate case for 3.25 additional years (75 months - 36 months). In addition, Citizens’ argued that the Company’s continued expenses related to tree trimming, capital replacements, and other reliability enhancing projects, combined with the Company’s limited prospects for load growth, results in a reasonable expectation of a 36-month period between rate cases. Citizens’ St. 1-R at 5; Citizens’ St. 4-R at 5.

In support, Citizens’ cited to cases for the proposition that, while historic filing frequency is a factor considered in determining the normalization for rate case normalization, it is not the only factor the Commission considers. Citizens’ M.B. at 55 (citing *Butler Township Water Co. v. Pa. PUC*,473 A.2d 219 (Pa. Cmwlth. 1984); and *UGI Order*).

I&E recommended that the Company’s claim for Rate Case Expense of $326,000 be normalized over a period of 48 months resulting in a normalized claim of $81,500. I&E argued that normalization of the rate case expense should be based on historic evidence of the Company’s filing frequency. I&E also objected to the claimed basis for a 36-month normalization period arguing that tree trimming and normal capital replacements are routine operational costs. According to I&E, the cost of such activities are normally forecast in the annual budget and do not merit deviation from the Commission’s endorsed practice of reviewing historical filing frequency. I&E M.B. at 25 (citing in part to *Pa. PUC v. Emporium Water Co.*, Docket No. R-2014-2402324 (Order entered January 28, 2015)); I&E St. 1-SR at 6.

The OCA argued that the Company’s claim for Rate Case Expense of $326,000 should be normalized over a period of 45 months resulting in a normalized claim of $86,933. According to the OCA, 45 months is the average period of the last four rate cases of Citizens’, including this present case. The OCA stated that for normalization of the Rate Case Expense, the Commission uses the average period between rate cases. The OCA also asserted that this method is not done to penalize a Company from filing a rate case; rather, it is a way to match the expense recovery over the average period of time when cases are filed. OCA St. 1-SR (Revised) at 11.

**(2) Recommended Decision**

The ALJs recommended adoption of the Company’s proposal to normalize its total rate case expense claim of $326,000 over 36 months, consistent with the anticipated frequency of base rate proceedings going forward, resulting in a normalized claim of $108,667. The ALJs found that the record supports a deviation from the general principle that history of rate filings represents the best evidence for normalization of rate case expense. Here, the ALJs determined that the record supports a finding that the Company’s proposed use of a three-year normalization period for rate case expense is appropriate and that a longer period between rate proceedings is unlikely. Specifically, the ALJs were persuaded that the Company’s expenses relating to tree trimming, capital replacements, and other reliability enhancing projects, in addition to the Company’s limited prospects for load growth, lead to the likelihood of another rate case filing occurring within the next three years as opposed to four years. R.D. at 42-43.

The ALJs also opined that the proposed three-year normalization period is consistent with the Commission’s recent affirmation in the *UGI Order* that rate case expense normalization period may be based on future expectations, explaining that a longer period between rate proceedings is unlikely, considering the lack of forecast future load growth, increased capital expenses and tree trimming costs. The ALJs reasoned that accepting the proposals of either I&E or the OCA would likely result in an under collection because Citizens’ will likely file a rate case within the next three years. The ALJs concluded, “[i]t is more likely that Citizens’ will file a rate case within the next three years as opposed to the next four years, given the history of Citizens’ filings not factoring in the 75-month outlier.” R.D. at 43.

**(3) Exceptions and Replies**

In its Exception No. 3, I&E objects to the ALJs’ recommendation and maintains that a normalization period of 48 months, based on the Company’s last three base rate case filings and resulting in a normalized claim of $81,500, is appropriate. I&E argues that deviating from reviewing historical filing frequency is inappropriate in this proceeding. In support, I&E contends that tree trimming and normal capital replacements – which the ALJs found to have supported the three-year time normalization period – are routine operational costs, which are normally forecast in an annual budget. Additionally, I&E submitted that the Recommended Decision provides an allowance for additional tree trimming costs and that the Company’s claims of limited load growth and change in industry are conclusory statements lacking record support. I&E Exc. at 6-7.

I&E also attempts to distinguish the Commission’s decision in the *UGI Order* arguing that Citizens’ has provided no quantifiable or otherwise specific bases or projections why the proposed 36-month normalization period is appropriate. *Id.* at 7.

In its Exception No. 6, the OCA also excepts to the ALJs’ recommendation and maintains that a normalization period of 45 months, based on the average time between the Company’s last four rate case filings, including this case, resulting in a normalized claim of $86,933, is appropriate. Like I&E, the OCA argues that the practice of utilizing historic filing frequency to establish the normalization period for rate case expense should not be deviated from. OCA Exc. at 12-13.

In its replies, Citizens’ urges the Commission to accept the ALJs’ recommendation to approve its claim for rate case expense to be normalized over a 36‑month period, reiterating its argument regarding the prospective nature of ratemaking, which allows for the consideration of factors other than simply the historic filing frequency of a utility, such as its limited prospects for load growth, increased capital expenses and tree trimming costs. Citizens’ R. Exc. at 4-5.

The Company also challenges the assertions of I&E and the OCA by stating that historic filing frequency is only one factor the Commission considers in determining rate case normalization. According to Citizens’, the goal of ratemaking is prospective in nature and the Commission may consider other factors to ensure its final decision reasonably reflects future conditions when new rates take effect. *Id.* at 5.

**(4) Disposition**

We agree with the ALJs’ recommendation that Citizens’ be permitted to normalize its rate case expense claim of $326,000 over a 36-month period. We find merit in the Company’s assertion that it is likely to file its next rate case within 3 years, as opposed to a longer time period and the record in this case supports such a conclusion. R.D. at 40-43.

As asserted by Citizens’, we find that I&E and the OCA each failed in their Exceptions to account for record evidence supporting the Company’s proposed normalization period. Citizens’ R. Exc. at 4-5. Contrary to the claims of I&E and the OCA, substantial evidence exists to support deviation from the Commission’s common practice of setting a normalization period for rate case expense based only on historic filing frequency. We note that this practice of relying on historic filing frequency is not an absolute and each case should be decided on the basis of evidence of historic filing frequency and future expectations. Examination of the record in this case indicates that both historic frequency and future expectations support the 36-month period used by the Company and adopted in the R.D. Citizens’ M.B. at 55-57.

We note further that this proceeding is premised on the use of a FPFTY and the recognition that certain expenses may be based on future expectations. Consistent with our determination in the *UGI Order*,the normalization period for rate case expense is one of those expenses. Thus, we may depart from the common practice of setting a normalization period based on historic filing frequency where substantial evidence exists to support a different normalization period. Such is the case here, where Citizens’ has enumerated convincingly the reasons that support a shortened filing frequency cycle.

Accordingly, we approve Citizens’ total rate case expense claim of $326,000 to be normalized over 3 years, consistent with its historic and anticipated frequency of base rate proceedings, and with prior Commission proceedings. This would result in a normalized claim of $108,667. Citizens’ St. 4-R at 5; Citizens’ R. Exc. at 4-5; Citizens’ M.B. at 54-57; R.D. 40-43.

#### Depreciation Expense

**(1) Positions of the Parties**

As a result of the Company’s use of the end of test year rate base, Citizens’ has based its test year depreciation expense on the projected balance of plant in service as of the end of the FPFTY. Citizens’ St. 1-R at 13.

The OCA recommended an adjustment to the depreciation expense in order to reflect its proposed use of an average test year rate base instead of the Company’s proposed end of test year rate base. The OCA asserted that the Company should base its depreciation expense on average plant in service in the FPFTY. Thus, the OCA submitted that the Company should use an average test year rate base; the OCA claimed that the accumulated depreciation expense should be reduced by $22,663. OCA R.B. at 21; OCA St. 2 at 7-8.

**(2) Recommended Decision**

Consistent with their recommendation that Citizens’ be permitted to utilize end-of-year methodology in its FPFTY, the ALJs recommended that the Commission adopt Citizens’ claim for depreciation expense. R.D. at 44-45.

**(3) Exceptions and Replies**

In its Exception No. 1, the OCA argues that if the Commission adopts the OCA’s proposed use of the average rate base, the depreciation expense should be adjusted accordingly. Specifically, the OCA submits that Citizens’ FPFTY claim for depreciation expense of $1,029,328 should be reduced by $22,663 in order to reflect the OCA’s proposed use of the average rate base methodology as opposed to the Company’s proposed end-of-year methodology. OCA Exc. at 2-5.

The Company responds that, consistent with its use of the end-of-test year rate base, Citizens’ has appropriately based its FPFTY depreciation expense on the projected balance of plant in service as of the end of the FPFTY. Citizens’ R. Exc. at 15‑16.

**(4) Disposition**

For the reasons set forth in our disposition of the issue pertaining to the OCA’s recommended adjustment to rate base, reflective of its advocacy for an average rate base approach, as opposed to the Company’s end-of-year methodology, *supra*, we find that the ALJs properly permitted Citizens’ to use the end-of-year methodology in its FPFTY. Accordingly, we shall deny the Exception of the OCA on this issue and adopt the Company’s annual depreciation expense for the FPFTY in the amount of $1,029,328.

## Fair Rate of Return

### Cost of Common Equity

**a. Positions of the Parties**

In the instant proceeding, Citizens’, I&E and the OCA presented their respective positions on reasonable rate of ROE. The OSBA did not take a position. The following table summarizes the cost of common equity claims made and the methodologies used by the Parties in the proceeding:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Party** | **DCF** | **CAPM** | **RPM** | **CAPM / ECAPM** | **CE** | **ROE** |
| **Citizens’** | 8.27% | 8.27% | 9.57% | 8.82% | 9.43% | 10.30%[[12]](#footnote-13) |
| **I&E** | 8.10% | 7.59% |  |  |  | 8.10% |
| **OCA** | 8.16 - 8.51% | 8.76% - 8.92% |  |  | 8.38%[[13]](#footnote-14) |

As indicated in the table above, Citizens’ recommended a 10.30% ROE, which is based on its proposed capital structure of 49.33% long term debt and 50.67% common equity.

The OCA recommended a fair overall rate of return of 6.64%, which includes an ROE of 8.38%. The OCA stated the Company’s request on equity of 10.30% is inappropriate and should be rejected because it is in excess of objective assessment of investor market requirements in the current economic environment. The OCA noted that its DCF analysis was checked by the CAPM. OCA M.B. at 35-36.

I&E recommended a 6.50% overall rate of return and an 8.10% ROE. In addition, I&E noted it used the DCF methodology and the CAPM method to verify the reasonableness of the DCF results. I&E M.B. at 27-28.

The Company’s recommended 10.30% ROE is based on Citizens’ witness D’Ascendis applying several cost of common equity models (DCF, CAPM, and the RPM) to the market data of the electric proxy group. Further, Mr. D’Ascendis applied the DCF model, RPM, and the CAPM to domestic, non-price regulated entities comparable in total risk to the electric utility proxy groups (non-price regulated proxy groups). The Company noted that this “multiple models” approach is consistent with best practices supported by the Commission’s policy of relying primarily on the DCF but referencing other models to ensure the overall ROE recommendation is reasonable. Citizens’ M.B. at 62-64 (citing Citizens’ St. 2 at 4-5).[[14]](#footnote-15)

Citizens’ presented the results derived from D’Ascendis’ methodology as Exh.\_(DWD-1R), Sch. 1R at 2. Citizens’ St. 2 at 4-5.

Citizens’ opined that in setting a utility’s ROE, it is important to utilize multiple models, because limiting the focus to any one model may result in understating the utility’s cost of equity. Thus, in the Company’s view, the use of multiple models adds reliability to the estimation of the common equity cost rate. According to Citizens’, the prudence of using multiple cost of common equity models is supported by both financial literature and regulatory precedent. Therefore, in addition to the DCF and CAPM methods, Citizens’ proposed the use of two additional methods, outlined below. Citizens’ M.B. at 73-76.

In addition to using the DCF and CAPM models, Citizens’ conducted a risk premium (RP) analysis. Citizens’ argued that an RP analysis seeks to quantify the additional ROE demanded by investors to account for the greater equity investment risk as compared to debt capital. Citizens’ stated that under an RP analysis, the cost of common equity equals the expected cost rate for long-term capital, plus a risk premium over that cost rate, to compensate common shareholders for the added risk of being unsecured and last-in-line for any claim on the corporation's assets and earnings upon liquidation. Citizens’ explained that its RP analysis averaged the results of two analyses. The first analysis was the Predictive Risk Premium Model (PRPM), which directly estimates the risk premium for equity capital investment based on an evaluation of the actual variance between historical equity risk premiums. The second analysis was the total market RP approach, which relies on known metrics to develop prospective RP model cost rates. Citizens’ determined a PRPM cost rate of 9.69% for its proxy group, and a total market RP cost rate of 9.44%, for a combined RP cost of capital of 9.57%. Citizens’ M.B. at 67-68; Citizens’ St. 2-R, Exhibit \_DWD-1R, Sch. DWD-1R at 27.

Citizens’ also conducted a CE analysis in which it calculated equity cost rates based on the application of the above-referenced DCF, RP, and CAPM models to a proxy group of domestic, non-price regulated companies. Citizens’ reasoned that this CE method provides a valuable indicator of anticipated investor returns for public utilities. Citizens’ opined that, because the purpose of rate regulation is to be a substitute for marketplace competition, non-price regulated firms operating in the competitive marketplace make an excellent proxy, if they are comparable in total risk to the gas proxy groupbeing used to estimate the cost of common equity. Therefore, Citizens’ alleged that this information is relevant to the Commission's consideration of an appropriate ROE for the Company. Citizens’ explained that applying its DCF, RPM, and CAPM analyses to its non-price regulated proxy group resulted in a CE cost of common equity of 9.43%. Citizens’ M.B. at 69-72.

The OCA also utilized an RPM and explained that the basic RP model consists of a bond yield plus a risk premium. The OCA submitted that, while the RPM, like the CAPM, has limitations when compared to the use of the DCF model, the RPM, nonetheless, provides an additional secondary method reasonableness measure in comparison to the DCF results. As previously noted, the OCA combined its CAPM and RPM analyses and determined a CAPM/RPM median of 8.76% and average of 8.92%, which, it asserted, confirms the validity of the OCA’s DCF results, because they provide upper limits not to be exceeded. OCA M.B. at 51-54.

The OCA opposed the Company’s use of the CE method. The OCA submitted that, contrary to the Company’s assertions, the Company’s proxy group of non-price regulated companies is not similar in risk to its proxy group of electric utilities. Rather, the OCA alleged that the common equity cost estimates for Citizens’ non-price regulated proxy group is systematically higher than its utility common equity cost estimates by 66 to 208 basis points. As such, the OCA submitted that non-price regulated proxy group results should be given no weight in determining the Company’s allowed ROE. OCA M.B. at 58.

I&E opposed both the use of the RPM and the CE method. I&E claimed that the RPM is a simplified version of the CAPM. Therefore, I&E took the position that, in addition to posing the same pitfalls as the CAPM,the RPM does not recognize company-specific risk through beta. With regard to the CE method, I&E argued that determining which non-regulated companies are comparable in risk to electric utilities is subjective, and that it is debatable whether historic accounting values are representative of the future. I&E claimed that, because the Commission has long recognized this problem, the historic usage of the CE method in this regulatory forum has been minima1. I&E M.B. at 39.

**b. Recommended Decision**

The ALJs agreed with the recommendation of I&E and the OCA that the DCF and CAPM models are the preferred models to determine an appropriate cost of common equity and did not see a reason to deviate from those methods. The ALJs referenced the Commission’s reliance on the DCF model in a prior proceeding. Specifically, in *Pa. PUC v. PPL Electric Utilities Corporation*,Docket No. R‑2012‑2290597 (Order entered December 28, 2012) (*2012 PPL Order*),the Commission explained that the DCF method applied to a barometer group of similar utility companies has historically been the primary determinant to estimate the cost of equity. Further, the Commission stated the DCF model assumes that the market price of a stock is the present value of the future benefits of holding the stock, and these benefits are the future cash flows of holding the stock. Therefore, the Commission determined that because dollars received in the future are worth less than present day dollars, the cash flow must be “discounted” back to the present value at the investors rate of return. R.D. at 51-52 (citing *2012* *PPL Order* at 96-97).

The ALJs further referenced a more recent proceeding that relied on the DCF method and denied giving equal weight to other methods. In the *UGI Order*, the ALJs adopted the positions of I&E and the OCA that the DCF method should be the primary method used to determine the cost of common equity, and that the results of the CAPM should be used for comparative purposes with the DCF results. Similar to the proceeding for the *UGI Order*, the ALJs in the instant proceeding did not see a reason to deviate from the historical, preferred methodology. R.D. at 52 (citing *UGI Order* at 103‑106).

**c. Exceptions and Replies**

In its Exception No. 9, Citizens’ argues that in developing an ROE that is based solely on the Company’s DCF analysis, the ALJs erred in declining to consider multiple methods to determine the appropriate ROE for the Company. According to Citizens’, the record in this proceeding presents evidence regarding market-to-book (M/B) ratios that demonstrates solely relying on DCF results in the current market environment will understate the appropriate rate of return for the Company by more than 100-basis points. The Company believes that the Commission should incorporate the multiple evidence models presented by Company witness D’Ascendis in determining Citizens appropriate ROE. Citizens’ Exc. at 18-22.

Citizens’ claims that the record evidence presents DCF results that will understate the appropriate rate of return for the Company. Citizens’ explains that even though the Recommended Decision quoted select material from the Commission’s decision in the *UGI Order*, language from the *UGI Order* that demonstrates the Commission will consider other methods where appropriate is not included in the Recommended Decision. Specifically, the Company references language from the *UGI Order* that indicates other cost of equity methods, to some degree, will be considered by the Commission, to determine the reasonableness of equity return, where evidence based on those other methods indicates the results of the DCF method may understate the utility’s current cost of equity capital. Citizens’ Exc. at 19 (citing Citizens’ M.B. at 74; *UGI Order* at 104-105).

Citizens’ presents Mr. D’Ascendis’ analysis of M/B ratios of the combined I&E and the OCA electric utility proxy groups, and notes the M/B value for the combined proxy group has significantly exceeded the 1.65 ten-year average, with particularly high M/B ratios since 2018. Further, the Company explains the DCF model assumes a M/B ratio of 1.0, meaning the model will overstate, or understate, the required ROE if the actual M/B value of the proxy group diverges from 1.0. Citizens’ Exc. at 19-20 (citing Citizens’ M.B. at 75). However, the Company continues, this effect is mitigated when the M/B ratio is at, or close to, 1.0. Therefore, Citizens’ submits that based on Mr. D’Ascendis’ M/B ratio analysis in the current environment, the DCF model will understate the ROE for the Company. Citizens’ Exc. at 20.

The Company adds that “extensive supporting evidence” was presented by Mr. D’Ascendis to corroborate his M/B analysis. According to Citizens’, Mr. D’Ascendis reviewed financial literature concluding that when the M/B ratio of a stock exceeds “unity,” the application of the standard DCF model to utility stocks understates the investor’s anticipated return. Further, Citizens’ claims I&E and the OCA’s ROE results are unreasonable because Mr. D’Ascendis applied the I&E and the OCA cost rates to book value instead of market value, which reduced the I&E and the OCA growth rates from 4.69% and 5.15% at market value, to 0.23% and 0.81% at book value. The Company also asserts that Mr. D’Ascendis applied the I&E and the OCA DCF models to the book value capital structure of the respective proxy group. Citizens’ explains that because the Recommended Decision relies on a DCF model with a market value capital structure, Mr. D’Ascendis’ application corrected “the apples-to-oranges result of the R.D.” and, therefore, increases the DCF ROEs for I&E and the OCA more than 100-basis points. Citizens’ Exc. at 21 (citing Citizens’ M.B. at 76).

Citizens’ is of the opinion that while the Recommended Decision does establish 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, it declines to consider analysis based on other models proposed by the Company, even though the results of the other models indicate the DCF results may be understated. Accordingly, the Company requests the Commission grant its Exception and develop an ROE that is based on the proposed models and does not include a size adjustment. Citizens Exc. at 21-22 (citing R.D. at 52, 73-74).

In its Replies to Citizens’ Exception No. 9, the OCA submits that the ALJs correctly rejected the Company’s deviation from the preferred methods in determining the cost of common equity. The OCA cites *Pa. PUC v. Pennsylvania American Water Company*, Docket Nos. R-00038304, *et al.* (Order entered January 29, 2004) (*PAWC Order*), where the Commission, based on several historical decisions, determined that the DCF method is the preferred method of analysis to determine a market based common equity cost rate. OCA R. Exc. at 12-13 (citing *PAWC Order* at 83). The OCA further cites the *UGI Order*, where the Commission affirmed its reliance on the DCF method, and stated it found no reason to deviate from the use of the DCF method. OCA R. Exc. at 13 (citing *UGI Order* at 106). According to the OCA, the Commission has stated, “on numerous occasions,” its preference to rely upon the DCF methodology over other methods in determining the rate of return.[[15]](#footnote-16) OCA R. Exc. at 14.

The OCA suggests that Citizens’ contention that reliance on the DCF alone would “understate the appropriate rate of return” disregards the use of the CAPM, which as the ALJs stated, is a verification of the DCF results. OCA R. Exc. at 14 (citing Citizens’ Exc. at 19; R.D. at 56). The OCA also cites a quote from the *PAWC Order* that describes the DCF model from a leading treatise on public utility ratemaking. OCA R. Exc. at 14-15 (citing *PAWC Order*). Further, the OCA contests the accuracy of the Company’s suggestion that the ALJs established the recommended ROE at the high end of the standard deviation range based on the average of the Company’s mean and median constant growth DCF results. Rather, the OCA argues that the use of the high end standard deviation is the ALJs’ attempt to acknowledge “the risk of a smaller utility.” *Id.* (citing Citizens’ Exc. at 21; R.D. at 51, 74).

In its Replies to Exception No. 9, I&E avers that the ALJs correctly declined to accept Citizens’ M/B ratio analysis to determine ROE, and that the ALJs did not err by relying primarily on a DCF analysis that was verified by CAPM. Further, I&E asserts the Company’s Exception depends on the Company’s M/B ratio analysis, which I&E believes is insufficient support to demonstrate that the DCF results are understated, or that the expected utility returns for investors should be set on a basis other than book value. Moreover, I&E argues the ALJs should not be expected to use, or equally weight, any method offered to verify the results of the DCF analysis. In addition, I&E references the *UGI Order* proceeding in acknowledging the consistency of the Commission to utilize the CAPM method as a check for the DCF analysis. I&E R. Exc. at 7-8 (citing Citizens’ Exc. at 19-22; I&E M.B. at 46-47).

**d. Disposition**

Upon our consideration of the record evidence, we agree with the finding of the ALJs that the Company’s cost of equity in this proceeding should primarily be based upon the use of the DCF methodology and that the results of the CAPM analysis should be used as a comparison to the DCF results. R.D. at 51-52. At the outset, we note the validity of the Company’s argument, in its Exceptions, that in the *UGI Order,* we stated that when evidence based on other cost of equity methods indicates that the reliance on only the DCF results may understate the utility’s cost of equity capital, we would give credence to those other methods, to an extent, in evaluating the appropriate range of reasonableness in setting an ROE. Citizens’ Exc. at 19; *UGI Order* at104-105. However, in the *UGI Order*,we also found that UGI failed to demonstrate on the record that the DCF method understated its ROE or that the other methods it proffered served as an aid in arriving at the appropriate cost of common equity. *UGI Order* at 105-106. We likewise find in the instant case that Citizens’ has failed to present a valid reason for why the other methods it has proffered should be given equal weight to the DCF method.

First, we are not persuaded by the Company’s argument that the difference between the market value of a utility’s stock and its book value causes the DCF method to undervalue the rate of return when the M/B ratio of a given stock exceeds unity. Citizens’ M.B. at 75-76; Citizens’ St. 2-R at 11-12. Rather, as I&E highlighted, the Company’s argument assumes that investors are unaware of the difference between the book value and the market value. The record indicates that the forecasted growth rates used in the DCF method are set by analysts based on current conditions, as well as future expectations for the stock. The stock market is impacted by regulatory policies and by economic and financial conditions. Therefore, while an M/B ratio greater than 1.0 implies that investors expect future cash flows to be more valuable than the historical accounting value of the company, an M/B ratio of less than 1.0 could result either when the stock market is in depression or when the company is underperforming. I&E St. 2‑SR at 12-13. Therefore, in establishing an ROE for regulatory purposes, we find that it is not appropriate to evaluate the results of the DCF using an M/B ratio.

Second, as to the RPM approach, the record indicates the Company’s PRPM analysis, which it used as an input in developing its RPM cost of equity, is a specialized form of the RPM. Citizens’ St. 2 at 20-21; I&E St. 2 at 32-33. Further, as noted above, the RPM is an indirect measure of the cost of equity, because it does not recognize company-specific risk through beta. In addition, the RPM relies on the use of historic data that may not accurately represent the current or future economic conditions. For these reasons, we find that Citizens’ has failed to demonstrate that any weight should be given to its use of the RPM in setting an appropriate cost of equity.

Third, we reject the Company’s use of the CE method. As both I&E and the OCA pointed out, the CE method utilizes data for non-regulated firms. Thus, by its very nature, determining which companies are comparable under the CE method is entirely subjective. In addition, the record evidence indicates that the proxy group of domestic, non-price regulated companies that Citizens’ utilized in conducting its CE method included such companies as Campbell’s Soup, Hershey Co., and General Mills. Citizens’ St. 2, Exh\_DWD-1, Sch. DWD-7 at 6. Each of these companies operate in industries that are very different from a utility company and have significantly more competition, which would require a higher return for the associated additional risk. Indeed, as the OCA noted, the Company’s common equity cost estimates for its non-price regulated proxy group are systematically higher than the Company’s utility common equity cost estimates by between 66 and 208 basis points, indicating that the two proxy groups are not similar in risk. OCA M.B. at 58.

Additionally, as both I&E and the OCA noted, we have expressly endorsed the use of the DCF method as the primary method for setting a utility’s cost of equity capital in several other rate proceedings that have come before the Commission. For example, in addition to our recent decision in the *UGI Order*,we affirmed the use of the DCF as our preferred methodology in the *2012* *PPL Order*, and again, more recently, in *Pa. PUC, et. al v. City of Dubois-Bureau of Water*, Docket No. R‑2016‑2554150, *et. al.* (Order entered March 28, 2017). Because Citizens’ has not presented substantial evidence on the record that would cause us to deviate from the use of the DCF method as the primary ROE setting method in the instant case, we shall reject the Company’s arguments. Accordingly, Citizens’ Exception No. 9 is denied and we adopt the ALJs’ recommendation that the Company’s cost of equity in this proceeding should primarily be based upon the use of the DCF methodology and that the results of the CAPM analysis should be used as a comparison to the DCF results.

### Return on Common Equity: Size Adjustment

**a. Positions of the Parties**

Citizens’ proposed a 100-basis point size adjustment to account for the additional risks associated with smaller public utilities. The Company argued that analysis and research by witness D’Ascendis supports a 470-basis point adjustment; however, Citizens’ recommends a “conservative size adjustment” of 100-basis points. Citizens’ M.B. at 96 (citing Citizens’ St. 2 at 45).

Citizens’ averred that the question relevant to whether a size adjustment is necessary to appropriately reflect the Company’s risk factors is whether Citizens’ is considerably smaller than the companies in the electric utility proxy group. The Company explained a market capitalization analysis was conducted by witness D’Ascendis to quantify the size risk. Citizens’ stated Mr. D’Ascendis’ analysis found that Citizens’ had a market capitalization of $26.840 million. The Company added that when compared with an average company market capitalization of $16,675.447 million for the electric utility proxy group, this results in the group being 621.3 times greater than the Company. Citizens’ M.B. at 96 (citing Citizens’ St. 2 at 44).

The Company revealed Mr. D’Ascendis quantified the appropriate size adjustment by relying on “size premiums for portfolios of New York Stock Exchange (NYSE), American Stock Exchange (AMEX), and NASDAQ listed companies ranked by deciles for the 1926 to 2018 period.” The Company explained the $16.7 billion market capitalization for the electric proxy group ranked in the 2nd decile, while the $26.8 million market capitalization for Citizens’ ranked in the 10th decile, resulting in a size premium spread of 4.70%. *Id.* (citing Citizens’ St. 2 at 45). Further, Citizens’ noted Mr. D’Ascendis refined his analysis to include the average market capitalizations of the I&E and OCA proxy groups and found similar results. *Id.* (citing Citizens’ St. 2-R at 32; Citizens’ Exh.\_(DWD-1R), Sch. DWD-5R.). Accordingly, Citizens’ recommended a size adjustment of 100-basis points (or 1.00%) to the Company’s ROE. *Id.* (citing Citizens’ St. 2 at 45).

The OCA witness Dr. David S. Habr testified that an additional 100-basis point adjustment to ROE would be a burden for ratepayers. Specifically, Dr. Habr stated, upon review of a Duff & Phelps study on ordinary least squares (OLS) betas and size premiums data for each size decile, positive size premiums are associated with OLS betas that are greater than one. Dr. Habr noted that all of the utility holding companies in the proxy groups in this proceeding have betas that were calculated using OLS and have values less than one. Therefore, Dr. Habr suggests that if any adjustment is made for size, it should be a negative adjustment. OCA R.B. at 30-31 (citing OCA St. 3 at 29-30). In addition, Dr. Habr commented that if a utility company chooses to operate at such a small scale that its cost of common equity is increased, there is no reason for the company’s customers to pay for increased costs resulting from the inefficient size of the utility. OCA M.B. at 60 (citing OCA St. 3 at 29-30).

Citizens’ disputed the OCA’s position, stating its opposition to the size adjustment lacks merit. Citizens’ M.B. at 99. Specifically, the Company stated that the OCA does not offer an explanation to support its contention that OLS beta is more relevant than market capitalization to assess size risk. Further, Citizens’ offered that its calculated size premium represents the *spread* between Citizens’ decile size premium and the average proxy group decile size premium. *Id.* (emphasis in original). The spread between decile 10 and decile 1, the Company continued, remains consistent with Citizens’ proposed size adjustment of 100-basis points, as demonstrated by the size premiums chart provided in OCA’s testimony. Citizens’ M.B. at 99.

In addition, Citizens’ argued that the OCA argument that public utility customers should not be required to pay higher costs through a size adjustment runs contrary to the *Bluefield* standard and should not be given weight. The Company stated that the OCA’s argument that the Company’s operations are “inefficient” should be disregarded because it does not make an effort to quantify the customer benefits of being served by a smaller public utility, such as Citizens’. *Id.*

I&E witness Anthony Spadaccio opposed Citizens’ size adjustment claims, citing the year-to-year variance of returns for large and small capitalization stocks listed on the NYSE, AMEX, and NASDAQ. Further, Mr. Spadaccio opined that the Company’s size adjustment is unnecessary and not appropriate because the technical literature supporting investment adjustments related to the size of a company is not specific to the utility industry. In addition, Mr. Spadaccio cited an article,[[16]](#footnote-17) stating a size adjustment for risk is not applicable to utility companies. I&E M.B. at 50-51.

The Company responded to I&E’s argument by pointing out inaccuracies in the article cited by Mr. Spadaccio. Specifically, Citizens’ noted the study in the article understates the impact of size risk, because the author of the article erroneously equates “a change in size to beta coefficients, which accounts for only a small percentage of diversifiable company specific risk.” Furthermore, the Company cited a more recent article[[17]](#footnote-18) that criticized the study in the article cited by I&E. The article cited by Citizens’ noted there is support for smaller utilities being more risky than larger ones, to the extent that water utilities are representative of all utilities. Citizens’ M.B. at 97 (citing Citizens’ St. 2-R at 33).

I&E’s response to the Company argued that the article cited by Citizens’ does not contain enough credible evidence to refute the findings cited by the author of the original article on the subject. I&E M.B. at 51-52.

Citizens’ countered by citing a study conducted by witness D’Ascendis on whether size effect is applicable to utilities. Specifically, the Company states Mr. D’Ascendis’ study calculated the ten-year coefficient of variation of net profit (or measure of risk) and current market capitalization (or measure of size) from each of the utilities’ *Value Line Ratings & Reports*. Mr. D’Ascendis concluded, after ranking the companies by size and risk, that approximately 9% of the change in risk is explained by size. Citizens’ M.B. at 98-99 (citing Citizens’ St. 2-R at 35-36).

**b. Recommended Decision**

The ALJs recommended Citizens’ ROE be based upon the higher end of the DCF range to ensure a market-based result is utilized, while acknowledging the risk of a smaller utility. The ALJs stated Citizens’ is significantly smaller than the companies in the proxy group, and it would face proportionally greater financial and business risk than a larger size utility. The ALJs concluded that a smaller company would be impacted to a greater extent by such factors as storms, the loss of large customers, or events that impact the sale of electricity.

Further, the ALJs recommended use of one standard deviation range of 7.05% to 9.49%, based on the average of the Company’s mean and median constant growth DCF results. The ALJs represented the DCF results by utilizing a 9.49% valuation because the top of Citizens’ range falls below the top of the range for both I&E and the OCA. R.D. at 73-74.

The following charts summarize the results of the ALJs’ recommended standard deviation range:

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

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

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

R.D. at 74.

**c. Exceptions and Replies**

In its Exception No. 4, I&E avers that because Citizens’ has failed to meet its burden of proof to provide justification for a size adjustment for utility companies, the Commission should reject a size adjustment to the ROE. Moreover, I&E adds that because Citizens’ is the party with the burden of proof, the dispositive factor is that size risk for utilities has not been established. I&E is of the opinion that the ALJs’ erred by finding that the evidence is substantial enough to support a size adjustment and award the Company an ROE at the highest point of a standard deviation range for the DCF analysis. I&E further asserts that any support of size risk generally should not constitute evidence of size risk for a utility. I&E Exc. at 8-9 (citing R.D. at 72-74). I&E notes the Commission’s rejection of such a size adjustment in the *UGI Order*. *Id*. Further, I&E offers that monopoly utilities are not subject to the market-based risks that face competitive companies included in a general size adjustment analysis. I&E adds that if Citizens’ faces difficulties or unforeseen risks, the Company may request higher rates to offset increased expenses. I&E Exc. at 9.

The OCA in its Exception No. 7 likewise excepts to the ALJs’ recommendation and reasoning, contending that the ALJs erred in utilizing a DCF result of 9.49% in order to accommodate the Company’s desired size adjustment. The OCA submits that the recommendation to award an ROE of 9.74% is not consistent with the evidence or the low cost of capital environment. OCA Exc. at 14, 17. Regarding the Company’s argument that investors demand greater returns to account for the associated size risk, the OCA remains of the opinion that a size adder to ROE would be unduly burdensome for ratepayers, and the economic literature presented by the Company actually supports a downward adjustment. OCA Exc. at 15-16 (citing R.D. at 65; OCA M.B. at 59-60; OCA St. 3 at 29-30). Further, the OCA asserts that the ALJs’ reasoning that Citizens’ faces size risk because it is a smaller company conflicts with ratemaking principles, particularly because utilities are natural monopolies and should be treated as such. OCA Exc. at 17 (citing R.D. at 72).

The OCA further argues that the ALJs’ adoption of the higher end of the DCF range is a violation of the OCA’s CAPM limit analysis. Moreover, the OCA continues, the ALJs adopted the Company’s CAPM analysis, which the OCA witness Dr. Habr found to be unreasonable. The OCA explains that the Company’s CAPM analysis relied on an average 3.36%, 30-year treasury yield, based on a period covering the second quarter of 2019 through 2029, and Dr. Habr states that the purpose of a test year in utility regulation is not to base test year costs on possible future period costs. Rather, Dr. Habr affirms the purpose of test year costs is to match the costs incurred in a year with the services provided during that year. Accordingly, the OCA offers a modified CAPM/Risk Premium analysis. OCA Exc. at 18; OCA M.B. at 54, 56-57; OCA St. 3 at 34.

In its Exception No. 10, Citizens’ states that, in developing a recommended ROE for the Company, the ALJs erred in failing to apply the Company’s requested 100‑basis point adjustment for size risk to the ROE. The Company elaborates that, while it appreciates the acknowledgement of size risk, the Company submits that the standard deviation methodology developed by the ALJs results in an ROE that is commensurate with the ROEs established for much larger EDCs, and does not truly reflect Citizens’ size risk. Therefore, Citizens’ asserts that 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%. Citizens’ Exc. at 22-23 (citing R.D. at 72, 74).

Citizens’ is of the opinion that the process of setting an ROE within a standard deviation of the mean or median DCF results does not reflect size risk. The Company explains that the Commission applied 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 the Distribution System Improvement Charge (DSIC) for an electric utility, and DSICs are primarily applicable to large EDCs. Therefore, the Company believes the Commission should apply a size adjustment to the result of the standard deviation method approved by the Recommended Decision. Citizens’ Exc. at 23 (citing Citizens’ M.B. at 85).

Further, Citizens’ remains of the opinion that the results of its analysis of the Company’s size risk relative to the proxy group companies corroborates the reasonableness of the Company’s proposed 100-basis point adjustment. Citizens’ reiterates that Company witness D’Ascendis calculated a 4.70%, or 470-basis point, size premium spread between the Company and the proxy group of companies. Therefore, Citizens’ avers that the Commission should apply the 100-basis point size adjustment to any ROE that the Commission would otherwise award to a larger EDC. Citizens’ Exc. at 23-24 (citing Citizens’ M.B. at 96).

Citizens’ replies that both arguments by I&E and the OCA should be rejected because they are misguided and lack support. Citizens’ adds that granting their Exceptions would improperly result in a historically low ROE for a regulated utility. Citizens’ R. Exc. at 8 (citing I&E Exc. at 9; OCA Exc. at 16, 18; Citizens’ M.B. at 77‑78).

In response to I&E’s claim that the Company failed to meet its burden of showing size risk exists for utilities, Citizens’ replies that the ALJs appropriately determined I&E failed to support its counterargument that even if small companies face size risk, utilities are exempt. Citizens’ R. Exc. at 8-9 (citing I&E Exc. at 8-9; R.D. at 72; *Pa. PUC v. Duquesne Light Company*, Docket Nos. R-2018-3000124, *et al.* (Order entered December 20, 2018) at 71). Citizens’ further states that in contrast to I&E’s Exception, Company witness D’Ascendis conducted an unrebutted analysis that presents unrebutted evidence of an inverse relationship between utility size and risk. Citizens’ R. Exc. at 9-10 (citing Citizens’ M.B. at 98-99).

Similarly, Citizens’ replies that the OCA fails to support its contentions that the ALJs’ conclusion that a size adjustment is warranted and the ALJs’ adoption of the standard deviation method to account for the Company’s size risk. Citizens’ R. Exc. at 10 (citing OCA Exc. at 15-18). Citizens’ adds that as concluded in the Company’s Main Brief, the OCA’s argument that adjusting for size risk for the Company is inappropriate defies logic because the size adjustment is intended to reflect the size premium spread. Citizens’ R. Exc. at 10-11 (citing Citizens’ M.B. at 99). Further, Citizens’ remains of the opinion that the OCA’s CAPM/Risk Premium model is an unfounded analysis that does not utilize a risk-free rate based on a forecast period. Citizens R. Exc. at 12 (citing Citizens’ M.B. at 87-88; Citizens’ St. 2-R at 56-57).

In its Replies, I&E requests that the Commission reject Citizens’ Exception to adjust the Company’s ROE to 10.30% because Citizens’ has not demonstrated the ALJs erred by not further adjusting the Company’s size adjustment.[[18]](#footnote-19) I&E elaborates that the Company is asking the Commission to abandon any methodological analysis and conclude that the ALJs’ recommended ROE is similar to DSIC ROEs, from which an additional size adjustment is necessary. Further, I&E claims that Citizens’ provides no reasoning as to why the Company should be awarded the upper end of one standard deviation of its DCF analysis, other than stating the Commission determines the ROE for DSICs using the same method. Moreover, I&E asserts that the Company’s reliance on the standard DSIC ROE for electric utilities is misplaced because it does not account for any specific facts or analyses in the instant proceeding. I&E R. Exc. at 8-10 (citing Citizens’ Exc. at 22-24; I&E R.B. at 17-19).

In its Replies, the OCA similarly states that the Company’s request for a 100-basis point adjustment should be denied by the ALJs. To justify rejecting such an adjustment, the OCA references the testimony of witness Dr. Habr, in which he explained why Citizens’ should not be awarded a size premium and if any adjustment is made for size, it should be a negative adjustment rather than positive. OCA R. Exc. at 15-17 (citing OCA St. 3 at 29-30). The OCA notes that I&E opposes the size adjustment as well, referencing the I&E witness testimony of Mr. Spadaccio that challenged the applicability of utility industry source material. OCA R. Exc. at 17 (citing I&E St. 2 at 41-42). Further, the OCA remains in a state of disagreement with the ALJs’ conclusion that Citizens’ faces size risk because it is a smaller company, and the ALJs’ recommendation based on a DCF result of 9.49%, particularly to reflect a size adjustment for the Company. OCA R. Exc. at 17-19 (citing R.D. at 72, 74; OCA M.B. at 44, 54).

**d. Disposition**

Based upon the evidence of record, we agree with the recommendation of the ALJs that the Company be awarded a DCF cost of common equity of 9.49%, which is one standard deviation above the average of the mean and median proxy group ROE from the Company’s DCF analysis. In so doing, we recognize that the Company’s size is a factor in assessing its ability to attract capital. Accordingly, we shall reject Citizens’ Exception No. 10, I&E’s Exception No. 4, and the OCA’s Exception No. 7, consistent with the following discussion.

We are not convinced by the arguments of I&E and the OCA that the ALJs erred in awarding a size adjustment to Citizens’. Rather, we are of the same opinion as the ALJs that the Company’s witness Mr. D’Ascendis offered persuasive record evidence that there is a general inverse relationship between size and risk, such that smaller companies like Citizens’ face greater risk. In this regard, Mr. D’Ascendis testified that smaller companies face greater business risk because they have fewer resources to enable them to handle significant events that affect their sales, revenues, and earnings. Therefore, the loss of revenues from a few larger customers would have a greater effect on a small company than on a bigger company that has a larger and more diverse customer base. Citizens’ St. 2 at 41-42. Accordingly, we find it intuitive that, because smaller firms are riskier, investors will generally demand greater returns to compensate for greater assumed risk. Further, because the record evidence demonstrates that Citizens’ is significantly smaller in size when compared to the EDCs in its proxy group, we find that this weighs in favor of awarding the Company a size adjustment.

At the same time, however, we echo the ALJs that the Parties have presented offsetting arguments such that there is not substantial evidence to determine whether size is specifically a risk for utilities. As I&E and the OCA both noted, the technical literature presented by Citizens’ is not specific to the utility industry and also may not definitively support a size adjustment. Additionally, as I&E observed, the empirical study undertaken by the Company’s witness Mr. D’Ascendis illustrates the difficulty in predicting the risk effect of a company’s size. More specifically, while Mr. D’Ascendis used market information from the NYSE, the AMEX, and the NASDAQ, we find that I&E offered evidence indicating that for certain periods, large-capitalization stocks have outperformed small-capitalization stocks such that there is not sufficient correlation to prove that size is a specific risk for utilities. I&E St. 2-SR at 23-24. Therefore, we are not persuaded by the Company’s argument that the ALJs erred by not awarding Citizens’ a greater size adjustment. For this reason, we decline to award an explicit 100-basis point size adjustment, as advocated by Citizens’.

Consistent with the foregoing discussion, like the ALJs, we shall not specify an exact size adjustment. Instead, we shall adopt the ALJs’ recommendation that Citizens’ be awarded a DCF cost of common equity of 9.49%. In our view, this cost of equity is reasonable and strikes an appropriate balance by recognizing the general inverse relationship between a company’s size and its risk, while acknowledging that there is not substantial evidence in the record to prove that an explicit size basis point adjustment is warranted in this case.

### Return on Common Equity: Management Effectiveness Adjustment

**a.** **Positions of the Parties**

Citizens’ requested a 25-basis point management effectiveness adjustment to the cost of common equity. Both I&E and the OCA opposed any allowance for management effectiveness, generally on the basis that the utility company should not be rewarded for doing what it is required to do under the Code.

Citizens’ submitted that, in accordance with Section 523 of the Code, 66 Pa. C.S. § 523, the Commission is required to consider management effectiveness in setting a utility’s rates. The Company claimed the following initiatives and accomplishments warrant a performance adjustment: (1) low number of customer complaints; (2) favorable customer feedback; (3) high responsiveness to customer support calls and in energizing new service locations; (4) excellent reliability metrics; (5) no reportable injuries; (6) technological improvements in customer service by offering “Smarthub” use to customers and providing line crews with tablets; (7) increased pole attachment billing; (8) recognition as a “Tree Line USA” utility;[[19]](#footnote-20) (9) replacement of 40% of all streetlights in its service area with LED lights; and (10) continued significant capital investment of approximately $1.4 million per annum. Citizens’ M.B. at 90 (citing Citizens’ St. 4 at 9-12).

Further, Citizens’ described some of the aforementioned achievements in more detail, to highlight the weight of the Company’s accomplishments. The Company noted, *inter alia*: (1) each informal complaint between 2016-2018 was dismissed in 19 days or less by the Commission; (2) regarding high responsiveness, Citizens’ responded to 97% of customer phone calls within thirty seconds; (3) reliability metrics in 2018 indicate the Company met, or exceeded, all Commission reliability objectives; (4) Citizens’ realized a 9.2% increase in pole attachment billing from 2018 to 2019; (5) an increase in revenues from pole attachment billing aided Citizens’ in offsetting increased distribution system expenses and reducing the revenue requirement to be recovered from ratepayers; and (6) the Company’s continued investment of approximately $1.4 million per annum in system replacement and improvements. Citizens M.B. at 90-91 (citing Citizens’ St. 4 at Exhs. \_(JK-1), \_(JK-3)).

The OCA contested the descriptions offered by the Company, adding that any successful company must take these actions to efficiently maintain its operations and provide satisfactory customer service. Moreover, the OCA continued, regulated utilities are expected to operate efficiently and should not be given a reward for meeting its expectations. OCA M.B. at 60 (citing OCA St. 3 at 31).

I&E echoed the position of the OCA and asserted that true management effectiveness is earning a higher return through its efficient use of resources and cost cutting measures. I&E noted that greater net income resulting from growth, cost savings, and true efficiency in management and operations is available to be passed on to shareholders. Accordingly, I&E averred the Company should not be granted additional basis points for having provided adequate, efficient, safe, and reasonable service, as required by 66 Pa. C.S. § 1501. I&E M.B. at 50-51 (citing I&E St. 2 at 43).

**b. Recommended Decision**

The ALJs agreed with Citizens’ and recommended approval of the Company’s request that it be given a 25-basis point addition to its cost of common equity due to management effectiveness. Further, the ALJs noted a particularly remarkable or extraordinary level of efficiency or effectiveness or customer service is required for the Commission to award a management effectiveness adjustment. Moreover, the ALJs opined that there is simply no record evidence in this proceeding demonstrating that the Company operated in an inefficient or ineffective manner, or that it does not provide very good service to its customers. R.D. at 77.

**c. Exceptions and Replies**

In its Exception No. 8, the OCA argues that the Commission should expect its regulated utilities to provide safe, adequate, efficient, and reasonable service in accordance with the utilities’ public service obligation. Therefore, the OCA continues, a management effectiveness adjustment should only be awarded in truly exceptional circumstances after careful consideration. The OCA submits that Citizens’ failed to demonstrate that such circumstances exist in the present case. OCA Exc. at 19-20 (citing OCA M.B. at 60-63; OCA R.B. at 30-32).

 In its Exception No. 5, I&E excepts to the ALJs’ recommendation and argues that no utility company should reap additional rewards for simply meeting its obligations to provide safe and reliable service. However, I&E contends that, should the Commission find evidence that merits awarding ROE basis points, consistent with the Commission’s decision in the *UGI Order*, the Commission should award no more than five basis points. I&E Exc. at 10-11 (citing R.D. at 77; I&E St. 2-SR at 26; I&E M.B. at 50-51).

 Citizens’ replies that the similar arguments of I&E and the OCA should be rejected because the ALJs correctly weighed the indicators of the Company’s service and found merit in awarding the Company’s performance. Citizens’ R. Exc. at 13 (citing R.D. at 75-77; I&E Exc. at 10-11; OCA Exc. at 19-20). Citizens’ notes that it clarified its efforts to provide customer service and innovation above and beyond its regulatory obligations. Citizens’ R. Exc. at 13 (citing Citizens’ M.B. at 89-92). Citizens’ adds that while the Commission awarded a smaller performance adjustment in the *UGI Order*, the Company submits that the record in the instant proceeding reflects a greater degree of innovation, particularly involving the adoption of new technologies. Citizens’ R. Exc. at 14.

**d. Disposition**

Pursuant to the Code, the Commission may reward utilities through rates for their performance. In pertinent part, Section 523 of the Code, 66 Pa. C.S. § 523 provides:

**§ 523. Performance factor consideration.**

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

(b) **Fixed utilities.** – As part of its duties pursuant to subsection (a), the commission shall set forth criteria by which it will evaluate future fixed utility performance and in assessing the performance of a fixed utility pursuant to subsection (a), the commission shall consider specifically the following:

(1) Management effectiveness and operating efficiency as measured by an audit pursuant to Section 516 (relating to audits of certain utilities) to the extent that the audit or portions of the audit have been properly introduced by a party into the record of the proceeding in accordance with applicable rules of evidence and procedure.

\* \* \*

(4) Action or failure to act to encourage development of cost-effective energy supply alternatives such as conservation or load management, cogeneration or small power production for electric and gas utilities.

\* \* \*

(7) Any other relevant and material evidence of efficiency, effectiveness and adequacy of service.

In considering the record evidence and arguments before us, along with the Exceptions and Reply Exceptions of the Parties, we are persuaded by the arguments of Citizens’ regarding its management performance and the initiatives it has undertaken to improve its operations to increase reliability, increase attention to customer needs and customer satisfaction, and increase the overall effectiveness of the Company’s service. We are particularly cognizant of Citizens’ initiatives in, *inter alia*: (1) systematically replacing its aging distribution infrastructure, including replacing aged poles, increasing conductor size to provide greater operating flexibility and reliability, replacing underground cable, reconductoring to increase capacity and reliability, and relocating lines for reliability improvement; (2) making technological improvements in customer service by offering “Smarthub” use to customers to allow them to pay bills and track their usage electronically and providing line crews with tablets; (3) lowering customer complaints; (4) responding quickly to customer support calls and in energizing new service locations; (5) pole attachment billing through an electronic attachment mapping and audit project during 2018; and (5) continuing its commitment to proper tree pruning techniques which result in a more efficient vegetation management program and healthier trees. Citizens’ M.B. at 90-92.

We are of the opinion that the above initiatives of the Company warrant consideration as a factor in our final cost of equity allowance such that we will grant a management effectiveness adjustment. However, similar to our recent decision in the *UGI Order,* we shall not grant the full 25-basis point adjustment requested by Citizens’ and recommended by the ALJs. Rather, we shall apply a 5-basis point (*i.e.*, 0.05%) adjustment to the Company’s rate of return on equity. *See UGI Order* at 113-115. In our view, this adjustment is supported by the record as reasonable, appropriate, and conservative based on Section 523 of the Code and better serves the public interest*.* Accordingly, we shall grant the Exceptions of I&E and the OCA, in part, and deny them, in part, and modify the recommendation of the ALJs on this issue.

### Rate of Return on Common Equity

**a. Positions of the Parties**

As noted above, four methods of determining the cost of equity were presented for inclusion in the record in this proceeding: DCF, CAPM, RPM, and CE. Citizens’ relied on each of these methodologies in presenting its recommended rate of return on equity of 10.30%. This figure is inclusive of the requested performance factor adjustment of 0.25%. Citizens’ M.B. at 10, 64.

 As previously discussed, both I&E and the OCA took issue with the Company’s analysis in arriving at the proposed cost of equity and argued that equal weight should not be given to the four different methodologies as Citizens’ did in its evaluation. Additionally, both I&E and the OCA submitted that the Commission has indicated a preference for using the DCF method to establish reasonable common equity costs. I&E M.B. at 30, 37-38; OCA M.B. at 41, 54-55.

 As a result of its DCF analysis, I&E recommended a cost of common equity of 8.10%. I&E noted that its analysis recognizes the time value of money, is forward looking, and has regulatory acceptance. I&E M.B. at 31, 51.

The OCA recommended an 8.38% return on common equity primarily based on the results of its DCF model. The OCA noted that its recommendation is reasonably in line with the current economic conditions. OCA M.B. at 40.

**b. Recommended Decision**

As noted previously, the ALJs relied on the DCF method, and utilized the CAPM as a comparison. Accordingly, the ALJs used the top of Citizens’ DCF range of 9.49%, noting that it reflects Citizens’ status as a company of many magnitudes smaller than the companies in the proxy group. Further, the ALJs granted the Company’s request for a management effectiveness adjustment of 0.25%, resulting in a recommended ROE of 9.74%. R.D. at 78.

**c. Exceptions and Replies**

As discussed *supra*, I&E and the OCA disagree with the ALJs’ finding and argue that the record lacks substantial evidence to support either a DCF result of 9.49% in order to accommodate the Company’s desired size adjustment or the additional 0.25% management effectiveness adjustment requested to award the Company an ROE of 9.74%. I&E Exc. at 8-9; OCA Exc. at 14, 18-19.

**d. Disposition**

We have previously determined above that, consistent with Commission precedent, we shall use the DCF method as the primary method in establishing the Company’s cost of common equity and shall use the results of the CAPM method as a comparison to our DCF results. Therefore, we have adopted the ALJs’ recommendation to use a DCF cost of common equity rate of 9.49% to account for the fact that Citizens’ is a smaller utility. Additionally, we have determined that Citizens’ should receive a 5‑basis point upward adjustment to its cost of common equity because it has demonstrated management effectiveness. This is in lieu of the 25-basis point adjustment recommended by the ALJs.

Finally, we shall reject the Exception of the OCA that the ALJs’ recommendation that the Company’s DCF cost rate be set at the higher end of the DCF range violates the OCA’s CAPM/RP limits. First, while we have determined that the CAPM should be used as a secondary method to check for the reasonableness of the DCF results, we have rejected the use of the RP method in any regard in this proceeding. Second, as Citizens’ points out, the OCA’s argument would undermine the purpose of adding a size adjustment, which is to award an ROE that is greater than the result of the stand-alone ROE analysis given that smaller utilities face greater risk than larger utilities. It would also ignore the record evidence regarding the initiatives undertaken by the Company, which warrant that its ROE be increased to recognize its management effectiveness. Therefore, although we will not award the 10.30% ROE that the Company has requested, we have found that the record supports a higher ROE than what has been recommended by either the OCA or I&E. Accordingly, we shall set a cost of equity rate of 9.54% for Citizens’, inclusive of the management effectiveness adjustment. All Exceptions to the contrary are denied.

### Overall Rate of Return

**a. Positions of the Parties**

Citizens’ claimed that it should be permitted to earn a 7.62 % overall rate of return, including a 10.30% return on common equity. Citizens’ M.B. at 100.

 I&E recommended that Citizens’ should be afforded the opportunity to earn an overall rate of return of 6.50%. This recommended overall rate of return is comprised of an 8.10% rate of return on equity. I&E M.B. at 51.

 The OCA proffered that the Commission should allow Citizens’ the opportunity to earn an 8.38% return on common equity and a 6.64% overall return on its rate base. OCA M.B. at 63.

**b. Recommended Decision**

The ALJs determined a cost rate of common equity of 9.74% is appropriate. The ALJs noted the Parties do not dispute a capital structure consisting of 49.33% debt and 50.67% equity, nor do the Parties disagree to a cost of debt of 4.86%. Accordingly, the ALJs recommended an overall rate of return that will result in just and reasonable rates of 7.34%. The ALJs outlined this weighted average cost of capital as follows:

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

R.D. at 78-79.

**c. Exceptions and Replies**

Consistent with its Exception to the ALJs’ recommended cost of common equity, Citizens’ submits that to ensure the Company has an opportunity to earn a reasonable rate of return, the Commission should consider and develop an unadjusted ROE based on the multiple alternative analyses developed by Mr. D’Ascendis. Citizens’ Exc. at 18-22.

 The remaining Party’s Exceptions and each Party’s Replies to Exceptions on this issue are based on their respective Exceptions and Replies to Exceptions regarding the cost of common equity, *supra.*

**d. Disposition**

For the reasons discussed above, we have modified the ALJs’ recommendation as to the appropriate cost of common equity for Citizens’. This, in turn, modifies the ALJs’ recommended overall rate of return. The following table summarizes our final determinations regarding the Company’s capital structure, cost of debt, and cost of common equity, as well as the resulting weighted costs. As this table indicates, we shall set an authorized overall rate of return for Citizens’ of 7.23%.

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **Capitalization Ratio** | **Cost Rate** | **Rate of Return** |
| Debt | 49.33% | 4.86% | 2.40% |
| Equity | 50.67% | 9.54% | 4.83% |
| Total | 100.00% |   | 7.23% |

## Rate Structure

This section of the Opinion and Order addresses the ALJs’ contested recommendations pertaining to cost of service, revenue allocation, and rate design. When a utility files for a rate increase and the proposed increase exceeds $1 million, the utility must include with its filing an allocated class cost-of-service study (ACCOSS) in which it assigns to each customer class a rate based upon operating costs that it incurred in providing that service. 52 Pa. Code § 53.53; *Lloyd v. Pa. PUC*,904 A.2d 1010, 1015 (Pa. Cmwlth. 2006) (*Lloyd*). Public utility rates should enable the utility to recover its cost of service and should allocate this cost among its customers. These rates are required by statute to be just, reasonable and non-discriminatory. 66 Pa. C.S. §§ 1301, 2804(10).

### Allocated Class Cost of Service Study

An ACCOSS is a benchmark for evaluating customer class cost responsibility with the fundamental purpose of aiding in the accurate and reasonable design of rates by identifying all the capital and operating costs incurred by the utility in serving its customers, and then directly assigning or allocating these costs to each individual rate class based on established principles of cost-causation.

Although not required under Commission Regulations to submit an ACCOSS for a rate increase under $1 million, Citizens’ prepared and presented its ACCOSS for its FPFTY in Schedules E through E-5D of Citizens’ Exhibit\_(HSG-1), showing the development of the allocation factors used in performing the functionalization, classification, and class allocation procedures within its ACCOSS on Schedules D through D6 of Citizens’ Exhibit\_(HSG-1). Citizens’ presented its cost of service and quantifies the revenue deficiency based on operating costs and revenues, as adjusted for the FPFTY. Citizens’ Exh.\_(HSG-1), Sch. E-1, line 28; Citizens’ Exh.\_(HSG-1), Sch. E-1A at 6, line 185. Despite having updated its ROE and overall rate of return claims in rebuttal testimony, as previously indicated, the Company’s ACCOSS reflects its as-filed overall rate of return claim of 8.05%. Specifically, the Company’s calculated cost of equity was reduced from 11.15% to 10.30%, reducing its overall rate of return claim from 8.05% to 7.62%. Citizens’ St. 2-R at 2. The Company’s revised revenue increase request of approximately $701,000 reflected this rate of return revision, as well as rate base adjustments to its as-filed request of $792,246. Citizens’ St. 1-R at 2. However, Citizens’ indicated that it has not revised its ACCOSS (Citizens’ Exh.\_(HSG-1), Sch. E), proposed revenue allocation (Citizens’ Exh.\_(HSG-1), Sch. B6‑4, line 24), or requested rates (Citizens’ Exh.\_(HSG-1), Sch. B6-3) to be reflective of its revised revenue increase request. Citizens’ St. 1-R at 2.

Nevertheless, the Company’s ACCOSS provided class revenues at proposed rates based upon equalized rates of return (all classes’ revenue produce the proposed overall rate of return (8.05%)), which can be used as a rough target for apportioning class revenue increases. Citizens’ Exh.\_(HSG-1), Sch. E-1, lines 13 and 26. The results of such a study can be utilized to determine the relative cost of service for each class and help determine the individual class revenue requirements and, to the extent a particular class is above or below the system average rate of return, show the additional revenues each class is to receive or conversely the additional revenues that each class is to contribute to the Company’s overall revenues. Citizens’ Exh.\_(HSG-1), Sch. E-1, line 28. In addition to the relative provision of revenues, relative rates of return are also provided which shows how the rate of return for each class compares to the system average rate of return, indicating if each class is either under-paying or over-paying its allocated cost of service. This information is then used to determine the manner in which the proposed revenue increase should be allocated among the various rate classes with the goal of moving each rate class towards the system average rate of return. Citizens’ Exh.\_(HSG-1), Sch. B6-4, lines 24-48. As Schedule B6-4 demonstrates, the results at equalized rates of return do not necessarily dictate the exact levels of class revenues proposed. As the ALJs noted, the proposed class revenues may depart from the equalized rates of return in order to recognize a number of factors, including such things as the value of service, gradualism, and conservation considerations. However, the ALJs noted that in *Lloyd*, the Commonwealth Court determined that cost of service is the “polestar” of ratemaking. R.D. at 86.

**a. Positions of the Parties**

Howard S. Gorman testified on behalf of Citizens’ regarding the Company’s ACCOSS, arguing that the ACCOSS presented in Schedule E of Citizens’ Exhibit\_(HSG-1) is reasonable and is consistent with the methodology used by other Pennsylvania electric utilities and Commission precedent in base rate proceedings. Citizens’ M.B. at 104-105; Citizens’ R.B. at 38.

Citizens’ explained that cost of service analyses are developed to assign and allocate the Company’s rate base, revenues and expenses among its customer classes based primarily upon the principle of cost-causation, which its ACCOSS has appropriately done by following the traditional three step process: (1) *functionalization*: dividing rate base and expense elements of the cost of service into categories that relate to the operations of the Company; (2) *cost classification*: dividing functionalized rate base and expense elements into demand, commodity, or customer related components based upon principles of cost-causation; and (3) *cost allocation*: allocating costs among the customer classes on the basis of the most appropriate measure of demand, energy or customers, in proportion to each class’ share of the various allocation measures. Citizens’ M.B. at 103.

Citizens’ further explained that within the framework of its ACCOSS, distribution facilities (*e.g*., transformers, conductors, poles, towers, and underground conduit) were functionalized as either primary or secondary facilities. Citizens’ witness, Mr. Gorman, classified the primary facilities (that are designed to move power from the transmission system to secondary distribution facilities) as demand-related. However, secondary upstream distribution facilities, such as poles, towers and fixtures (Account 364); overhead conductors and devices (Account 365); underground conduits and conductors (Account 366) and transformers (Account 368), were classified as customer and/or demand-related. In order to determine the customer-related portions of line transformers the Company employed a “minimum size” method. For the remaining secondary distribution plant, a “zero-load analysis” was used to estimate the customer-related portions. Citizens’ St. 1 at 17-21.

Citizens’ argued that the utilization of “minimum system” classification methods are appropriate means of classifying the costs of secondary distribution plant upstream of meters and services, in order to recognize that such costs are partially driven by the number of customers, and are therefore customer-related. Citizens’ M.B. at 104. “Minimum system” methods attempt to estimate the cost to replicate the configuration of an existing distribution system, assuming that system was built to serve minimal or zero load. As previously indicated, Citizens’ employed two approaches in estimating the cost of this hypothetical minimum distribution system. The “minimum size” approach the Company used to determine the customer-related portion of line transformers attempts to estimate the cost of reconstructing the distribution system with the smallest-size equipment possible, which was determined to be a 50 kilovolt-amperes (kVA) transformer serving four customers, or one-fourth of a 50 kVA transformer. Alternatively, the “zero-load analysis,” which Citizens’ used to determine the customer-related portion of the remaining secondary distribution plant, attempts to estimate the portion of the costs required to serve a customer with minimum or no load. Under either approach, the costs of the hypothetical minimum distribution system were classified as customer-related, with the remaining portion of the costs classified as demand-related. Citizens’ St. 1 at 21.

Citizens’ pointed out that its methodology is consistent with methods approved inthe *2012* *PPL Order* and the *UGI Order*. Specifically, the *UGI Order* found that the minimum system method is consistent with the National Association of Regulatory Commissioners (NARUC) Electric Utility Cost Allocation Manual (NARUC Manual), which states that distribution costs should be either customer related, demand related, or a combination of both. Essentially, Citizens’ argued that absent the use of a “minimum system” classification method, the distribution costs are incorrectly allocated to each class. Citizens’ M.B. at 104-105.

The OCA was the only party that opposed Citizens’ ACCOSS. The OCA took issue with two components of the Company’s ACCOSS, namely, (1) the consideration and reflection of the loss of load and the corresponding reduction in revenue associated with the anticipated completion of a 3 MW solar installation at Bucknell,[[20]](#footnote-21) and (2) the classification of secondary portions of distribution plant (Accounts 264, 365, and 366) and transformers (Account 368) as customer-related. OCA M.B. at 68-69.

According to the OCA, the Company’s ACCOSS improperly classified upstream secondary distribution plant as both customer-related and demand-related. In the OCA’s view, primary, as well as secondary, distribution plant are demand-related investments and classification of these costs as partially customer-related is not reasonable. The OCA submitted that the Company’s use of “minimum system” classification methods are flawed. Specifically, the OCA contended that the Company’s “minimum size” method fails to reflect how coincident load drives the transformer costs, nor does the Company’s analysis account for the load-carrying capability of the hypothetical minimum system. Likewise, the OCA argued that the Company’s “zero-load analysis” fails to account for how the distribution system is engineered and how it is designed to work on a day-to-day basis, submitting that secondary distribution plant costs are incurred to meet the coincident loads of customers and the size and costs are a function of the diversity of customers’ loads and expected future coincident loads. OCA M.B. at 68-76; OCA R.B. at 33-37.

Therefore, the OCA proffered an alternative ACCOSS, which it contended more closely adheres to cost-causation principles. More specifically, the OCA recommended that Citizens’ should be required to classify one hundred percent of its upstream primary and secondary distribution plant as demand-related. Further, as previously alluded to, the OCA proposed an additional modification to reflect its opposition to the claimed reduction in revenue associated with the anticipated completion of the solar installation at Bucknell. OCA St. 4 at 16.

Maintaining its position, as to the reasonableness of its ACCOSS, Citizens’ explained that the changes noted by the OCA and incorporated into the OCA’s alternative ACCOSS do not have a significant impact on the relative rates of return, as shown in Table 2 on page 16 of OCA Statement No. 4. Therefore, the effect on revenue allocation, which is the primary purpose of the ACCOSS, is also very small. Citizens’ St. 1-R at 14.

**b. Recommended Decision**

The ALJs recommended that the Company’s ACCOSS, excluding the inclusion of the solar revenue loss due to the installation at Bucknell, should be accepted and used as a guide to set rates in this proceeding, and that the OCA’s alternative ACCOSS should be denied. The ALJs found that the methods utilized by Citizens’ in this proceeding are consistent with the NARUC Manual, as well as methods approved by the Commission in the *UGI Order* and the *2012* *PPL Order*. R.D. at 90-92.

**c. Exceptions and Replies**

In its Exception No. 9, the OCA submits that the ALJs erred by recommending the adoption of the Company’s ACCOSS. The OCA remains of the opinion that its own proposed ACCOSS more accurately follows the principles of cost-causation, maintaining its contention that it is inappropriate to classify any portion of secondary upstream distribution plant, such as poles, towers and fixtures (Account 364); overhead conductors and devices (Account 365); underground conduits and conductors (Account 366) and transformers (Account 368) as customer related, but rather should be classified one-hundred percent as demand-related. According to the OCA, there is no direct relationship between the number of customers and the size or the cost of poles or conductors. Rather, the OCA submits that poles, wires, and transformers are designed in order to meet the loads placed on them. Therefore, the OCA asserts that assigning costs for these facilities based on the number of customers is not consistent with how the system was designed or operated in everyday use. OCA Exc. at 20-25.

The OCA argues that the ALJs erred in their reliance on the *UGI Order* and the *2012* *PPL Order* and reiterates its argument that the ALJs did not appropriately consider the flaws in the Company’s “zero-load analysis,” which it claims has no basis in how secondary distribution costs are actually incurred or the reason for the incurrence of such costs. The OCA also submits that even if it is determined that some portion of secondary plant is customer related, the Company’s “minimum size” method used to determine the customer percentage for line transformers is flawed. In this regard, the OCA reasons that Citizens’ has presented no evidence to demonstrate the correlation between the length or mileage of the Company’s secondary distribution system and the number of customers served by the system, nor does the Company’s methodology reflect how coincident load drives the transformer costs. Furthermore, Citizens’ contends that the size of the transformer that has been deemed minimum, in fact, has significant load carrying capability, which the Company’s analysis does not account for. OCA Exc. at 22-25.

In its Replies to Exceptions, Citizens’ maintains that in developing its ACCOSS it adhered to public accounting practices, demonstrated by its use of the minimum system method and zero-load analysis, which recognizes that upstream secondary distribution plant contains customer costs and that such secondary plant facilities are partially driven by the number of customers. Citizens’ contends that the adjustments and alternatives proposed by the OCA attempt to ignore cost-causation and are contrary to Commission precedent, which should not be deviated from. Therefore, Citizens’ argues that the OCA’s Exception should be denied, as the ALJs have properly recognized that the OCA has simply continued to advance arguments that have been repeatedly rejected by the Commission, *i.e*., the *UGI Order* and the *2012 PPL Order*. Citizens’ R. Exc. at 16-20.

**d. Disposition**

The Commission uses the results from cost of service studies as a guide in developing appropriate customer class rates. Nevertheless, as we have stated in past rate decisions, cost of service studies are tools to be used in the ultimate design of customer rates, but they are necessarily subject to the philosophies of the analysts preparing them. We therefore emphasize that appropriate judgment and discretion is required in analyzing the cost of service studies and using them to help set the final customer class rates based on the evidentiary record.

We agree with the ALJs’ recommendation that Citizens’ proposed ACCOSS, without the inclusion of the Bucknell solar revenue loss, be approved, and the OCA’s arguments be rejected. We do not find merit in the OCA’s position and Exceptions on this issue, and we are not persuaded by the arguments the OCA presented in support of its recommended alternative ACCOSS methodology. R.D. at 90-92.

As Citizens’ pointed out, we note the OCA presented its contention that secondary distribution plant should be classified as 100% demand related in the *UGI Order* and *2012 PPL Order* proceedings, and we rejected the OCA’s argument in those prior proceedings*.* Citizens’ R. Exc. at 18*.* We agree with the ALJs’ conclusion that the OCA did not present convincing arguments in this proceeding that would cause us to re‑evaluate our determinations in the *UGI Order* or *2012 PPL Order*. R.D. at 91.

As Citizens’ further noted, we observe that the minimum system approach methodology employed by the Company is the same methodology approved for UGI in the *UGI Order* proceeding. Citizens’ R. Exc*.* at 18-19.The Commission has affirmed the use of the “minimum system method” as the accepted approach to classify and allocate distribution system costs in prior proceedings. *See, UGI Order, supra; see also 2012 PPL Order, supra*; *see also, Pa. PUC v. PPL Electric Utilities Corp*., Docket No. R-2010-2161694 (Order entered December 21, 2010) (*2010 PPL Order*). We agree with the ALJs that Citizens’ ACCOSS is consistent with the NARUC Manual and more accurately reflects adherence to cost-causation principles than the ACCOSS methodology proposed by the OCA. Moreover, we share the opinion of the ALJs thatthe Company’s utilization of the “minimum system method” and “zero-load analysis” in its ACCOSS methodology is reasonable and in accordance with Commission precedent. R.D. at 90‑92. Accordingly, we shall deny Exception No. 9 of the OCA regarding Citizens’ ACCOSS.

### Revenue Allocation

**a. Positions of the Parties**

Citizens’ submitted that under *Lloyd, supra,* cost of service is the “polestar” of utility rates and a proposed revenue allocation will only be found to be reasonable where it moves distribution rates for each class closer to the full cost of providing service. Therefore, regarding revenue allocation, Citizens’ submitted that it prioritized cost of service principles, while reflecting gradualism. Specifically, Citizens’ based the reasonableness of its proposed revenue allocation on the significant progress made by each rate class toward the system average rate of return, with no class receiving an increase greater than 1.6 times the system average, meeting the goals of moving each class closer toward their respective costs of service, while mitigating extreme impacts. Citizens’ M.B. at 106-108.

Therefore, Citizens’ asserted that its proposed revenue allocation is consistent with regulatory practice and precedent, including *Lloyd*,and allocates revenues consistent with the cost to serve each class. Rate classes RS (Residential Service), SH (Space Heating), and MBL received increases intended to move their classes toward parity with the overall total rate of return. The limit on the increases proposed for the GLP-1 and OL (Outdoor Lighting Service) rate classes is the Company’s effort to lower the relative rates of return for these classes, which, according to the Company’s ACCOSS, are currently generating revenue that are greater than their respective cost to serve. As shown below, Citizens’ has opted to propose a revenue reduction for the GLP‑3 rate class.

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

*See* Citizens’ Exh.\_(HSG-1), Sch. B6-1.

Citizens’ averred that its proposed revenue allocation among the individual rate classes, ranging from a 3.2 percent decrease for the GLP-3 rate class to a 26.2 percent increase for the MBL rate class, is reasonable and properly moves the rates of return for all classes closer to the overall system average rate of return, as demonstrated by the following indexed relative rates of return by customer class at present and proposed rates:

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

*See* Citizens’ Exh.\_(HSG-1), Sch. B6-4, lines 8 and 33. Furthermore, based on the results of the Company’s ACCOSS, Citizens’ illustrated the effect its proposed revenue allocation would have on the “subsidies” paid and received by each rate class, as follows:

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

*See* Citizens’ Exh.\_(HSG-1), Sch. B6-4, lines 42-44.

Based on its ACCOSS, Citizens’ proposed that the GLP-3 class should receive a decrease in revenue (target revenue compared to revenue at present rates) for the FPFTY. Conversely, I&E, the OCA, and the OSBA are in agreement that no rate class should receive a decrease. However, each of these opposing Parties offered a different proposal for which class(es) should benefit from not giving a decrease to the GLP-3 class.

Based on Citizens’ ACCOSS, I&E recommended rate class GLP-3 be allocated neither an increase nor decrease under proposed rates. Rather, I&E proposed a revenue allocation which eliminates the proposed $35,830 reduction in revenue for the GLP-3 class and reallocates it between the GLP-1 and OL classes. I&E argued that its approach is more reasonable since it allows more rate stability for the GLP-3 class by allowing costs to “catch up” to rates more gradually, facilitates greater movement towards cost of service for the GLP-1 and OL classes, both of which have relative rates of return above 1.0, and attains these benefits without negatively affecting any of Citizens’ other rate classes. I&E M.B. at 53-59.

Of the $35,830 reallocated from the GLP-3 rate class, I&E originally recommended that: (1) the first $10,500 be allocated to the OL class; and, (2) the remaining $25,316 be applied to the GLP-1 rate class.[[21]](#footnote-22) *Id.* at 53. As I&E explained in its Main Brief, if a rate class has a relative rate of return greater than 1.0, that class is generating revenue greater than its cost to serve. I&E M.B. at 56. Therefore, although I&E acknowledged that its recommendation does not move the GLP-3 class towards a relative rate of return of 1.0 as aggressively as the Company’s proposal, I&E explained that its method for reducing the relative rates of return for the GLP-3, GLP-1, and OL rate classes is more reasonable since it effectively moves rate class GLP-3 closer to its cost of service, while assigning further rate relief to rate classes OL and GLP-1, as demonstrated by the following table:

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

I&E M.B. at 56.

After considering other Parities’ positions, I&E accepted the OSBA’s recommendation that the rate class with the higher relative rate of return should receive more rate relief. I&E thereby modified its original recommendation to provide greater relief to the GLP-1 rate class. Accepting this aspect of the OSBA’s recommendation, I&E stated that the $35,830 in excess revenue reallocated from the GLP-3 class should be allocated based on the percent increase the GLP-1 and OL rate classes are proposed to receive prior to any overall scale back. I&E M.B. at 58-59.

Both the OCA and the OSBA agreed with I&E that rate class GLP-3 should not be allocated a rate decrease; however, the OCA and the OSBA both disagreed with I&E regarding the allocation of the excess $35,830 revenue from the GLP-3 class.

The OCA echoed I&E’s contention that such a rate decrease for the GLP-3 class when others’ rates are increasing is not appropriate. The OCA argued that the Commission recognized such a consideration in the *2012 PPL Order*, finding that “as a matter of fairness, those customer classes that have not been allotted any rate increase via the Company’s original revenue allocation should not receive rate decreases as argued by the OSBA and PPLICA.” OCA M.B. at 79-80 (citing *2012* *PPL Order* at 124). Therefore, the OCA recommended that the rate decrease proposed for the GLP-3 rate class be eliminated and proportionally distributed to the rate classes receiving an increase that is greater than or equal to 1.5 times (rounded) the system average increase. OCA M.B. at 80 (citing OCA St. 4 at 21-22). The OCA’s recommendations are summarized in Table 6 of OCA Statement No. 4, as follows:

|  |
| --- |
| **Table 6. Citizens’ Electric Company of Lewisburg, PA –OCA Proposed Revenue Distribution** |
| Rate Class | Present Rates | Proposed Rates | Increase | Percent |
| RS | $2,647,362 | $3,279,887 | $632,525 | 23.9% |
| SH | 24,362 | 29,945 | 5,583 | 22.9 |
| GLP -1 | 917,008 | 1,055,971 | 138,963 | 15.2 |
| GLP -3 | 1,110,186 | 1,110,186 | 0 | 0.0 |
| MBL | 17,615 | 22,001 | 4,386 | 24.9 |
| OL[[22]](#footnote-23) | 73,307 | 86,532 | 11,225 | 14.9 |
| **Total:** | **$4,791,840** | **$5,584,522** | **$792,682** | **16.5%** |

 OCA St. 4 at 21.

After considering other Parties’ positions and evaluating the impact that its recommendation would have on the MBL class, the OCA acknowledged that its proposal would cause revenue recognition from the MBL class to move slightly away from the cost of service (1.7%), as shown on Table 1-S of OCA Statement No. 4-SR, as follows:

|  |
| --- |
| **Table 1-S. Citizens’ Electric Company of Lewisburg, PAPercentage of Cost of Service Recovered atPresent and OCA Proposed Revenues[[23]](#footnote-24)** |
| **Rate Class** | **Present Rates** | **OCA Proposed Rates** |  **Change** |
| RS | 84.3% | 90.2% | 5.8% |
| SH | 86.3 | 90.4 | 4.1 |
| GLP-1 | 113.1 | 111.6 | (1.5) |
| GLP-3 | 158.5 | 135.3 | (23.2) |
| MBL | 32.5 | 30.8 | (1.7) |
| OL | 128.6 | 114.0 | (14.6) |
| **TOTAL:** | **100.0%** | **100.0%** | **0.0%** |

OCA St. 4-SR at 13. Therefore, the OCA submitted that its recommended revenue allocation could be modified to eliminate the MBL class from a share of the rate reduction associated with eliminating the decrease to the GLP-3 rate class, essentially reallocating $245 from rate class MBL to other customer classes. OCA M.B. at 83 (citing OCA St. 4-SR at 13).

The OSBA likewise recommended that no class receive a decrease, proposing to reallocate the decrease to the GLP-3 class that the Company proposed among other classes, while limiting the rate increase for rate class MBL. OSBA M.B. at 8. The OSBA proposed to measure toward cost of service by measuring the change in the absolute level of class subsidies at present and proposed rates, rather than changes in relative rates of return. OSBA M.B. at 6-8. Under this measure, the OSBA argued that classes GLP-1 and MBL did not move closer to cost of service under the Company’s proposal. OSBA St. 1 at 6-7. The OSBA’s recommendation resulted in the following revenue allocation, as shown in Schedule BK-3(C) of OSBA Statement No. 1:

|  |
| --- |
| **CITIZENS’ ELECTRIC COMPANY OF LEWISBURG, PA**OSBA Recommended Allocation of the Company’s Requested Increase in Distribution Revenue (FPFTY Ending December 31, 2020) |
|

|  |  |  |  |
| --- | --- | --- | --- |
| Line | Classification | Present Base Revenue |  OSBARecommended Increase |
| Amount |  Percent |
|   |   | 1 | 2 | 3 |
| 1 | Residential | $2,647,362 | $694,038 | 26.2% |
| 2 | Space Heating | $24,362 | $6,387 | 26.2% |
| 3 | GLP-1 | $917,008 | $82,772 | 9.0% |
| 4 | GLP-3 | $1,110,186 | $0 | 0.0% |
| 5 | Municipal Lighting | $17,615 | $4,618 | 26.2% |
| 6 | Outdoor Lighting | $75.307 | $4,880 | 6.5% |
| 7 | Total Rate Revenue | $4,791,840 | $792,695 | 16.5% |
| 8 | Other Revenue | $68.568 | $0 | 0.0% |
| 9 | Total Company | $4,860,408 | $792,695 | 16.3% |

 |
| Source: Exh (HSG-1),  Sch. B6-1 |

OSBA St. 1, Sch. BK-3(C).

**b. Recommended Decision**

Although the ALJs generally rejected the position that there should never be a rate decrease for a rate class while rates are increasing for others, the ALJs did not approve the Company’s proposed rate decrease for the GLP-3 class. The ALJs recommended that I&E’s revenue allocation, which modifies the Company’s proposed revenue allocation by eliminating the $35,830 reduction in revenue from the GLP-3 class and reallocating the $35,830 in excess revenue to the GLP-1 and OL classes based on the percent increase the GLP-1 and OL rate classes are proposed to receive prior to any overall scale back, should be adopted. The ALJs opined that this proposal most closely reflects the actual cost of service to the various customer classes, most reasonably moves distribution rates for each class closer to the full cost of providing service and most thoroughly considers factors such as gradualism, rate shock, rate continuity, competitive concerns, and principles of fundamental fairness in reaching a fair determination. R.D. at 104-106.

**c. Exceptions and Replies**

In its Exception No. 10, the OCA submits that the Commission should reject the ALJs’ recommendation and adopt the OCA’s proposed revenue allocation. The OCA agrees with I&E that a rate decrease for the GLP-3 rate class when other rate classes are experiencing significant rate increases is not appropriate. However, the OCA disagrees with I&E’s proposed redistribution to different rate classes, and alternatively recommended that the rate decrease proposed for the GLP-3 class should be proportionately redistributed to the rate classes receiving an increase that is greater than or equal to 1.5 times the system average increase. The OCA asserts that, while cost of service should guide the Commission when setting rates, other ratemaking principles such as gradualism, rate shock avoidance, and basic fairness should not be abandoned. OCA Exc. at 25-28.

In its Exception No. 11, Citizens’ also excepts to the ALJs’ recommendation, contending that the ALJs erred in approving a revenue allocation that fails to adequately move all customers towards cost of service, and maintaining that a rate decrease for class GLP-3 is appropriate and corroborated by the Commission’s decision in the *UGI Order* granting a rate decrease to a rate class. The Company contends that the ALJs’ recommendation fails to sufficiently move rate schedule GLP-3 towards cost of service. Citizens’ Exc. at 24-25.

In its reply to OCA Exception No. 10, Citizens’ reiterates its request that the Commission approve its proposed revenue allocation, which specifically implements a rate decrease for the GLP-3 class, as it moves all classes closer to the cost-of-service and avoids extreme rate impacts. Citizens’ R. Exc. at 20.

In its reply to Citizens’ Exception No. 11, the OCA requests that Citizens’ Exception No. 11 be denied, maintaining that a rate decrease for the GLP-3 rate class is not appropriate. OCA R. Exc. at 19-20.

In its reply to OCA Exception No.10, I&E maintains that its proposal most fairly allocates revenue, appropriately moving classes towards their cost of service. I&E argues the reasonableness of its proposal in that it provides relief to the only two rate classes whose relative rates of return are above 1.0 (GLP-1 and OL) whereas the OCA’s recommendation would provide relief to classes whose relative rates of return are below 1.0, *i.e.*, classes not generating sufficient revenue to cover the cost incurred by the utility in providing service to those classes. I&E R. Exc. at 10-11.

In its Replies to Citizens’ Exception No. 11 and the OCA’s Exception No. 10, the OSBA submits that the ALJs properly rejected the proposed revenue allocations of Citizens’ and the OCA in favor of I&E’s proposal, which, although not identical to the OSBA’s proposal, better balances the factors set out in *Lloyd* and the goal of moving all customer classes closer to cost of service than the proposals of Citizens’ and the OCA. OSBA R. Exc. at 3-5.

**d. Disposition**

Once an appropriate cost of service study has been adopted, the rate design process may begin, which involves two primary functions. The first step is the determination of inter-class rates, which involves the assignment of the revenue requirement between the various customer classes. The second step in the rate design process is the allocation of any class rate increase (or decrease) among the various intra-class rate elements. In this step, we must examine the manner in which the class revenue requirement will be collected from customers.

Therefore, based upon our prior determination and discussion, *supra*, we have accepted Citizens’ ACCOSS, excluding the Bucknell solar revenue loss, as reasonable, consistent with Commission precedent and in adherence with the methods set forth in the NARUC Manual. In developing its proposed revenue allocation, Citizens’ cited the following objectives: (1) to move each class closer to its cost of service, as computed in the ACCOSS; and (2) to mitigate extreme rate impacts on rate classes and on customer subgroups. Citizens’ St. 1 at 29-30. Accordingly, as discussed *infra*, we find that Citizens’ revenue allocation proposal is consistent with *Lloyd* and moves all rate classes closer to cost of service in a reasonable manner.

Before us are three divergent positions regarding the appropriate distribution of the Company’s requested revenue increase among its customer classes, with the actual numbers to be based on the proportionate adoption of the actual revenue requirement approved. The methods that were employed by each Party in consideration of their respective proposals have been summarized by I&E witness Cline as follows:

If a rate class has a relative rate of return of less than 1.0, that class is not generating sufficient revenue to recover the costs the utility spends to serve that class. The solution in this instance would be to increase rates for that rate class in order to generate more revenue to cover its cost to serve. In the event a rate class has a relative rate of return of greater than 1.0, that class is generating revenue greater than its cost to serve. Some possible solutions to a rate class generating revenue greater than its cost to serve are 1) to reduce the rates of that rate class to match the cost to serve, 2) to not increase or decrease rates and allow costs to “catch up” to the revenue over lime as costs inevitably increase between rate cases, or 3) propose a smaller rate increase that allows costs to “catch up” at a more gradual pace.

I&E St. 3 at 27.

In this instance, Citizens’ chose to increase rates for the RS, SH, and MBL rate classes by approximately 25%, while limiting the rate increases for the GLP-1 and OL rate classes and reducing the rates for the GLP-3 rate class by 3.2%. In contrast, both the OCA and I&E shared the opinion that no rate class should receive a decrease, nonetheless differing in their recommendations on how the decrease to the GLP-3 class should be reallocated. I&E’s proposal, adopted by the ALJs’ and supported by the OSBA in Reply Exceptions, sought to reallocate the decrease to the OL and the GLP-1 rate classes, while the OCA proposed to proportionally distribute the decrease among the rate classes receiving an increase that is greater than or equal to 1.5 times the system average increase. I&E St. 3 at 30; I&E St. 3-SR at 18; OCA St. 4 at 21; R.D. at 104-106; OSBA R. Exc. at 3-5. It is the OCA’s opinion that its proposal simply provides for additional gradualism and is therefore more reasonable than I&E’s recommendation. OCA St. No. 4-R at 5.

As noted above, the evidence shows that, regarding the three rate classes (GLP-1, GLP-3, and OL) that are currently subsidizing the cost to serve the remaining rate classes (RS, SH, and MBL), the GLP-3 rate class currently pays significantly more than its cost of service, in comparison to the other rate classes. Therefore, we are of the opinion that a slight reduction in rates for the GLP-3 class, as proposed by Citizens’, is appropriate in this instance. As shown on page 101 of the Recommended Decision, this proposed 3.2% reduction in rates for the GLP-3 class will reduce the subsidy currently provided by 40%, while moving all rate classes toward their respective cost of service.

Additionally, we also find that Citizens’ revenue allocation proposal considers the principle of gradualism. The record indicates that although there are no definitive rules for determining what kind of rate increase would violate the principle of gradualism, one common metric that has been used by experts in the Commonwealth has been the “1.5 times” rule, wherein the maximum average rate increase for any particular class should not exceed 1.5 times the system average increase. OCA St. 4 at 17. In the instant case, the Company’s proposal for the MBL class is slightly above this, with a 1.6 factor (26.3% for the MBL class over 16.5% for the system average). Nonetheless, we note that even with the 26.3% increase that the MBL class will experience under the Company’s proposal, the class’ current amount of revenue subsidy received from other classes is shown to increase by approximately 30%. Therefore, we do not consider the Company’s proposal to be unreasonable. Accordingly, we shall grant Citizens’ Exception No. 11, deny the OCA’s Exception No. 10, and modify the findings and recommendations of the ALJs.

### Rate Design

The Company’s proposed rates are summarized in Schedule B7 of Citizens’ Exhibit\_(HSG-1), which it argued, properly reflects the fixed and variable costs of service associated with its proposed revenue allocation. Citizens’ proposed to increase the monthly customer charge as follows:

|  |
| --- |
| **Citizens’ Proposed Class Customer Charge Increases** |
| **Rate** | **Present** | **Proposed** | **% Increase** |
| **RS** | $11.24 | $15.00 | 33.5% |
| **SH** | $18.57 | $24.00 | 29.2% |
| **GLP-1** | $14.17 | $15.00 | 5.9% |
| **GLP-3** | $50.83 | $51.00 | 0.3% |

Citizens’ Exh.\_(HSG-1), Sch. B7. As shown above, Citizens’ proposes to increase the monthly customer charge for residential customers from $11.24 to $15.00, with the balance of the revenue target to be recovered from the volumetric kWh charge. This proposed increase of 33.5% in the RS class customer charge reflects the Company’s proposal to begin including a small portion of demand costs (equal to the minimum demand for residential customer pursuant to the ACCOSS) through its residential monthly customer charges. Specifically, Citizens’ proposed to base its residential customer charge on two components: (1) *customer-related costs* totaling $12.94[[24]](#footnote-25) of the $15.00 proposed customer charge, which have been historically included in the fixed monthly charge, and (2) *demand-related costs* totaling $2.06 of the $15.00, representing a portion of residential demand costs. Specifically, Citizens’ explained that the $2.06 represents the cost of 0.38 kW-month per user, based on the $5.40 per kW-month demand costs for the RS class set forth in Schedule E1-B of Citizens’\_(HSG-1). Citizens’ St. 1 at 32.

The Company’s proposed 29.2% increase in the SH class customer charge, from $18.57 to $24.00, reflects a similar structure for residential space heating customers. Specifically, Citizens’ proposed to base its customer charge for the SH class on two components: (1) *customer-related costs* totaling $17.96, representing the costs that have historically been included in the fixed monthly charge, and (2) *demand-related costs* totaling $6.04, representing the cost of 0.95 kW-month, based on the $6.37 per kW-month costs for the SH class set forth in the Company’s ACCOSS. Citizens’ St. 1 at 38.

**a. Positions of the Parties**

Citizens’ argued that moving the residential rate design towards cost of service would require the addition of a demand billing element and that incorporating demand costs into the monthly customer charge will be easier for residential customers to understand. R.D. at 109. To recognize cost of service in the proposal, Citizens’ chose a demand level (0.38 kW) attained by 99% of the RS accounts at least annually, indicating that more than 98% had demand of 1.0 kW at least once per year. Likewise, for residential space heating customers, Citizens’ argued that its proposal to include costs equal to the monthly cost of 0.95 kW of demand in the SH class customer charge reflects a demand level attained by 81% of the SH accounts monthly and by over 95% of the SH accounts at least once in 2018. Citizens’ submitted this proposal reflects a gradual approach to making this transition. R.D. at 109 (citing Citizens’ St. 1 at 37-38). Citizens’ asserted that by including only the portion of demand charges that effectively functions as the minimum demand for the affected customers, the Company realistically reflects cost-of-service principles while supporting rate stability and gradualism. R.D. at 109 (citing Citizens’ St. 1 at 32-33, 38). By aligning rates with costs, the Company argued its proposal supports the Company’s ongoing efforts to invest in reliability projects. R.D. at 111 (citing Citizens’ St. 1 at 34-37). Citizens’ argued that its proposal to include a small part of demand costs in the fixed monthly fee is reasonable, aligns closely with cost-causation principles and satisfies the 14 policy factors enumerated in the Commission’s Final Policy Statement on alternative ratemaking. *See, Fixed Utility Distribution Rates Policy Statement, Final Policy Statement Order*, Docket No. M‑2015‑2518883 (Order entered July 18, 2019) (*Final Policy Statement*); 52 Pa. Code §§ 69.3301-3302. R.D. at 110-112 (citing Citizens’ St. 1 at 34-37).

The OCA opposed the inclusion of any demand-related costs in the monthly customer charge and most certainly opposed the idea that the inclusion of demand-related amounts should increase over time simply to attain greater revenue recognition from fixed monthly charges. The OCA argued that the Company’s proposal marks a dramatic change in how it and the Commission have developed customer charges in the past without any support and that such a change would also alter the price signals customers have become accustomed to without any meaningful benefit. R.D. at 112 (citing OCA St. 4 at 25-26).

The OCA submitted that the Company’s proposal does not align with the goals enumerated in the *Final Policy Statement*, the main purpose of which is to promote the efficient use of electricity, rather the proposed inclusion of demand-related costs as a part of the customer charge has the opposite effect because the inclusion of demand costs in the fixed customer charge prevents the customer from seeing price signals that would otherwise encourage conservation and the efficient use of electricity. R.D. at 114-115 (citing OCA St. 4 at 26).

Like the OCA, I&E also opposed Citizens’ proposal to include a portion of the demand-related costs in the customer charge because it will send inaccurate price signals to customers. R.D. at 116-117 (citing I&E St. 3 at 30-31). I&E proposed customer charges be limited to what can be supported by the Company’s customer cost analysis, which shows that the RS class customer charge should only be increased to approximately $13.00 per month and that there is no cost basis for increasing the SH class from its existing customer charge of $18.57 per month. R.D. at 117 (citing I&E St. 3 at 41).

Additionally, I&E addressed the Company’s claim that it incurs distribution system costs based on the number customers connected to the system and the peak demand the system is designed to serve. In response to the Company’s contention that once an investment is made it is considered a fixed cost, and therefore appropriately recovered through a fixed customer charge,[[25]](#footnote-26) I&E submitted the following response:

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

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

I&E St. 3 at 30-31.

I&E also disagreed with Citizens’ argument that the proposed adjustment to the customer charge should be considered “alternative ratemaking” and accepted by the Commission. I&E witness Cline disagreed with Citizens’ witness Gorman that the 14 factors enumerated by the Commission in its *Final Policy Statement* are satisfied.[[26]](#footnote-27) R.D. at 117-119 (citing I&E St. 3 at 35-40). I&E grounded its opposition primarily on three concerns: (1) efficiency and energy conservation; (2) low-income customers; and (3) cost-causation. R.D. at 118 (citing I&E St. 3 at 38-40).

Lastly, I&E argued that while Citizens’ primarily justified its proposal by reference to reliability, which may have some bearing on the Commission’s analysis; however, the multiple concerns cited by I&E should outweigh this singular consideration. Therefore, I&E requested that the Commission reject Citizens’ proposal to assign a portion of demand-related costs to the RS and SH class customer charges and instead adopt I&E’s recommendations in accord with the Company’s cost of service study. R.D. at 118-119.

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

**b. Recommended Decision**

The ALJs recommended that the Commission reject Citizens’ proposal to assign a portion of demand-related costs to customer charges on the basis that customer charges have historically been limited to the unavoidable direct costs associated with billing an individual customer and because the Company’s proposed customer charges are not supported by the customer cost analysis. R.D. at 119-120. The ALJs rejected the Company’s argument that its proposal constitutes a qualifying alternative ratemaking proposal based on their finding that the proposal would not meet the stated purpose of the Commission’s *Final Policy Statement* at 52 Pa. Code § 69.3301, which is to encourage efficient use of electricity. R.D. at 120-121. The ALJs found that the OCA and I&E demonstrated that including a portion of demand-related costs in the fixed customer charges will prevent customers from seeing price signals and thus have a detrimental effect on customer incentives to employ efficiency measures and distributed energy resources. R.D. at 120. The ALJs also agreed with I&E that low-income customers who are also low usage customers would experience a higher percentage increase to their bill under the Company’s proposal compared to a rate established under traditional ratemaking design. Moreover, the ALJs found that the Company’s proposed rate design does not align revenues with cost-causation principles because it improperly counts demand costs as fixed costs and because its rate design fails to reduce intraclass cost-shifting. R.D. at 120-121. The ALJs recommended that the Commission adopt I&E’s proposed customer charges, which are supported by the Company’s customer cost analysis. R.D. at 122.

**c. Exceptions and Replies**

In its Exception No. 12, Citizens’ submits that the ALJs erred in rejecting the Company’s proposal to increase the fixed monthly charges for residential customers to include a portion of demand charges, maintaining that its proposal is a form of alternative ratemaking consistent with Act 58 of 2017 as well as the goals outlined by the Commission in its *Final Policy Statement.* Citizens’ argues the ALJs erred by misapplying the flexibility afforded by the *Final Policy Statement* by misperceiving the purpose of alternative ratemaking mechanisms as intended to unilaterally promote energy efficiency. Citizens’ cites to *Pa. PUC v. Aqua Pennsylvania,* Docket Nos. R-00038805, *et al*., 2004 Pa. PUC LEXIS 39 (Order entered August 5, 2004) (*Aqua*), to support its proposal. The Company further argues that the inclusion of the minimum customer demand is consistent with cost-causation principles, retains price signals, and respects the principle of gradualism. Citizens’ Exc. at 25-30 (citing Citizens’ M.B. at 108-115; Citizens’ R.B. at 40-46).

In I&E’s Replies to Citizens’ Exception No. 12, I&E submits the ALJs correctly denied the Company’s proposal to recover minimum demand costs through the fixed monthly charge. Regarding Citizens’ cite to *Aqua*, I&E submits it is a limited example and Citizens’ misapplies it here as that case only applies to “general and administrative costs,” which volumetric charges are not. Regarding the ALJs noting that customer charges have historically been limited to unavoidable direct costs associated with billing an individual customers, I&E argues that Citizens’ mischaracterizes its proposal as only shifting a minimum of costs because the Company views its proposal as just the first step to shifting more of the volumetric charge to the customer charge in the future. I&E submits, therefore, that Citizens’ has not justified why the ALJs erred in not allowing the Company to deviate from the historic practice of limiting the customer charge to recovery of unavoidable costs. As for alternative ratemaking, I&E acknowledges that while energy efficiency is a consideration, the ALJs clearly considered other factors in their analysis of the proposal. Specifically, the ALJs found, in addition to discouraging energy efficiency, the Company’s proposal does not reflect cost-causation principles and does not properly consider customer impacts. I&E avers the Company’s primary concern here is revenue stability, and the ALJs properly acknowledged revenue stability is only one of many considerations. Therefore, I&E submits the ALJs did not err by weighing the various considerations presented by the Parties. I&E requests the Commission deny Citizens’ Exception No. 12. I&E R. Exc. at 12-13.

In the OCA’s Replies to Citizens’ Exception No. 12, the OCA submits the ALJs correctly rejected the Company’s proposal to include a demand component in the customer charge. The OCA submits that the Company’s proposal does not align with the goals in the *Final Policy Statement*, does not retain price signals, and is not consistent with cost-causation principles. The OCA contends that Citizens’ is incorrect in its argument that energy efficiency is not a goal of the *Final Policy Statement*. The OCA provides that the proposal would mute the Company’s price signals by including demand charges as part of the customer charge, unduly prejudicing low usage customers, and would not provide a price signal to encourage customer conservation. OCA R. Exc. at 20-23 (citing OCA M.B. at 83-92; OCA R.B. at 41-44).

**d. Disposition**

In this proceeding, Citizens’ is simply asking for greater revenue recognition from fixed monthly charges by couching their proposal as a plea for the Commission to regard its proposal as a form of alternative ratemaking, consistent with the goals outlined in the *Final Policy Statement*, and engage in an exercise to enact reforms in rate design and restructuring. Specifically, as indicated *supra*, the Company’s proposal invites a departure from the traditional utility rate model, where a utility recovers its customer costs, those appropriately evaluated in a customer cost analysis, through a monthly customer charge with the remaining fixed distribution costs recovered through a rate that varies with usage. As noted by I&E and the OCA, the specific fixed costs recovered through customer charges have historically been limited to the direct costs associated with billing an individual customer, regardless of their usage or demand characteristics. I&E St. 3 at 34; OCA St. 4 at 28. With this in mind, we recognize that the Company’s request is a departure from the manner in which utilities have traditionally recovered demand-related costs, and take note of I&E’s contention that although an investment, once made, may be considered a fixed cost, it should not dictate the manner in which the fixed cost is recovered. To this point, I&E submitted that, while the energy charge does not perfectly reflect demand-related costs imposed on the system, it is far superior to allocating demand-related costs to all residential customers equally through the fixed customer charge, since there is no direct relationship between the number of customers and the common costs of poles, conductors or transformers. I&E St. 3 at 34. Although we take note of this argument, we are more persuaded by the effect the Company’s proposal will have on the economics of energy efficiency and conservation and its ability to restrict how much control customers have over how much they pay, making it more difficult for customers to pay less by using less, as discussed *infra*.

The Company’s proposed rate realignment would shift the recovery of some of its fixed costs from the variable energy charges to monthly fixed customer charges. Fixed monthly charges have a direct relationship to the variable energy charges in classes that have no demand charge, such as the Company’s RS and SH rate classes. Specifically, the Company’s rate design proposal includes increasing the fixed monthly customer charges for rate classes RS and SH by 33.5% ($11.24/($15-$11.24)) and 29.2% ($18.57/($24-$18.57)), respectively, and increasing the respective per kWh distribution usage rate by 21.7% ($0.02184/($0.02658-$0.02184)) and 23.3% ($0.0301/($0.03712-$0.0301)). *See*, Citizens’ Exh.\_(HSG-1), Sch. B7. Regardless of the level of these fixed and variable charges, the entire rate design must recover the FPFTY revenue requirement for each class. For every dollar that is recovered via fixed charges, a dollar less needs to be recovered from the usage charges. The converse is also true; if the fixed charge is less, energy rates must be higher to recover the same amount of revenue. While the revenue to be recovered from each rate class is a separate determination, the increases proposed for the fixed customer charges should likewise take into consideration the principles of gradualism and cost of service.

While we commend the Company’s effort to comply with the goals of the *Final Policy Statement*, in reviewing changes in rate design, it is important that we balance the interests of utilities and consumers. Utilities desire to stabilize revenues in light of weather, economic and conservation factors, all of which create potential uncertainty to recovering their approved cost of service. Further, consumers and utilities may benefit from the lower cost of capital associated with stable revenues – including lower debt costs, and lower expected return on equity by shareholders for stable revenue industries. I&E and the OCA have rightfully noted the important factor that rate design plays in promoting conservation and energy efficiency. I&E St. 3 at 38-40; OCA St. 4 at 26.

Although we acknowledge that traditional ratemaking, inherently linking revenues to sales volume, can put utility decisions at odds with public policies favoring energy efficiency, we agree with the ALJs’ reasoning that revenue stability for the utility must be balanced against affordability and conservation concerns. R.D. at 121. As Citizens’ views its proposal as just the first step in shifting more demand-related costs to the customer charge,[[27]](#footnote-28) we find that, while this shift has the effect of decoupling the Company’s earnings from consumption, it also has the effect of decoupling a customer’s usage from their bill. This reduces the value to the customer of shifting or decreasing consumption because the avoided usage rates are lower. We note that one of the objectives of good utility rate design is sending an appropriate consumption price signal to the ratepayer. This shifting of additional costs to the customer charge and lowering variable rates, as proposed by Citizens’, serves to mask the marginal impact of consumption. By shifting distribution costs to the fixed customer charge component of the rates as proposed by Citizens’, incentives for consumers to take charge of their energy costs by reducing usage will be stunted. Such an anti-conservation policy is contrary to the Commission’s goals outlined in the *Final Policy Statement.*

We find compelling I&E’s arguments that the Company’s rate design direction for its RS and SH classes is poised to produce significant price increases for low usage customers, which could be negatively exhibited in two ways. First, it will serve to penalize those customers who have invested in energy efficiency and minimized their consumption. Second, for lower income customers who have reduced their usage to fit a budget, the bill increase, associated with the shifting of costs to the customer charge, represents another obstacle to financial stability.

We do not believe that this type of rate structure represents sound regulatory policy or best serves the public interest. Movement towards significantly higher monthly fixed charges typically present public acceptability problems. Customers resist paying a high monthly charge month after month regardless of use, especially if it does not reflect changes in their use of the product. In other words, if customers try to reduce their energy consumption as a means of reducing their energy expense, they will expect, reasonably so, to see that reflected on their bill. With the Company’s proposed rate design, that will not happen to the full extent that it could. In addition, low usage customers within a customer class would experience a greater percentage increase than high usage customers. This seems almost punitive to customers who attempt to control their usage. Lastly, we agree with the ALJs that the Company’s rate design proposal fails to reflect the sound application of cost of service principles, as the Company’s own cost of customer cost analysis shows no basis for increasing the SH class from its existing customer charge and also supports a smaller increase in the RS class than Citizens’ has proposed. Therefore, we shall deny Citizens’ Exception No. 12 and adopt the ALJs’ recommendation on this issue.

## Miscellaneous Issues: Reporting Requirements

1. **Positions of the Parties**

I&E recommended that Citizens’ provide the Commission’s Bureaus of Technical Utility Services (TUS) and I&E with an update to Citizens’ Exhibit\_(HSG-1), Schedule C3(R) no later than April 1, 2020, which should include actual capital expenditures, plant additions, and retirements by month for the twelve months ending December 31, 2019. I&E stated that an additional update should be provided for actuals through December 31, 2020, no later than April 1, 2021. I&E witness Cline testified that these reports would “provide the Commission with actual data to gauge the accuracy of Citizens’ projected investments in future proceedings as has become common practice among Pennsylvania utilities as the use of the FPFTY has gained prevalence.” I&E M.B. at 65-66 (citing I&E St. 3 at 10-11).

Citizens’ opposed the imposition of additional requirements not required by statute or regulation. The Company noted that it submits numerous filings to the Commission each year, including the Annual Reports required by the Commission’s regulations. Citizens’ M.B. at 116-117 (citing 52 Pa. Code § 57.47). Citizens’ explained that these Annual Reports include detailed plant, expense, and sales data that the Commission and I&E can review. Citizens’ requested that the Commission mitigate the regulatory burden on small utilities of this reporting requirement by denying I&E’s request. Citizens’ M.B. at 117.

1. **Recommended Decision**

The ALJs disagreed with I&E’s recommendation that the Commission require Citizens’ to provide updated filings related to its plant in service projections.

The ALJs noted that the Commission may include such requirements at such time as it adopts comprehensive FPFTY regulations but the ALJs will not require the reporting by Citizens’ in this proceeding. The ALJs provided that the proceedings cited by I&E in support of its request were settled and the utilities voluntarily agreed to the requested reporting. R.D. at 124-125.

1. **Exceptions and Replies**

In its Exception No. 6, I&E submits the ALJs erred by denying I&E’s recommendation that Citizens’ be required to provide certain accounting reports – specifically an update to Citizens’ Exhibit\_(HSG-1), Schedule C3(R) no later than April 1, 2020, including actual capital expenditures, plant additions, and retirements by month for the twelve months ending December 31, 2019, followed by an additional update for actuals through December 31, 2020, no later than April 1, 2021. I&E argues that this type of reporting is needed and in the public interest until FPFTY regulations are implemented. I&E provides that this reporting will be an apples-to-apples comparison in a form directly corresponding to a schedule provided in the rate filing of what the Company is projecting and what actually will be in plant, allowing TUS and I&E to review the accuracy of the Company’s projections. This reporting will provide TUS and I&E with the information and opportunity required to review the accuracy of the Company’s projections. I&E Exc. at 11-12; I&E M.B. at 65-68, I&E R.B. at 24-25.

In Replies to I&E Exception No. 6, Citizens’ states that I&E’s Exception should be denied as the Recommended Decision correctly rejected I&E’s recommendation that Citizens’ be required to provide certain accounting reports. The Company must already submit numerous filings to 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. Additional reporting requirements would impose an unfair regulatory burden on small utilities such as Citizens’. 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 EDCs. The Company, therefore, requests that the Commission approve the ALJs’ recommendation and deny I&E's request for additional reporting requirements. Citizens’ R. Exc. at 14-15; Citizens’ M.B. at 117.

1. **Disposition**

We find that, on balance, and because reporting requirements are not uniform to all EDCs, requiring additional reporting by Citizens’, is unnecessary in this case. I&E had requested that Citizens’ be required to provide TUS and I&E with an update to its plant in service projections by updating Citizens’ Exhibit\_(HSG-1), Schedule C3(R) showing actual capital expenditures, plant additions, and retirements by month for the twelve months ending December 31, 2019, followed by an additional update for actuals through December 31, 2020, no later than April 1, 2021. I&E Exc. at 11-12. This proposal was soundly rejected by the ALJs. R.D. at 124-125.

We agree with I&E that the Code provides the Commission broad power to require informational filings from utilities and that the Commission has accepted a reporting requirement such as that requested by I&E in other rate proceedings. I&E Exc. at 11-12. However, the imposition of additional reporting requirements is not required by statute or regulation. The ALJs noted that the Commission may include such requirements at such time as it adopts comprehensive FPFTY regulations, but the ALJs did not require the reporting by Citizens’ in this proceeding. The ALJs emphasized that the proceedings cited by I&E in support of its request involved negotiated settlements where the utilities voluntarily agreed to the requested reporting. R.D. at 124-125.

In addition, a careful review of each case is advisable when considering the imposition of reporting beyond that required in the already heavily regulated utility industry. The instant case is distinguishable from I&E’s cited cases, in that there is no agreement by the utilities in the context of a negotiated settlement. Further, we find that requiring such augmented reporting is not in the public interest, because we have not adopted comprehensive FPFTY regulations defining reporting parameters. Finally, we find persuasive the Company’s argument that requiring increased reporting would impose an unfair regulatory burden on a small utility. R.D. at 124-125; Citizens’ R. Exc. at 14‑15.

We observe that, consistent with the regulatory requirements for EDCs, Citizens’ already submits numerous filings to the Commission each year, providing much of the information that I&E seeks. Citizens’ R. Exc. at 14-15; Citizens’ M.B at 117. Therefore, we adopt the ALJs’ recommendation on this reporting issue.

# Conclusion

We have reviewed the record as developed in this proceeding, including the ALJs’ Recommended Decision and the Exceptions and Replies filed thereto. Based upon our review, evaluation and analysis of the record evidence, we shall grant, in part, and deny, in part, the Exceptions filed by Citizens’, I&E and the OCA, and adopt the ALJs’ Recommended Decision, as modified, consistent with this Opinion and Order; **THEREFORE,**

**IT IS ORDERED:**

1. That the Exceptions of the Bureau of Investigation and Enforcement, filed on March 12, 2020, are granted, in part, and denied, in part, consistent with this Opinion and Order.

2. That the Exceptions of Citizens’ Electric Company of Lewisburg, PA, filed on March 13, 2020, are granted, in part, and denied, in part, consistent with this Opinion and Order.

3. That the Exceptions of the Office of Consumer Advocate, filed on March 13, 2020, are granted, in part, and denied, in part, consistent with this Opinion and Order.

4. That the Recommended Decision of Administrative Law Judges, Steven K. Haas and Benjamin J. Myers, issued on February 28, 2020, is adopted as modified by this Opinion and Order.

5. That Citizens’ Electric Company of Lewisburg, PA shall not place into effect the rates, rules, and regulations contained in Supplement No. 132 to Tariff Electric Pa. P.U.C. No. 14, as filed.

6. That Citizens’ Electric Company of Lewisburg, PA is authorized to file tariffs, tariff supplements and/or tariff revisions, on at least one day’s notice, and pursuant to the provisions of 52 Pa. Code §§ 53.1, *et seq.*, and 53.101, designed to produce an annual distribution rate revenue increase of approximately $494,749, to become effective for service rendered on and after May 1, 2020.

7. That Citizens’ Electric Company of Lewisburg, PA shall file detailed calculations with its tariff filing, which shall demonstrate to the Commission’s satisfaction that the filed tariff adjustments comply with the provisions of this final Opinion and Order.

8. That Citizens’ Electric Company of Lewisburg, PA shall allocate the authorized increase in operating distribution revenue to each customer class, and rate schedule within each customer class, in the manner prescribed in this Opinion and Order.

9. That, upon acceptance and approval by the Commission of the tariff supplements filed by Citizens’ Electric Company of Lewisburg, PA, consistent with this Opinion and Order, the investigation at Docket R-2019-3008212 be marked closed.

10. That Citizens’ Electric Company of Lewisburg, PA shall comply with all directives, conclusions, and recommendations contained in the body of this Opinion and Order, which are not the subject of an individual directive in these ordering paragraphs, as fully as if they were the subject of a specific ordering paragraph.

11. That the Complaint filed by the Office of Consumer Advocate in this proceeding at Docket Number C-2019-3011849 be dismissed and marked closed.

**BY THE COMMISSION,**

Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: April 16, 2020

ORDER ENTERED: April 27, 2020

**Pennsylvania Public Utility Commission**

**v.**

**Citizens’ Electric Company of Lewisburg, PA**

**Docket No. R-2019-3008212**

# Commission Tables Calculating Allowed Revenue Increase

**Table I Income Summary**

**Table IA Rate of Return**

**Table IB Revenue Factor**

**Table II Adjustments**

**Table III Interest Synchronization**

**Table IV Cash Working Capital: Interest and Dividends**

**Table V Cash Working Capital: Taxes**

**Table VI Cash Working Capital: O&M Expense**

















1. I&E submitted a request for an extension of time to file Exceptions and Reply Exceptions, which was approved by Secretarial Letter on March 6, 2020. The approval extended the due date for the filing of Exceptions to March 13, 2020 and the due date for the filing of Reply Exceptions to March 23, 2020. [↑](#footnote-ref-2)
2. The future test year (FTY) ended December 31, 2019, and the historic test year (HTY) ended December 31, 2018. [↑](#footnote-ref-3)
3. *See*, Citizens’ Exh.\_(HSG-1), Sch. C1. Citizens’ subsequently revised its proposed revenue increase to $701,264, reflecting a $74,029 decrease to its as-filed rate base claim and revising its claim for return on equity from 11.15% to 10.30%. Citizens’ St. 1-R at 2; Citizens’ Exh.\_(HSG-1R), Sch. C1(R). [↑](#footnote-ref-4)
4. Among other things, Section 1308(d) of the Code requires the Commission to render a final decision granting or denying, in whole or in part, the general rate increase requested by a public utility, within a general time frame not to exceed seven months from the proposed effective date of the utility’s proposed tariff supplement. *See*,66 Pa. C.S. § 1308(d); *see also*, 52 Pa. Code § 53.31 (requiring a tariff proposing rate increase to be effective upon sixty days’ advance notice). Unless the utility voluntarily extends the suspension period, the Commission’s non-action within this timeframe means, by operation of law, the utility’s proposed general rate increase will go into effect, as proposed, at the end of such period. *See*, 66 Pa. C.S. § 1308(d). [↑](#footnote-ref-5)
5. 1 Pa. C.S. § 1922(1), *PA Financial Responsibility Assigned Claims Plan v. English*, 541 Pa. 424, 430-431, 64 A.2d 84, 87 (1995). [↑](#footnote-ref-6)
6. It appears that the Recommended Decision inadvertently misstated the reduction in the Federal income tax rate due to the TCJA to be from 34%, rather than 35%, to 21%. [↑](#footnote-ref-7)
7. On March 18, 2020, the Department of the Treasury and the Internal Revenue Service (IRS) issued Notice 2020-17 providing relief under 26 U.S. Code § 7508A(a), which postponed the due date for filing certain Federal income tax returns and making Federal income tax payments from April 15, 2020 until July 15, 2020 in response to the ongoing Coronavirus Disease 2019 (COVID-19). Notice 2020-18 restated and expanded upon the relief provided in Notice 2020-17. [↑](#footnote-ref-8)
8. The OCA’s proposal averages the Company’s FPFTY projection of $26,687,785 (at December 31, 2020) with the FTY amount of $25,502,273 (at December 31, 2019) to obtain an adjusted FPFTY balance of $26,095,029. OCA St. 2, Sch. LKM‑1. [↑](#footnote-ref-9)
9. This discrepancy resulted from the inclusion of a Gross Receipts Tax expense of $282,719, based on the Company’s projected operating revenue for the FPFTY at *present rates*, in the Taxes other than income amount of $356,823, and the inclusion of a Gross Receipts Tax expense of $324,085, based on the Company’s projected operating revenue for the FPFTY at *proposed rates*, in the Taxes other than income amount of $398,189. Citizens’ Exh.\_(HSG-1), Sch. C1-3(R). [↑](#footnote-ref-10)
10. I&E Exhibit No. 3-SR, Schedule 2 specifically shows the projected average number of customers for each class for the twelve months ending December 31, 2020, based on the three-year average of customer growth from December 2015 through December 2018 projected into the FTY and FPFTY, in addition to removing the one-time loss of 32 customer in the FTY. [↑](#footnote-ref-11)
11. We note that I&E’s annualized FTY expense of $119,532 is based on the annualization of actual costs incurred during the first 6 months of the FTY, not the first 9 months as Citizens’ states on page 17 of its Exceptions. I&E St. 1 at 11. [↑](#footnote-ref-12)
12. Citizens’ averaged multiple ROE methods to determine a 9.05% cost of equity plus an additional 1.25% to reflect a size adjustment and management efficiency. [↑](#footnote-ref-13)
13. The OCA’s recommended ROE is the median value of all cost rates of the constant growth DCF and the FERC-two-step, an alternative model. [↑](#footnote-ref-14)
14. Citizens’ Rebuttal update reduced the recommended ROE for Citizens’ from 11.15% to 10.30%. Citizens’ M.B. at 64. [↑](#footnote-ref-15)
15. *2012* *PPL Order*; *Pa. PUC v*. *PPL Electric Utilities Corporation*, 237 P.U.R. 4th 419, 2004 Pa. PUC LEXIS 40 (December 2, 2004). [↑](#footnote-ref-16)
16. Wong, Annie, “Utility Stocks and the Size Effect: An Empirical Analysis,” *Journal of the Midwest Finance Association* (1993), at 95-101. [↑](#footnote-ref-17)
17. Zepp, Thomas M., “Utility Stocks and the Size Effect – Revisited,” *The Quarterly Review of Economics and Finance*, 43 (2003), at 578-582. [↑](#footnote-ref-18)
18. I&E notes, however, that it opposes any size adjustment. I&E R. Exc. at 10. [↑](#footnote-ref-19)
19. The “Tree Line USA” designation recognizes utilities that have made commitments to proper tree pruning techniques. [↑](#footnote-ref-20)
20. This issue is discussed at length in Section V.B. – Revenues, *supra*. [↑](#footnote-ref-21)
21. I&E’s recommendation to reallocate $35,816 of the revenue reduction assigned to the GLP-3 class, rather than the proposed reduction of $35,830, as stated by the Company, appears to be the result of rounding. [↑](#footnote-ref-22)
22. The typographical error in the table indicating Rate PL has been corrected to Rate OL. [↑](#footnote-ref-23)
23. The OCA indicated that the percentages in Table 1-S, provided on page 13 of OCA St. 4-SR, were based on Citizens’ ACCOSS in recognition that results of the OCA’s recommended ACCOSS did not vary significantly from the results of Citizens’ ACCOSS, and to facilitate the comparison of the proposed revenue distribution. OCA St. 4-SR at 13. [↑](#footnote-ref-24)
24. The customer-related components which produce $12.94 of the proposed $15.00 monthly customer charge are provided in the Company’s customer cost analysis on Schedule E1-C of Citizens’ Exhibit\_(HSG-1). [↑](#footnote-ref-25)
25. Citizens’ St. 1 at 32. [↑](#footnote-ref-26)
26. 52 Pa. Code § 69.3301. The 14 factors considered by I&E witness Cline and Citizens’ witness Gorman are now found at 52 Pa. Code § 69.3302. [↑](#footnote-ref-27)
27. Citizens’ witness Mr. Gorman states that “it would be reasonable to include the cost of additional kW of demand, based on the proportion of customers reaching certain levels of demand. In my view, including 0.38 kW-month of demand-related costs in the residential monthly charge is an appropriate first step for Citizens’. The Commission could increase this in future cases based on the percentage of the customers that it deems appropriate and on principles of gradualism.” Citizens’ St. 1 at 38. [↑](#footnote-ref-28)