**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17105-3265**

Public Meeting held October 4, 2018

Commissioners Present:

Gladys M. Brown, Chairman

Andrew G. Place, Vice Chairman, Statement

Norman J. Kennard, Statement

David W. Sweet

John F. Coleman, Jr.

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| Pennsylvania Public Utility Commission  Office of Consumer Advocate  Office of Small Business Advocate  Matthew Josefwicz  Barbara McDade  v.  UGI Utilities, Inc. – Electric Division | R-2017-2640058  C-2018-2646178  C-2018-2647268  C-2018-2647099  C-2018-3000056 |

**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 Andrew M. Calvelli, issued on August 24, 2018, relative to the above-captioned general rate increase proceeding. Also, before the Commission are the Exceptions and Replies to Exceptions filed with respect thereto.

Exceptions to the Recommended Decision were filed on September 13, 2018, by the following Parties: UGI Utilities, Inc. – Electric Division (UGI or Company), the Commission’s Bureau of Investigation and Enforcement (I&E), the Office of Consumer Advocate (OCA), and the Office of Small Business Advocate (OSBA). On September 24, 2018, UGI, I&E, the OCA, and the OSBA filed Replies to Exceptions.

Also, before the Commission is the Partial Stipulation Resolving Certain Contested Issues (Joint Stipulation) filed on June 20, 2018, by UGI, I&E, the OCA, and the OSBA. For the reasons stated, *infra*, we shall adopt the Joint Stipulation. Additionally, we shall grant, in part, and deny, in part, the Exceptions filed by UGI, I&E and the OCA, deny the Exception filed by the OSBA, and adopt the ALJs’ Recommended Decision, as modified, consistent with this Opinion and Order.

As discussed below, UGI proposed a rate base change that would have increased its annual revenues by $7.705 million, or 8.6%, based on a fully projected future test year (FPFTY) ending September 30, 2019. In this Opinion and Order, we shall approve an annual revenue increase of $3.201 million, or 3.6%. Additionally, the Company proposed to increase its monthly residential customer charge from $5.50 to $14.00. Although we shall approve the Company’s proposed rate design, this Opinion and Order directs UGI to scale back its rates proportionally to the percent increase originally requested.

# Background

UGI provides electric distribution services to approximately 61,832 residential, commercial and industrial customers in a service territory of approximately 1,200 square miles in portions of Luzerne and Wyoming Counties. UGI maintains over 1,200 miles of overhead and underground primary distribution lines, twelve distribution substations and forty-nine distribution circuits. The Company is a public utility and an electric distribution company (EDC) as those terms are defined in the Pennsylvania Public Utility Code (Code), 66 Pa. C.S. §§ 102 and 2803.

UGI seeks approval of an increase in its annual jurisdictional distribution operating revenues of $7.705 million. The Company’s requested increase is based on a fully projected future test year (FPFTY) ending September 30, 2019, and is designed to provide the Company with an opportunity to earn an 8.24% overall rate of return, including an 11.25% return on common equity, on a claimed rate base of $119.242 million. In its request, UGI proposes to increase its residential monthly customer charge from $5.50 to $14.00.

UGI asserts that the requested rate increase reflects the business environment the Company currently faces, including: accelerated investment in the repair, replacement or improvement of an aged and aging distribution system; the modernization of core technology systems occurring as a part of the UGI Next Information Technology Enterprise (UNITE) system modernization initiative at UGI Utilities, Inc.; the modernization, consolidation and relocation of UGI operations personnel out of outdated facilities and into a new operations center location; and modest increases in employee wages and salaries since its last base rate case in 1996. UGI further asserts that the growth in operating and capital costs, along with relatively stagnant customer usage and growth trends, prevent it from earning a fair rate of return on its investment, at present rate levels.

1. **History of Proceeding**

On January 26, 2018, UGI filed Tariff – Electric PA. P.U.C. Nos. 6 and 2S (Tariff Nos. 6 and 2S), to become effective March 27, 2018. In Tariff Nos. 6 and 2S, UGI proposed changes to its base retail distribution rates designed to produce an increase in revenues of approximately $9.254 million, based upon data for the FPFTY ending September 30, 2019. In its initial filing, however, UGI noted that it intended to submit Supplemental Direct Testimony to address the impact of the recently enacted federal Tax Cuts and Jobs Act of 2017, Public Law No. 115-97, 131 Stat. 2054 (the TCJA), which became effective on January 1, 2018. Thereafter, UGI served Supplemental Direct Testimony and revised supporting information that reflected the impacts of the TCJA on UGI’s initial filing and updated its claimed revenue increase to $8.491 million.

By Order entered March 1, 2018, Tariff Nos. 6 and 2S were 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 October 27, 2018, unless permitted by Commission Order to become effective at an earlier date. The Commission also initiated an investigation of UGI’s proposed general rate increase.

On February 5, 2018, I&E filed a Notice of Appearance. Complaints against the proposed rate increase were filed by the OCA, on February 6, 2018; Matthew Josefwicz, on February 8, 2018; the OSBA, on February 12, 2018; and Barbara McDade, on February 22, 2018.

On March 12, 2018, UGI filed the Supplemental Direct Testimony of five witnesses, as well as Revised Exhibit A – Fully Projected, Revised Exhibit A – Future, Revised Exhibit D – Cost of Service Study, and Revised Exhibit E – Proof of Revenues. The Supplemental Direct Testimony and revised exhibits reflect the effects of the TCJA on the 2018 Base Rate Case. These adjustments reduced the Company’s revenue increase from $9.254 million to $8.491 million.

Two public input hearings were held on April 18, 2018, at which four UGI customers testified telephonically. Complainant Barbara McDade presented on the record testimony at the public input hearing. R.D. at 134-136.

On April 26, 2018, I&E, the OCA and the OSBA served their Direct Testimony and associated exhibits. On May 25, 2018, UGI, the OCA and the OSBA filed Rebuttal Testimony and associated exhibits. I&E, OCA and OSBA served Surrebuttal Testimony and exhibits on June 7, 2018. On June 11, 2018, UGI served Rejoinder Testimony and exhibits. Pursuant to UGI’s Rebuttal Testimony and the Partial Stipulation, which uses a total rate base of $119.242 million and a return on equity of 11.25%, UGI submitted a final claimed revenue increase of $7.705 million.

Evidentiary hearings were held on June 11, 2018, and June 12, 2018, at which the Parties’ respective testimonies and exhibits were admitted into the evidentiary record and various witnesses were cross-examined. Formal Complainants Matthew Josefwicz and Barbara McDade did not submit any testimony during the evidentiary hearings and did not appear at or participate in the evidentiary hearings. On June 20, 2018, UGI, I&E, the OCA and the OSBA filed the Joint Stipulation

UGI, I&E, the OCA and the OSBA filed Main Briefs on July 2, 2018, and Reply Briefs on July 18, 2018. The record was closed on July 18, 2018, upon the filing of the parties’ Reply Briefs.

In their Recommended Decision issued on August 24, 2018, the ALJs recommended that the Company be permitted to file tariffs or tariff supplements containing rates designed to produce a $2,789,000 increase over its present annual operating revenues. R.D. at 136. As previously noted, UGI, I&E, the OCA and the OSBA filed Exceptions on September 13, 2018, and Replies to Exceptions on September 24, 2018.

1. **Legal Standards**

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) 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,[[1]](#footnote-1) 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 issue 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)

1. **Joint Stipulation of Partial Settlement**

UGI, I&E, the OCA and the OSBA[[2]](#footnote-2) filed the Joint Stipulation to resolve the following outstanding issues pertaining to the proposed rate increase: (1) UGI’s capital structure, (2) its depreciation rates, (3) the electric vehicle (EV) rider, (4) the storm damage expense rider, (5) the Pennsylvania Public Utility Realty Tax (PURTA), (6) the Company’s universal service programs, and (7) miscellaneous accounting issues. As summarized below, the ALJs recommended approval of the settlement terms for each of these issues as being in the public interest. R.D. at 6-12.

1. **Capital Structure**

The ALJs noted UGI’s description of its capital structure in the direct testimony of Paul R. Moul. In his testimony, Mr. Moul recommended using UGI’s actual capital structure ratios at the end of the FPFTY of 45.98% long-term debt and 54.02% common equity. R.D. at 6 (citing UGI St. 5 at 15).

As part of the Joint Stipulation, the Joint Petitioners agreed to accept UGI’s capital structure of 45.98% long-term debt and 54.02% common equity. The ALJs found this provision to be in the public interest because it properly reflects the Company’s capital structure, which is within the barometer group proposed in the testimony of UGI and I&E. The ALJs further concluded that the provision otherwise conforms to the practice normally adopted by the Commission in determining capital structure. R.D. at 7.

1. **Depreciation Rates**

The ALJs explained that UGI’s depreciation studies, accrued depreciation claim, and annual depreciation expense claim were set forth in UGI St. 7 and UGI Exhibits C (Historic), C (Future), and C (Fully Projected). The OCA proposed to reduce the Company’s depreciation expense based on two primary changes: (1) increasing the service lives for certain distribution plant accounts; and (2) changing the longstanding, approved depreciation calculation procedure known as the Equal Life Group (ELG) procedure to the Average Service Life (ASL) procedure. R.D. at 7 (citingOCA St. 2).

After the submission of rebuttal testimony and further negotiations, the Joint Petitioners agreed to accept UGI’s as-filed depreciation rates. Joint Stipulation at ¶ 7. According to the ALJs, this provision is in the public interest because it properly accounts for UGI’s outlook and plans, including its Commission-approved Long-Term Infrastructure Improvement Plan (LTIIP), and is consistent with the depreciation procedure used by most other Pennsylvania utilities. R.D. at 7.

1. **EV Rider**

During its direct case, UGI proposed to install and maintain EV charging station equipment. The ALJs indicated that the Company’s proposed Rate EV consisted of a flat monthly charge based on the equipment costs and maintenance expenses associated with the station type and energy usage rates at the applicable Generation Supply Rate (GSR) or electric generation supplier (EGS) generation rate. Additionally, customers electing service under the rate would be responsible for installation costs incurred by UGI. R.D. at 7-8 (citing UGI St. 8 at 14). However, the ALJs noted that both the OCA and the OSBA opposed the EV rider for a variety of reasons. R.D. at 8 (citing OCA St. 4 at 26 and OSBA St. 1 at 26-27).

Pursuant to the Joint Stipulation, UGI agreed to withdraw the Rate EV rider at this time without prejudice to the Company’s right to refile it in a future rate case or in a separate proceeding at the Company’s discretion. Joint Stipulation at ¶ 8. The ALJs viewed this provision as being in the public interest because it removes a contentious issue from the proceeding and allows UGI to continue to explore options that further the Commission’s goal of fostering the development of a market for EVs in Pennsylvania. R.D. at 8.

1. **Storm Damage Expense Rider**

In order to provide for timely tracking of storm expenses, UGI proposed a new Storm Expense Rider (SER). In the SER, UGI sought to recover or refund storm damage expenses in excess, or below a base amount of $275,000 claimed in base rates. UGI St. 8 at 13. I&E and the OCA opposed the SER. I&E St. 1 at 41; OCA St. 4 at 25‑26.

In the Joint Stipulation, UGI agreed to withdraw the proposed SER without prejudice to its right to refile the SER in a future rate case or to file with the Commission for deferral of any major storm expenses incurred on and after June 1, 2018. Joint Stipulation at ¶ 9. The ALJs explained that the Company believes that the rider for storm recovery is appropriate because of the unique nature of storm events and their potentially devastating physical and financial impacts. According to the ALJs, however, removal of the recovery provision is in the public interest because it resolves a contested issue in a way that does not reduce or undermine UGI’s ability to recover appropriately identified storm expenses as part of this proceeding and does not limit UGI’s ability to file for deferred accounting of any storm expenses incurred after the period reflected in actual storm expenses in this base rate proceeding. The ALJs also noted that the withdraw of the provision does not impact UGI’s ability to seek an SER in the future if UGI believes it is appropriate to do so. R.D. at 8-9.

1. **Pennsylvania Public Utility Realty Tax**

The Parties disputed the appropriate level of PURTA to be reflected in rates. I&E had recommended an adjustment to the Company’s PURTA claim based on the belief that the 2016 PURTA Notice of Determination issued by the Pennsylvania Department of Revenue in the amount of $449,000 was an outlier that will not be repeated in future years. I&E argued that this uncommon occurrence should not be used as the basis for the Company’s claim. I&E St. 4 at 7-9.

In the Joint Stipulation, the Joint Petitioners agreed that base rates established in this proceeding shall reflect $97,000 for PURTA obligations. They further agreed that any future recalculations of the State Tax Adjustment Surcharge (STAS) after the effective date of new rates in this proceeding also shall reflect this base amount unless and until a different tax obligation is established by the Pennsylvania Department of Revenue. Joint Stipulation at ¶ 10. The ALJs concluded that this provision is in the public interest because it addresses I&E’s concern that the 2016 PURTA Notice received by the Company is an outlier, while still allowing the Company to recover future PURTA assessments, pursuant to the STAS mechanism. R.D. at 9.

1. **Universal Service Programs**

UGI did not propose any changes regarding the administration, services provided, or funding levels of its universal service programs in this distribution base rate proceeding. However, the ALJs noted that the OCA recommended several structural changes to UGI’s universal service programs which were largely unrelated to the proposed rate increase. R.D. at 9 (citing OCA St. 5). In response, UGI submitted that it believes the universal service program issues are better dealt with in its triennial universal service program filing, which is currently pending Commission review. Nonetheless, the Company agreed to address and adopt certain proposed changes to its universal service programs in this proceeding. R.D. at 9-10.

In the Joint Stipulation, the Joint Petitioners agreed to use a base Customer Assistance Program (CAP) participation of 2,448, which reflects the 12‑month period ending December 2017, for purposes of applying a CAP credit and arrearage forgiveness credit offset to CAP costs collected through the Company’s Rider C. Under the settlement terms, which adopted the OCA’s position, the number of CAP participants will be the average monthly number of CAP participants in the 12‑month period for which costs are being reconciled. Joint Stipulation at ¶ 11(a).

The Joint Stipulation provided that UGI will accept self-certification of low income status for purposes of identifying “confirmed low-income customers” in the same way that self-certification is required to be accepted by the UGI Gas affiliates. Joint Stipulation at ¶ 11(b). The ALJs acknowledged UGI’s argument that this provision of the Joint Stipulation is in the public interest, because it will harmonize UGI’s practices with those of its affiliate natural gas companies. R.D. at 10.

The Joint Stipulation also provided that UGI will modify Rider C (proposed tariff page 42) to include the following italicized language: “CAP costs will be calculated to include: 1) the projected CAP credit; 2) projected CAP customer application and administrative costs *paid to external agencies that would not have been incurred in the absence of CAP*; and . . .. ” Joint Stipulation at ¶ 11(c).

In addition, the ALJs noted that UGI has agreed in the Joint Stipulation to clarify that it is currently acting in accordance with two of the OCA’s universal service recommendations. First, UGI agreed to allow year-round rolling enrollment for its budget billing program and shall modify related tariff language accordingly in its compliance filing. Joint Stipulation at ¶ 11(d). Second, UGI agreed that for customers completing payment plans, UGI will automatically retain the customer on budget billing unless the customer explicitly requests to be removed from budget billing. Joint Stipulation at ¶ 11(e). Regarding UGI’s budget billing program, the ALJs highlighted that the Company has been permitting year-round rolling enrollment; however, it appeared that UGI’s tariff language had not been updated to properly reflect that rolling enrollment was available to its customers. The ALJs noted that UGI will clarify this procedure now that this error has been identified. As to the OCA’s recommendation to retain customers on budget billing upon completion of payment plans, the ALJs explained that UGI already keeps customers on budget billing once they have completed a payment plan and will continue to follow this practice. R.D. at 10-11.

1. **Miscellaneous Accounting Issues**

UGI initially proposed to capitalize certain costs incurred to develop new database assets in connection with its use of cloud-based information services. Under generally accepted accounting principles (GAAP), such costs are ordinarily accounted for as operating expenses. The ALJs noted that in this proceeding, however, UGI requested Commission approval to record these costs as a long-lived capital asset. R.D. at 11 (citing UGI St. 4 at 13-15). According to the ALJs, no party challenged or otherwise opposed UGI’s proposed accounting treatment for the cloud-based information services. As such, the Joint Petitioners agreed that UGI will be permitted to record the Cloud Based Implementation Costs, as described on pages 13-15 of the direct testimony of Megan Mattern, UGI St. 4, as a capital asset and shall begin depreciation of the costs after the systems are placed in service. Joint Stipulation at ¶ 12(a). The Joint Petitioners also agreed that, with regard to UGI’s UNITE Phase 2 Costs, UGI will be permitted to capitalize the pre-implementation costs, as described on page 15 of the direct testimony of Megan Mattern, UGI St. 4, and will begin depreciation of the costs after the systems are placed in service. Joint Stipulation at ¶ 12(b).

According to the ALJs, the Joint Stipulation provisions are in the public interest because they recognize that the new databases will provide benefits to customers over extended periods of time and not just the period in which the costs are incurred. The ALJs concluded that UGI’s cloud-based services will offer many advantages to traditional on-premise software such as enhanced security, reliability, and flexibility. The databases created for the cloud-based services will also be used by UGI to optimize various aspects of the utility service provided to its customers over, at a minimum, the life of the cloud-based service agreement. Moreover, the ALJs determined that UGI will retain ownership and control of these databases after the close of the cloud-based service for which they are being created and likely will use the information in subsequent applications. Accordingly, the ALJs found that it is appropriate for the costs of these cloud-based services to be capitalized and depreciated over the life that the databases will remain used and useful. R.D. at 10-11.

1. **Disposition**

The policy of the Commission is to encourage settlements, and the Commission has stated that settlement rates are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa. Code §§ 5.231, 69.401. A full settlement of all the issues in a proceeding eliminates the time, effort and expense that otherwise would have been used in litigating the proceeding, while a partial settlement may significantly reduce the time, effort and expense of litigating a case. A settlement, whether whole or partial, benefits not only the named parties directly, but, indirectly, all customers of the public utility involved in the case. *Pa. PUC, et al. v. Columbia Gas of Pennsylvania, Inc.*, Docket Nos. R-2015-2468056, *et al.* (Order entered December 3, 2015) at 6-7.

Rate increase proceedings are expensive to litigate, and the reasonable cost of such litigation is an operating expense recovered in the rates approved by the Commission. Partial or full settlements allow the parties to avoid the substantial costs of preparing and serving testimony and the cross-examination of witnesses in lengthy hearings, the preparation and service of briefs, reply briefs, exceptions and replies to exceptions, together with the briefs and reply briefs necessitated by any appeal of the Commission’s decision, yielding significant expense savings for the company’s customers. For this and other sound reasons, settlements are encouraged by long-standing Commission policy. *Id.*

Despite the policy favoring settlements, the Commission does not simply rubber stamp settlements without further inquiry. In order to accept a settlement such as those proposed here, the Commission must determine that the proposed terms and conditions are in the public interest. *Pa. PUC v. York Water Co.*, Docket No. R‑00049165 (Order entered October 4, 2004); *Pa. PUC v. C. S. Water and Sewer Assoc.*, 74 Pa. P.U.C. 767 (1991).

The Joint Stipulation resolves a variety of the issues necessary for the ultimate resolution of the rate proceeding. It also removes several potentially contentious issues that would have prolonged or required further litigation or administrative proceedings. The benefits of approving the Joint Stipulation are numerous and will result in savings of time and expenses for all Parties involved by avoiding the necessity of further administrative proceedings, as well as possible appellate court proceedings, conserving precious administrative resources. Moreover, the Joint Stipulation provides regulatory certainty with respect to the disposition of issues which benefits all parties. We agree with the ALJs’ conclusions that the provisions of the Joint Stipulation are in the public interest. Accordingly, we shall adopt the ALJs’ recommendation and approve the Joint Stipulation, without modification.

1. **Rate Base**

As discussed above, UGI has requested that the Commission approve an increase in annual jurisdictional operating revenues of $7.705 million. The Company bases this increase on an FPFTY ending September 30, 2019, which is designed to provide UGI with the opportunity to earn an 8.24% overall rate of return on rate base, including an 11.25% return on common equity, on a claimed rate base of $119.242 million. UGI Main Brief, Exh. A, Schedule A-1.

I&E and the OCA have proposed adjustments to the rate base. I&E submitted that the Company should receive a revenue increase of only $824,000 with a return on common equity of 8.62%. I&E R. Brief at 77. Initially, the OCA proposed a revenue increase of $1,237,000 with an 8.5% return on common equity. In response to the Joint Stipulation, the OCA later revised its proposed revenue increase to approximately $2.1 million. OCA Main Brief, Appx. A, Table 1 – Income Summary.

A threshold issue is whether UGI is permitted to premise its FPFTY rate base and associated depreciation expense on the use of a year-end rate base methodology as the Company proposes. In opposition, I&E, the OCA and the OSBA recommend using an average rate base methodology.

In their Recommended Decision, the ALJs provided an overview of the legislative changes implemented under Act 11 of 2012 – codified in Section 315 of the Code, 66 Pa. C.S. § 315 (Act 11) – which amended the burden of proof requirements in rate proceedings by authorizing a utility to employ an FPFTY to meet its burden. The ALJs explained that under Act 11, a utility, as part of its base rate case, may use an FPFTY to project items such as revenues, operating expenses, and capital expenditures throughout a twelve-month period beginning with the first month that new rates would be in effect. R.D. at 13. Specifically, Act 11 added provisions pertaining to the burden of proof requirements as set forth in the following emphasized portions of Section 315 of the Code:

§ 315. Burden of proof.

\* \* \*

(e) Use of future test year.—In discharging its burden of proof the utility may utilize a *future test year or a fully projected future test year, which shall be the 12-month period beginning with the first month that the new rates will be placed in effect after application of the full suspension period permitted under section 1308(d) (relating to voluntary changes in rates).* The commission shall promptly adopt rules and regulations regarding the information and data to be submitted when and if a future test period or a fully projected future test year is to be utilized. Whenever a utility utilizes a future test year or a fully projected future test year in any rate proceeding and such future test year or a fully projected test year forms a substantive basis for the final rate determination of the commission, the utility shall provide, as specified by the commission in its final order, appropriate data evidencing the accuracy of the estimates contained in the future test year *or a fully projected future test year*, and the commission may after reasonable notice and hearing, in its discretion, adjust the utility's rates on the basis of such data. *Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission may permit facilities which are projected to be in service during the fully projected future test year to be included in the rate base.*

66 Pa. C.S. § 315(e) (emphasis added).

Thus, Act 11 defines the FPFTY as the twelve-month period that begins with the first month that the new rates will be placed into effect after the application of the full suspension period permitted under Section 1308(d) of the Code, 66 Pa. C.S. § 1308(d). The ALJs noted that UGI used the twelve months ending September 30, 2017, as the historical test year (HTY), the twelve months ending September 30, 2018, as the future test year (FTY), and the twelve months ending September 30, 2019, as the FPFTY. R.D. at 14.

1. **Original Cost Utility Plant-in-Service**
2. **End of Year vs. Average Rate Base Methodology**
3. **Position of Parties**

Originally, UGI projected a claim for original cost utility plant-in-service in the amount of $188,423,000. The Company prepared this claim using its intangible assets (*i.e.*, organization costs, franchise and consents cost, and land and land right costs) and its tangible assets (*i.e*., facilities and equipment) and based it on projected plant-in-service at the end of the FPFTY on September 30, 2019. R.D. at 14.

The opposing parties – I&E, the OCA, and OSBA[[3]](#footnote-3) – objected to UGI’s calculation of plant-in-service at the end of the FPFTY and instead proposed an “average” rate base calculation. I&E argued, in part, that the absence of clear guidance from the Commission regarding application of the FPFTY necessitates UGI’s use of an average rate base methodology. According to I&E, an average rate base methodology results in rates that are more just and reasonable because ratepayers are not paying for approximately a year of plant that is only proposed and is not guaranteed to be completed and placed into service. Thus, I&E argued that UGI’s FPFTY year-end utility plant-in-service claim be rejected. Instead, I&E proposed the adoption of a total utility plant-in-service amount of $173,871,383. R.D. at 15 (citing I&E St. 3 at 4-13, I&E St. 3-SR at 2-12).

The OCA also argued that rates must be set based on the average rate base projected to be used and useful in the FPFTY. The OCA contended that using an average rate base properly matches the calculation of rate base with the other elements of UGI’s revenue requirements and income in a given year. The OCA submitted that the average rate base is preferable because it measures the net investment over the course of the year, rather than as of a point in time at the end of the year.[[4]](#footnote-4) According to the OCA, it is internally consistent with the measurement of expenses, billing determinants, and income over the course of the year. R.D. at 17-18.

In response, UGI contended that the arguments of the opposing parties are inconsistent with the plain language of Act 11, the policy of Act 11, and are factually incorrect. R.D. at 14.

1. **Recommended Decision**

The ALJs noted that a fundamental principle of utility regulation is that a public utility should be permitted to include projects in rate base and earn a reasonable return on its investments after they became “used and useful” for the utility’s public service. However, the ALJs concluded that Act 11 fundamentally altered ratemaking in Pennsylvania by adopting the FPFTY to reduce the risks associated with regulatory lag. The ALJs found that the plain language and policy of Act 11 permits UGI to base its FPFTY, and associated depreciation expense, on the use of a year-end rate base methodology. Accordingly, the ALJs found in favor of UGI on this issue. R.D. at 19‑22.

1. **Exceptions and Replies**

In its Exception No. 2, I&E argues that in the absence of clear guidance regarding the application of the FPFTY to rate base proceedings, UGI’s position should be rejected and an average rate base methodology should be used to calculate UGI’s FPFTY utility plant-in-service amount. This will result in rates that are more just and reasonable because ratepayers are not paying for plant that is not yet in service. I&E Exc. at 6-10.

The OCA, in its first Exception, contends that the ALJs erred by accepting UGI’s proposal because the plain language of Act 11 does not directly address this issue. Thus, in order to comply with the standard that rates be just and reasonable, the OCA takes the position that rates must be set based on the average rate base projected to be used and useful in the FPFTY. OCA Exc. at 2-6.

The OSBA, likewise, asserts in its Exception that the use of an average rate base for the FPFTY provides a proper match between the period when costs are incurred and the period when new rates are in place. In contrast, the OSBA contends that UGI’s methodology results in ratepayers being charged for the entire year for assets that go into place throughout the year. OSBA Exc. at 3-7.

In its Replies to the Exceptions, UGI submits that the use of end of test year data to calculate its claimed plant in service is fully consistent with, *inter alia*,the plain language of Act 11, the goal of Act 11 to reduce regulatory lag, and long-standing precedent approving calculation of rate base at a point in time, *i.e*., the end of the relevant test year. UGI also argues that the rate base deductions sought by I&E and the OCA as to Employee Additions Expense, Annual Depreciation Expense, Salaries and Wages Net of Employee Additions, Power Supply Expense and EADIT should be rejected because the adjustments are directly tied to the ALJs’ adoption of the end of FPFTY methodology. UGI R. Exc. at 3-8; UGI M.B. at 25-34.

1. **Disposition**

Upon review, we agree with the rationale and the recommendation of the ALJs to permit UGI to utilize a year-end rate base methodology. Accordingly, we shall deny the Exceptions of I&E, the OCA and the OSBA on this issue.

The ALJs explained that Act 11 addressed regulatory lag and encourages plant investment to address aging infrastructure in two separate but related ways by authorizing: (1) the use of an FPFTY; and (2) a Distribution System Improvement Charge (DSIC) in certain conditions under 66 Pa. C.S § 1358(b)(1). The ALJs correctly noted that the Commission has long recognized regulatory lag as an important variable that should be addressed in the ratemaking process. R.D. at 19 (citing *Lower Paxton Twp. v. Pa. Pub. Util. Comm’n*, 317 A.2d 917, 921 (Pa. Cmwlth. 1974), and *Implementation of Act 11 of 2012,* Final Implementation Order, Docket No. M-2012-2293611 (Order entered August 2, 2012) (*Implementation Order*)).

Additionally, Section 315(e) of the Code specifically exempts application of 66 Pa. C.S. § 1315, which, for electric utilities, requires projects to be “used and useful” before being included in the rate base. The ALJs properly determined that the “used and useful” standard in Section 1315 is not a bar to including all plant added during the FPFTY.

The “used and useful” standard is set forth in Section 1315 as follows:

**§ 1315. Limitation on consideration of certain costs for electric utilities.**

Except for such nonrevenue producing, nonexpense reducing investment as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is *used and useful* in service to the public. Excepted as stated in this section, no electric utility property shall be deemed *used and useful until it is presently providing actual utility service to the customers.*

66 Pa. C.S. § 1315 (emphasis added).

However, the new language under Act 11 as set forth in Section 315(e) plainly exempts the application of Section 1315 which, for electric utilities, requires projects to be “used and useful” before being included in the rate base. Specifically, the last sentence of 315(e) provides:

. . . Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission may permit facilities which are projected to be in service during the fully projected future test year to be included in the rate base. . ..

66 Pa. C.S. § 315(e).

Thus, by using an FPFTY, a utility is essentially permitted to require ratepayers to pre-pay a return on its projected investment in future facilities. This is evident because: (1) the future facilities are not in place and providing service at the time the new rates will take effect; and (2) there is no guarantee of the facilities being completed and placed into service. Therefore, we agree 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.

In addition, we find no error in the ALJs’ rejection of the OCA’s arguments pertaining to a decision issued by a public utility commission in another state. The OCA cited to a decision of the Illinois Commerce Commission in *Re North Shore Gas Company,* ICC Docket Nos. 12-0511/0512, 2013 WL 3762292 (Order entered June 18, 2013) (*North Shore Gas*), which found that an average rate base methodology was more appropriate than a year-end rate method because the year-end method inappropriately assumes that all investments are made at the beginning of the test year. OCA Exc. at 4; OCA M.B. at 16. Although the decision of a contemporary jurisdiction may have persuasive value in some circumstances, we are not bound by such a decision, especially in this case where a different state statute exists. As the ALJs noted, it would be inappropriate to consider another jurisdiction’s statute where there was no indication that the General Assembly based Pennsylvania legislation on legislation adopted in other jurisdictions. R.D. at 21 (citing *Elder v. Orlucky*, 515 A.2d 517, 522 (Pa. 1986)).

The ALJs also properly recognized that it is not persuasive to cite to one provision of another jurisdiction’s ratemaking practice without looking at other issues and aspects of that jurisdiction’s overall ratemaking policy. Indeed, different jurisdictions adopt different approaches and mechanisms to various ratemaking issues, including capital structure, cost of equity, normalization, annualization and amortization, automatic adjustment clauses and post-test year adjustments. Therefore, the ALJs found it inappropriate to select one isolated element of the ratemaking formula from another jurisdiction and apply it to Pennsylvania ratemaking policy. We agree.[[5]](#footnote-5)

Regarding the concerns that UGI’s projections may be overstated if plant is not completed, we agree with the ALJs that this issue is addressed through some of the available protections that the Commission may invoke, including requiring verification through a subsequent rate filing and ordering an audit when appropriate. In our *Implementation Order*, we expressed an interest in back testing prior projections through subsequent rate filings. “[A]lthough there is no reconciliation of revenue and expenses between base rate cases we expect that in subsequent base rate cases, the utility will be prepared to address the accuracy of the fully projected [future] test year projections made in its prior base rate case.”  *Implementation Order* at 7.

Furthermore, the legislature has addressed the concerns of overstated plant projections in Section 315(e) of the Code, which authorizes a Commission audit of the FPFTY results after the fact to determine whether they were accurate and an adjustment of rates to reflect material differences. Section 315(e) provides in pertinent part:

. . . Whenever a utility utilizes a . . . fully projected future test year in any rate proceeding and such . . . fully projected test year forms a substantive basis for the final rate determination of the commission, the utility shall provide, as specified by the commission in its final order, appropriate data evidencing the accuracy of the estimates contained in the . . . fully projected future test year, and the commission may after reasonable notice and hearing, in its discretion, adjust the utility's rates on the basis of such data . . . .

66 Pa. C.S. § 315(e).

1. **Electrical Engineering and Operations Center**
2. **Positions of the Parties**

In its original filing, UGI proposed a claim of $10 million for an Electric Engineering and Operations Center (Operations Center). UGI St. 3 at 16. According to UGI, the Operations Center project includes the remodeling of an existing 54,000 square-foot facility and associated property which will accommodate all of the Company’s needs at one location, including consolidation of office and field personnel, development of a dedicated electric training area, creation of a back-up Energy Control Center, and existing future warehouse needs. UGI reflected the proposed costs in plant-in-service because it projects the new Operations Center will be placed into service in the FPFTY by September 2019. In rebuttal testimony, UGI updated this claim, increasing the budgeted amount from $10 million to $17.3 million based on a “more comprehensive estimate” of expected costs. UGI St. 3-R at 17.

According to UGI, the original cost of $10 million significantly underestimated the construction cost per square foot, in addition to other significant cost areas such as site preparation, paving, utilities, furnishings and storm water retention costs, and it did not consider adequate room for growth, training facilities, warehouse space and staging area for assistance crews and vehicles. *Id.* at 17-18.

The OCA opposed the claim for the Operations Center and requested that an adjustment to UGI’s plant-in-service should be made to remove the $17.3 million in the FPFTY. The OCA argued that the Company’s updated information was speculative and that UGI’s confidential exhibits raised serious concerns about the completion of the project during the FPFTY because UGI has failed to demonstrate that the new Operations Center will be in operation in the FPFTY. OCA St. 1-S at 2-3 (OCA’s confidential analysis of UGI Exhibit EWS-8). In support of its position, the OCA contends that: (1) as of the date of the evidentiary hearing, there was no formal agreement to purchase the property; (2) no contractors had been hired to do the remodeling and site preparations to complete the Operations Center; (3) UGI only recently toured the facilities; and (4) UGI has not followed any disciplined budgeting process in making the changed proposal. R.D. at 23-24.

1. **Recommended Decision**

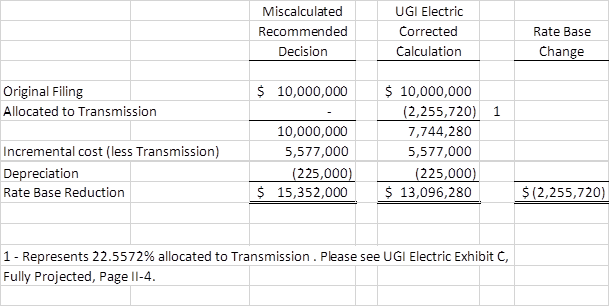
The ALJs agreed with the OCA and found that UGI did not sufficiently demonstrate that the new Operations Center will be in operation in the FPFTY. The ALJs found it significant that as of the date of the evidentiary hearing, there was no formal agreement to purchase the property, no contractors had been hired to do the remodeling and site preparations to complete the Operations Center, and that UGI only recently toured the facilities. According to the ALJs, the proposed facility appears to remain in preliminary planning stages. Thus, the ALJs determined that there was too much uncertainty surrounding the proposed $17.3 million Operations Center to conclude with reasonable certainty that it will be operational in the FPFTY. R.D. At 24.

Accordingly, the ALJs adjusted UGI’s plant-in-service claim by removing the $17.3 million for the proposed new Operations Center in the FPFTY. The ALJs explained that the actual adjustment to rate base should be $15.352 million. The ALJs assumed that the initial $10 million claim was entirely a rate base item. Regarding the remaining $7.3 million, the ALJs continued, it appears that only $5.577 million is attributable to plant in service less the depreciation expense of $225,000. R.D. at 24 (citing UGI St. 2-RJ at 2).

1. **Exceptions and Replies**

In its Exception Nos. 2 and 3, UGI objects to the ALJs’ exclusion of the Operations Center from rate base and their associated calculation of the impact on rate base, respectively. In its Exception No. 2, UGI argues that it provided ample record evidence that its proposed Operations Center will be in service within the FPFTY and that the OCA has produced no evidence to the contrary. Thus, UGI submits that, as explained in more detail below, it is appropriate to include $13.4 million in rate base consistent with Act 11 because the plant will be in service within the FPFTY. UGI Exc. at 18-21.

With regard to the ALJs’ calculation of the impact the Operations Center will have on its rate base, the Company contends that the full $10 million was not included in rate base. Instead, consistent with the Company’s transmission and distribution separation study, approximately $2.3 million of the original $10 million claim was allocated to the transmission function. UGI St. 2 at 9‑10. UGI submits that when the Company increased its total Operations Center claim to $17.3 million, only $13.4 million was applied to distribution service, and $3.9 million was allocated to transmission service. According to UGI, the ALJs’ calculation overstates the rate base reduction by approximately $2.25 million, which translates to a $237,000 reduction in the revenue requirement. UGI submits that if the Commission adopts the ALJs’ recommendation, it should also adopt the correct rate impact calculation as follows:



UGI Exc. at 21-23.

In its Replies, the OCA asserts that the ALJs properly determined that UGI did not sufficiently demonstrate that the Operations Center will be in operation in the FPFTY and, therefore, an adjustment to the Company’s claimed plant in service should be made to remove $17.3 million from plan in service in the FPFTY. OCA R. Exc. at 7‑8.

Similarly, I&E argues that the ALJs properly rejected UGI’s arguments and correctly determined that the Company did not sufficiently demonstrate that the new Operations Center will be in operation in the FPFTY. I&E R. Exc. at 12-13. Regarding, the requested adjustments to the ALJs’ calculations, I&E proffers that the Operations Center was properly removed from the Company’s plant-in-service claim and no recalculation of the amount associated with the plant is necessary. I&E submits that the calculation in the Recommended Decision should be adopted. *Id.* at 13

1. **Disposition**

Upon review, we find that the Operations Center appears to be in the preliminary planning stages. Thus, we agree with the ALJs that there is insufficient record evidence to support a finding that the proposed Operations Center will be in service within the FPFTY. Accordingly, we shall deny UGI’s Exception No. 2 and adopt the rationale set forth in the Recommended Decision on this issue. However, we agree with UGI that the calculation of the impact of excluding the Operations Center from the rate base is incorrect. Therefore, we shall grant UGI’s Exception No. 3.

The Company has demonstrated that the ALJs’ calculation failed to recognize that UGI provides both transmission and distribution service. As this proceeding deals only with distribution service and all costs associated with transmission service were removed from UGI’s revenue requirement, it is necessary to recalculate the revenue requirement using the correct cost of the Operations Center that is allocated to the distribution function. Here, the full amount of the initial $10 million claim was not included in the rate base. Rather, UGI showed that $2,255,720 of the original $10 million claim was allocated to the transmission function. In its revised Operations Center claim of $17.3 million, the Company maintained that only $13.4 million was applied to distribution service and $3.9 million was allocated to transmission service. As such, the ALJs’ calculation overstates the Company’s rate base reduction by approximately $2.25 million. This miscalculation would result in a deduction of $237,000 in the revenue requirement. Accordingly, we shall adopt the Company’s corrected calculation that results in a reduction to rate base reduction by $13,096,280 rather than $15,352,000.

1. **Accrued Depreciation**

The ALJs noted that the Parties have agreed to use UGI’s proposed accrued depreciation claim. R.D. at 24 (citing Joint Stipulation at ¶ 7). As discussed above, we have approved the Joint Stipulation as being in the public interest. Since the Parties have not filed any Exceptions to the issue of the accrued depreciation claim, we need not address the claim.

1. **Additions to Rate Base**
2. **Cash Working Capital**

In the Recommended Decision, the ALJs explained that cash working capital (CWC) includes the amount of funds necessary to operate a utility during the interim period between the rendition of service, including the payment of related expenses, and the receipt of revenue in payment for services rendered by the utility. R.D. at 25. UGI’s original claim for CWC was $7,333,000. UGI Rev. Ex. A-Fully Projected, Sch. A-1 (Revised). During the proceeding, the Company revised its original claim in response to some of I&E’s claims. In rebuttal testimony, UGI provided an updated CWC claim of $7,180,000. UGI Ex. A – Fully Projected (REBUTTAL), Sch. C-4. The Company’s final position on CWC is $7.15 million, of which operating and maintenance (O&M) expense is $5.52 million. UGI Reply Brief at 16.

1. **Positions of the Parties**

The majority of UGI’s CWC was not challenged. However, I&E objected to the Company’s meter read lag, which reflects the time between when the meter was read and when the bills were mailed to customers. Meter reading lag is an accepted component of CWC. R.D. at 25 (citing *Pa. PUC v. National Fuel Gas Distribution Corp*., Docket No. R-00942991 (Order entered December 6, 1994)). The Company claimed a meter read lag of 2.70 days. UGI M.B. at 39.

I&E sought an adjustment of UGI’s meter read lag of 2.70 days down to 1.5 days due to major software system improvements made by the Company. I&E argued that the Company has made a major investment in software installation in its UNITE Phase I software implementation and that this software program should have an effect on the Company’s meter read lag days. I&E St. 1 at 45-46; I&E St. 1-SR at 46-47. According to I&E, the Company-claimed CWC allowance of $7,180,000 should be reduced by $425,000 for a total CWC amount of $6,755,000. I&E Reply Brief at 17 (citing I&E St. 1-SR at 50).

In response, UGI argued that the evidence does not support the conclusion that its new software system has or will reduce meter read lag by the 44% claimed by I&E. UGI Main Brief at 39. UGI also contended that meter read timing was not within the scope of the Company’s new software program, and therefore, no adjustment in meter read lag was expected or shown. UGI St. 4-R at 8.

1. **Recommended Decision**

The ALJs found in favor of UGI on the issue of the meter lag. The ALJs concluded that there was insufficient evidence to conclude that the new software, which was implemented for other purposes, should, or should be expected to reduce the meter lag from 2.70 days to 1.5 days. Finding insufficient evidence to support I&E’s position of the effect of UGI’s new software on meter read lag, the ALJs rejected I&E’s requested adjustment to the Company’s CWC allowance. R.D. at 26.

1. **Exception and Reply**

In its third Exception, I&E objects to the ALJs’ finding and contends that assuming that a significant reduction in meter read lag days will not occur is unrealistic given UGI’s recent major software installation. I&E cites, in part, to its witness testimony that, historically, regulated utilities which install new customer information system software experience declines in meter read lag days. I&E maintains that a reduction of UGI’s meter read lag from 2.7 to 1.5 days, which would reduce UGI’s CWC claim by $425,000, to $6,755,000, is appropriate and consistent with the record evidence. I&E Exc. at 10-11; I&E R.B. at 17.

UGI rejoins that I&E’s Exception on meter read lag should be denied. The Company asserts, in part, that I&E’s adjustment is based on the experience of its accounting witness who has no training or expertise in software applications. Thus, UGI claims there is no record evidence to support I&E’s Exception that UGI’s installation of new software has reduced meter lead by 44% to 1.5 days. UGI R. Exc. at 20; UGI M.B. at 38-39; UGI R.B. at 16.

1. **Disposition**

Upon our review of the record, we find that the ALJs have correctly rejected I&E’s proposed adjustment to CWC. Nothing in the record supports I&E’s requested reduction in meter read lag days. Here, meter read timing was not within the scope of UGI’s new software system and I&E did not provide a sufficient basis for reducing the lag days to 1.5, which would represent a 44% reduction in lag time over an eighteen-month period. UGI St. 4-R at 8. Accordingly, we shall deny I&E’s Exception No. 3.

1. **Materials and Supplies**

UGI’s initial filing included a claim of $1.44 million for materials and supplies. The ALJs explained that based on the most recent thirteen-month average, I&E and UGI have agreed that the Company maintains $1,464,692 for materials and supplies in inventory. UGI Main Brief at 40; I&E Main Brief, p. 29. In noting that there was no opposition to this amount, the ALJs recommended that it be approved. No Parties filed Exceptions on this issue. We find that the $1,464,692 amount agreed upon by I&E and UGI is reasonable. Accordingly, we shall adopt it without further comment.

1. **Deductions from Rate Base**
2. **Accumulated Deferred Income Taxes**

UGI has proposed an Accumulated Deferred Income Tax (ADIT) balance at the end of the FPFTY of $16,572,000, inclusive of adjustments reflecting the impacts of the TCJA. UGI St. No. 9-SD at 3-4; Revised UGI Electric Exhibit A – Fully Projected, Schedule C-6. Both I&E and the OCA challenge the Company’s claim. I&E St. 1 at 36-39; OCA St. 1 at 14-15. We shall address this issue in Section IX, below.

1. **Act 40 of 2017**

In its initial filing, UGI claimed that in the absence of Act 40, the amount of the consolidated tax savings adjustment applicable to UGI would have been $75,400 (*i.e.*, $41,000 multiplied by the gross revenue conversion factor). UGI St. 2 at 24-25. The OCA challenges the Company’s claim and we shall address the issue in Section IX, below.

1. **Customer Deposits**

UGI has proposed a claim for customer deposits in the FTY and the FPFTY in the amount of $1,419,000. UGI Main Brief at 41-42. The Company asserted that it is necessary to address the decrease caused by the passage of the Act of October 22, 2014, Pub. L. 2545, No. 155 (Act 155) prohibiting UGI from collecting customer deposits from customers who qualify for low-income programs. UGI’s position is that because it is no longer able to collect customer deposits from low income customers, its customer deposits have fallen and subsequently leveled off. UGI Main Brief at 41-42. Thus, UGI used the customer deposits balance at the end of the HTY (September 30, 2017) to determine its rate base offset. I&E St. 3 at 23.

I&E opposed UGI’s proposal arguing that the Company should use its most recent thirteen months of actual customer deposit balances. I&E contended that, based on the actual customer deposit levels from October 2016 through February 2018, UGI’s claim that the customer deposit balance is decreasing or has leveled off is unsupported. *Id.* I&E asserted that the $1,419,000 balance at September 2017 is actually the lowest balance in the referenced seventeen-month period. I&E St. 3-SR at 18 (citing I&E Ex. 3, Sch. 8; I&E Main Brief at 34). As such, I&E recommended a customer deposits level of $1,495,692 for both the FTY and FPFTY. I&E St. 3-SR at 19.

The ALJs found I&E’s arguments to be persuasive and determined that the actual customer deposits of the most recent thirteen months should be used to determine the rate base offset. As such, the ALJs made an adjustment consistent with I&E’s recommendation. R.D. at 28. No Party filed Exceptions on this issue. We agree with the ALJ’s recommendation on this issue. Accordingly, we shall adopt the ALJ’s recommendation and the adjustment to the customer deposits level to reflect $1,495,692 for both the FTY and FPFTY.

1. **Cloud Based Program**

The ALJs explained that the issue relating to Cloud Based Implementation Costs was resolved in the Joint Stipulation under ¶ 12(a). See Miscellaneous Accounting Issues, *supra*. The Joint Stipulation provides that UGI will be permitted to record these costs as a capital asset and will begin depreciation of the costs after the systems are placed in service. R.D. at 28 (citing UGI St. 4 at 13-15). The ALJs adopted this provision of the Joint Stipulation and no Exceptions have been filed concerning this matter. As discussed above, we have approved the Joint Stipulation as being in the public interest. Thus, no further discussion on this matter is necessary.

1. **UNITE Phase 2 Costs**

In their Recommended Decision, the ALJs noted that the issue regarding UGI’s UNITE Phase 2 Costs was resolved in the Joint Stipulation at ¶ 12(b). See Miscellaneous Accounting Issues, *supra*. The ALJs explained that pursuant to the Joint Stipulation the Company will be permitted to capitalize the pre-implementation costs and will begin depreciation of the costs after the systems are placed in service. R.D. at 28 (citing UGI St. 4 at 15). As indicated above, we have approved the Joint Stipulation as being in the public interest. Since the Parties have not filed any Exceptions to this issue, we need not address the claim.

1. **Revenues and Revenue Requirement**

**A. Positions of the Parties**

In its initial filing, UGI sought a revenue increase of $9.254 million. However, because the TCJA was passed and became effective while UGI prepared its initial filing, UGI filed supplemental direct testimony and revised supporting exhibits and updated its claimed revenue increase to $8.491 million. Additional adjustments resulted in a claimed revenue increase of $8.092 million. UGI adopted further adjustments based on, *inter alia*, its rebuttal testimony and the Joint Stipulation. Therefore, UGI proposed a final revenue requirement of $96,767,000, which would result in an overall revenue increase of $7.705 million. UGI submitted that its final claimed revenues at proposed rates are reasonable and should be adopted. UGI M.B. at 1 n.1, 42-43.

I&E proposed a revenue requirement for UGI of $89,850,000, which would result in an overall revenue increase of $818,000. Additionally, based on its position that UGI’s rate base should be calculated based on an average rate base methodology, I&E submitted that UGI’s total operating revenues under *pro forma* present rates should be decreased by $60,000. I&E reasoned that the adjustments to present rate revenue claimed by UGI will occur in the eleven months after rates go into effect. As a result, I&E contended that the rates customers will be paying on October 28, 2018, will be improperly calculated based on a projected revenue requirement for the year ending September 30, 2019. I&E M.B. at 36-37; I&E R.B. at 21-22.

The OCA proposed an overall distribution revenue increase of $2.137 million. The OCA noted that its witness, Mr. Morgan, identified $158,000 of revenue resulting from the expansion of the primary underground distribution system in the Hanover Industrial Park that was not included in the FPFTY. The OCA made an adjustment of $158,000 to reflect the revenue associated with upgrades serving the industrial park, which UGI agreed to incorporate in its revised revenue requirement request. The OCA presented no other total operating revenue adjustments. OCA M.B. at 5, 25.

**B. Recommended Decision**

The ALJs recommended an overall revenue requirement of $91,881,000 for UGI based on the various adjustments they adopted in their Recommended Decision, resulting in an overall distribution revenue increase of $2.789 Million. The ALJs emphasized that because they have rejected the use of the average rate base methodology, they disagreed with I&E’s recommended adjustments to UGI’s revenue proposal. R.D. at 29.

**C. Exception and Reply**

In its Exception No. 4, I&E objects to the ALJs’ recommendation that an overall revenue requirement of $91,881,000 should be adopted. I&E reiterates that its proposed revenue requirement of $89,850,000 should be adopted. Further, I&E continues to recommend the application of an average rate base methodology, in lieu of the ALJs’ recommendation to apply the end-of-the-year methodology to calculate UGI’s rate base and depreciation claims. Therefore, I&E maintains that it is necessary to calculate UGI’s revenue requirement in the FPFTY using a consistent average rate base methodology. I&E Exc. at 12.

In reply, UGI argues that I&E’s Exception should be denied because I&E’s proposed revenue requirement is too low and excludes legitimate rate base and expense items. UGI maintains its position that the Commission should adopt an overall revenue requirement of $96,797,000. UGI R. Exc. at 20.

**D. Disposition**

As noted above, we have modified the ALJs’ recommendation regarding certain inputs in UGI’s rate base. Additionally, as will be discussed in more detail in the sections that follow, we shall modify certain recommendations in the Recommended Decision as they relate to UGI’s expenses, cost of common equity, and overall rate of return. Therefore, consistent with these modifications, we shall approve an overall revenue requirement of $92,293,000 for UGI, which will result in an overall distribution revenue increase of $3,201,000 on an annual basis. Finally, with regard to I&E’s argument that it is necessary to calculate UGI’s revenue requirement in the FPFTY using a consistent average rate base methodology, we note that we have previously addressed and adopted the ALJs’ recommendation to apply the end-of-the-year methodology to UGI’s rate base and depreciation claims, *supra.*  Accordingly, I&E’s Exception No. 4 is denied.

1. **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. 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).

1. **Vegetation Management Expense**
2. **Positions of the Parties**

UGI claimed a vegetation management expense in the amount of $2,118,501 for the FPFTY. According to UGI, the amount requested reflects increased costs due to the damage and death to Pennsylvania ash trees in UGI’s service territory by an invasive insect infestation of the Emerald Ash Borer (Borer). The Borer is an invasive insect which causes damage to Pennsylvania ash trees, increasing the propensity for trees to fail at the root system resulting in more significant risk to distribution lines. UGI alleged unprecedented vegetation management fees associated with the large number of trees impacted by the Borer, the necessity of tree removal from the right-of‑way locations, and the necessity for safety precautions in high risk climbing conditions. In its claim, the Company asserted that it anticipates increased expenses associated with the Borer damage to trees continuing over the next seven to ten years. UGI St. 3-Rat 6, 8; UGI M.B. at 44-47; UGI R.B. at 19-20.

UGI submitted that the increase reflected in the FPFTY is associated with a specific and quantifiable expense: one additional vegetation management crew. The Company maintained that the additional vegetation management crew was a direct result of Borer impact on the Pennsylvania ash trees in UGI territory. UGI asserted that due to Borer damage to trees, the typical calculation of the historical average of the vegetation management expense, modified by a yearly inflation factor, would not accurately calculate the Company’s vegetation management expenses because it would not account for the increased cost of hiring the additional vegetation maintenance necessary to respond to new conditions caused by Borer damage. The one additional vegetation maintenance crew was added in the FTY which is reflected fully in the FPFTY. UGI St. 3-RJ at 5; UGI M.B. at 44-47.

I&E maintained that UGI’s request for a 14.8% increase to the allowance for future vegetation management costs is excessive and unsupported. I&E argued that the allowance for future vegetation management is reflected in the typical calculation based on the historic average of the expense modified by a yearly inflation factor. I&E recommended an allowance of a 5.2% increase, or $1,912,266, for vegetation management expenses. I&E’s calculation is based on a historic average increase between fiscal years ended September 30, 2015, 2016, and 2017 for the non-payroll/other component which is 5.2%. I&E contended that UGI’s vegetation management expenses are adequately reflected in the historical test year calculation, which encompasses years during which UGI engaged in proactive efforts to address the impact of the Borer in its service territory. I&E St. 1 at 13-15; I&E St. 1-SR at 10.

1. **Recommended Decision**

The ALJs recommended that the Commission adopt UGI’s claim for vegetation management expenses in the amount of $2,118,501. The ALJs found that UGI presented sufficient evidence to support the proposed increase to vegetation management expenses directly resulting from the hiring of an additional vegetation maintenance crew in the FTY. The ALJs noted that I&E’s opposition to the increase does not refute that the Borer has caused large and unforeseeable devastation to Pennsylvania ash trees in the service territory of UGI. Further, I&E’s own witness admitted that a traditional calculation based on historic average with inflation would not account for the occurrence of a “very large unforeseeable event,” and that additional relief may be granted by the Commission for such an occurrence. R.D. at 31 (citing Tr. at 130). The ALJs concluded that the large and unforeseen devastation caused by the Borer to ash trees in UGI’s service territory is an occurrence that was not reflected in the historical test year, for which the Commission should approve the Company’s vegetation management expenses. R.D. at 31.

1. **Exception and Reply**

In its Exception No. 5, I&E objects to the ALJs’ recommendation allowing the expense, on the basis that the historical test year already adequately encompasses expenses associated with the Borer. I&E asserts that UGI’s claim for increased vegetation management expenses is not supported on the record because it is based on an extraordinary event and should be rejected. I&E restates its recommended vegetation management expense of $1,912,266, based on the average increase between fiscal years ended September 30, 2015, 2016, and 2017, for the non-payroll/other component of UGI expenses. I&E asserts that UGI’s incursion of such an extraordinary expense should be deferred and recovered rather than memorialized into the Company’s base rates. I&E Exc. at 12-14.

In its Reply, UGI counters that deferred accounting of an expense is only appropriate for extraordinary and nonrecurring events. According to the Company no party, including I&E, asserts that the vegetation management expense claim is nonrecurring and thus it is appropriate for the Commission to allow full recovery of the expenses. UGI R. Exc. at 15.

1. **Disposition**

We agree with the ALJs’ conclusion that the large and unforeseen devastation caused by the Borer to ash trees in UGI’s service territory is an occurrence not reflected in the historical test year, and for which we should grant additional relief. Further, the increase in UGI’s FPFTY based upon the addition of a single vegetation management crew is warranted due to the circumstances and is projected to be required over a period spanning nearly a decade. Therefore, we shall deny I&E’s Exception No. 5, and adopt the ALJs’ recommendation to approve UGI’s $2,118,501 claim for vegetation management expenses.

However, before concluding this issue, because we are approving estimated projected expenses that will be included in the Company’s base rates, it is in the public interest that the Company’s future actual expenditures related to the allowed expense be monitored to ensure the accuracy of projected expenses. Because UGI’s claim for projected vegetation management expenses related to the Borer is factored into UGI’s calculation of rates using the FPFTY, we shall require UGI to file annual reports with the Secretary’s Bureau and the Commission’s Fixed Utility Financial Analyst Supervisor in I&E by December 1 following the end of each fiscal year for the next five years, or until the implementation of new base rates in a subsequent rate case within this same time frame. The annual reports shall delineate the actual annual expenses incurred by the Company for vegetation management maintenance specifically related to damage caused by the Borer to Pennsylvania ash trees and shall also include the status of hiring an additional vegetation management crew.

1. **Company Owned Services Program**
2. **Positions of the Parties**

UGI claimed $454,418 for expenses relating to the project cost and implementation of a Company-Owned Service (COS) Transition Program. The plan pertains to COS facilities including service entrance cables, meter sockets, panel boxes, main breakers and 240-volt breakers which are located inside the homes of customers. Pursuant to its duty to provide reasonable and safe service to its customers, UGI has identified 5,000 of its service facilities located in the homes of customers that are not adequately maintained due to the difficulty in accessing the facilities. Under the plan, UGI will inspect and repair or replace the facilities located in those 5,000 customers homes, and then transition ownership and maintenance responsibility of the facilities from UGI to the homeowner. UGI St. 3 at 16. UGI expects that the COS Transition Program will result in the inspection and transfer of responsibility for approximately 500 services a year for the next 10 years. UGI M.B. at 50-51.

In order to implement the COS Transition Program, UGI explained that it will send notices to affected customers, conduct inspections and, if necessary, repair or replace the COS equipment so that it passes inspection by an approved electrical inspector certified by the Pennsylvania Department of Labor and Industry. Once the inspection is completed, UGI’s former COS equipment will be deemed customer-owned equipment consistent with the terms of UGI’s tariff. UGI M.B. at 50-51.

UGI submitted that it will not profit from the COS Transition Program because the proposal would only permit the Company to recover the actual program expenditures rather than permitting it to capitalize any allowed expenses. Additionally, UGI stated that it is willing to coordinate its program with the Commission’s Bureau of Consumer Services (BCS) and the OCA to achieve the required access to customer homes without the threat of termination. UGI asserted the necessity of requiring homeowners to allow access for the Company to complete inspection and repair and replacement of facilities, as needed, prior to transfer of ownership to customers. UGI M.B. at 50. As a last resort, if a homeowner refuses to allow the Company to inspect the service facilities, UGI would retain the right to obtain a court order granting entry. UGI St. 3-R at 9-10; and UGI St. 3-RJ at 7.

UGI argued that the program should be mandatory to ensure the safety of all customers who currently have COS, and to meet UGI’s obligations under 66 Pa. C.S. § 1501 and 52 Pa. Code § 57.194(b) (establishing the utility’s duty to inspect and maintain safe facilities).

As explained in more detail below, I&E argued that the COS Transition Program should be voluntary rather than mandatory and recommended an allowance of $140,000, rather than $454,418, for the program because it alleged UGI’s estimated costs are inflated and speculative.

In support of its position, I&E first asserted that since UGI is not required by law to perform these inspections prior to relinquishing ownership of the equipment, the homeowner’s participation should be voluntary and not mandatory. I&E argued that homeowners should have the option to decide whether they wish to permit UGI to have access for repairs and inspections performed prior to the change in ownership. I&E St. 1 at 30; I&E Exh. 1, Sch. 10 at 2.

Second, I&E challenged the reasonableness of UGI’s projected expenses, as speculative since costs projected nearly ten years in the future cannot be accurately estimated. According to I&E, if the terms of the program are voluntary as I&E recommends, UGI would not even be able to estimate the number of homeowners who would participate. I&E St. No. 1 at 30-31.

Third, I&E contended that UGI may realize a profit from the COS program. In this regard, I&E asserted that if an inaccurately inflated expense was factored into a rate base calculation, even if none of the expense was capitalized, the company would over-recover and realize a profit based on the inaccurately inflated expense projection. I&E St. 1-SR at 25-26.

The OCA contended that it supports the program and allowance of the expenses directly related to its implementation, as the program addresses a safety issue unique to UGI presented by the COS equipment. OCA M.B. at 27. However, the OCA submitted that while UGI should be permitted to recover the actual expenses associated with the program, UGI should not be permitted to profit from the approval of the COS Transition Plan. OCA St. 4 at 28. The OCA agreed with the Company that it should coordinate its efforts with BCS and the OCA since the program impacts nearly ten percent of UGI’s residential customers but disagreed with the Company that there should be service terminations. OCA M.B. at 27; OCA St. 4 at 28.

1. **Recommended Decision**

The ALJs agreed with UGI on this issue and recommended approval of UGI’s COS Transition Plan and its $454,418 COS Transition Plan expense claim with the following conditions: (1) UGI shall be prohibited from earning a profit from the program; (2) UGI shall be prohibited from terminating service in conjunction with the program; and (3) UGI shall be required to coordinate with BCS and the OCA in implementing and executing the program. R.D. at 34.

The ALJs further recommended that the inspections be mandatory for homeowners under the COS Transition Plan because it will ensure that UGI is granted access to the customers’ home so that it can inspect the service facilities for safety issues and make any necessary repairs or replacements. The ALJs noted that the OCA supports the program to address a significant safety issue unique to UGI related to COS facilities located in customers’ homes. *Id*.

1. **Exception and Replies**

In its Exception No. 6, I&E opposes the ALJs’ recommendation, asserting that the allowance claimed by UGI is inflated and speculative in nature and that an allowance of $140,000 is more than adequate under the circumstances. I&E reiterates its argument that since there is no present requirement for homeowners to provide access, UGI’s estimates on the number of inspections and repairs is speculative. I&E submits that it does not oppose the program entirely; however, it believes it should be approved with an expense allowance of $140,000 rather than the $454,418 requested by the Company given that UGI has no history of expending resources for inspection and repair of the COS facilities at issue. I&E Exc. at 14-15.

In its Reply, UGI asserts that the ALJs properly rejected I&E’s position on the COS program because I&E’s position does not adequately address the safety and service concerns of aging service facilities located in customers’ homes, for which the Company requires access to maintain and repair. UGI R. Exc. at 16.

In its Reply, the OCA maintains that approval of the COS Transition Program and associated costs is warranted for the stated safety reasons provided the approval is conditioned on precluding the Company from profiting for the program, terminating service in conjunction with the program, and requiring the cooperation with BCS and the OCA in implementing the program. OCA R. Exc. at 15-16.

1. **Disposition**

On review of the record and the positions of the parties, we agree with the ALJs’ recommendation to approve UGI’s COS Transition Program and associated implementation expense claim of $454,418 with the following conditions: (1) UGI shall be prohibited from earning a profit from the program; (2) UGI shall be prohibited from terminating service in conjunction with the program; and (3) UGI shall be required to coordinate with BCS and the OCA in implementing and executing the program.

We reject I&E’s contention that UGI’s projected expenses are speculative in nature. To the contrary, we find UGI’s calculation of the projected expenses in implementing the proposed COS Transition Program is reasonable based on estimated costs for inspection and transfer of responsibility for approximately 500 services per year for the next ten years. The estimate of the cost was formed on UGI’s knowledge of updated electrical code requirements, experience implementing the program, and the projected costs to conduct the inspections and make the necessary repairs or replacements. *See* UGI Electric Exhibit EWS-7. We further note that UGI has voluntarily agreed to comply with the conditional provisions proposed by the OCA and recommended by the ALJs.

In light of the above, we shall approve UGI’s claim for projected expenses in the amount of $454,418 for the proposed Company Owned Services Transition Program implementation.

Before concluding this matter, because we are approving estimated projected expenses that will be included in the Company’s base rates, it is in the public interest that we monitor the Company’s future actual expenditures related to the allowed expense. Because UGI’s claim for estimated projected expenses related to the COS Transition Program is factored into UGI’s calculation of rates using the FPFTY, we shall require UGI to file annual reports with the Secretary’s Bureau and the Commission’s Fixed Utility Financial Analyst Supervisor in I&E by December 1 following the end of each fiscal year for the next five years, or until the implementation of new base rates in a subsequent rate case within this same time frame. The annual reports shall include the actual expenses incurred by UGI for implementation of the COS Transition Program as well as the number of service facilities transitioned from Company ownership to customer ownership.

1. **Environmental Remediation Expense**
2. **Position of the Parties**

UGI claimed estimated projected expenses for environmental remediation in the amount of $417,000, to be amortized over three years. The environmental remediation work to be performed is required in one of the Company’s warehouse buildings, referred to as the Forty Fort site. UGI’s claim is based on remediation work required in connection with the Company’s plan to relocate company operations from the Forty Fort site and ultimately sell the property in question after the site is remediated in 2020. UGI St. No. 3-R at 3, 19.

UGI submitted that the cost of remediation should not be offset with the net proceeds from the sale. The Company argued that because the environmental remediation expense will be incurred in the FPFTY, the expense is appropriately accounted for in the rate calculation based on that period. According to the Company, the sale of the property is not expected until after the FPFTY, and therefore, should not be accounted for in the rate calculation based on the FPFTY. The Company further argued that the sale price of the building, is an amount which can only be determined at the time of the actual sale, and therefore, no knowable amount can be calculated to offset the expense. Finally, future net proceeds from the sale of the property, if any, will be credited to net salvage expense which is an accepted element of the ratemaking formula. Therefore, UGI took the position that the sale of the property should not be considered regarding the claim for allowance of environmental remediation costs incurred for the property. UGI St. 3R at 4.

The OCA countered that UGI’s environmental remediation expense should be denied and that the Company’s claimed O&M expense should be reduced by the amount attributed to amortization of the expense*, i.e.,* by $139,000. The OCA asserted that environmental remediation expenses for excavation, loading, transportation, and disposal services at UGI’s Forty Fort site should not be included as a cost of service is not recoverable as an expense in the rate base. The OCA based its position on UGI’s stated intention to sell the property in 2020. The OCA contended that the cost of remediation should be recovered by UGI’s sale proceeds from the Forty Fort site. Further, the OCA asserted that UGI should be required to reduce the gain on the land by the environmental remediation costs as the value of the land on the sale would decline without remediation. OCA M.B. at 28-29; OCA St. 1 at 1, 16-17; OCA St. 1S at 5.

I&E concurred with the OCA’s position and argued in the alternative, if Commission allows the claimed expense, the costs should be amortized over five years. I&E St. 1 at 8.

1. **Recommended Decision**

The ALJs agreed with the OCA and I&E on this issue, recommending denial of UGI’s claim for allowance of expenses in the amount of $417,000 related to environmental remediation in total, and accepted the OCA’s adjustment to reduce O&M expenses by $139,000. The ALJs found that expenses related to remediation of UGI’s Forty Fort site which serve to enhance the property’s value may be recovered from the sale proceeds of property. The ALJs concluded it would be improper to allow UGI’s claim for environmental remediation costs, which enhance the value of property the Company intends to sell, and thereby pass those costs onto ratepayers by inclusion in the rate base calculation. R.D. at 35-36.

1. **Exception and Reply**

In its Exception No. 7, UGI disputes the ALJs’ conclusion that sale of the property should be a factor in determining whether the remediation expense is allowable. The Company maintains that under existing precedent addressing proceeds from property, UGI should be permitted to amortize the remediation expense claim of $417,000 over three years, *i.e*., at $139,000 per year. UGI Exc. at 34 -37.

In its Reply, the OCA also maintains that the ALJs properly rejected the claim for remediation expenses, noting that “there is a direct correlation of the remediation and the salability of the property.” OCA R. Exc. at 17 (citing OCA St. 1S at 5). The OCA concludes that the expense incurred by UGI for remediation to enhance the value of property the Company intends to sell should not be borne by ratepayers, where the proceeds from the sale of the property will directly benefit the Company and its shareholders. Further, the OCA argues that it follows that the Company’s claimed O&M expense should be reduced by the amount attributed to amortization of the expense, *i.e*. by $139,000. OCA R. Exc. at 17.

1. **Disposition**

We agree with the ALJs on this issue and shall deny UGI’s Exception No. 7, consistent with the following discussion. We find that the expenses related to environmental remediation of UGI’s property at the Forty Fort site can be recovered from the sale proceeds of the associated property. Therefore, it is appropriate to recover the costs of the remediation from the sale proceeds rather than to pass those costs onto ratepayers.

We find UGI’s arguments that the remediation is necessitated due to activity at the property which served the customers interests to be unpersuasive. The Company intends to sell the property, and therefore, intends to conduct remediation to increase the sale price of the property. Any increase in the sale price of the property will be gains realized by the Company and its shareholders. Accordingly, there is a direct benefit to the Company from remediation to increase the value and eventual sale price of the property. In our view, ratepayers should not bear expenses incurred to benefit UGI and its shareholders. Consequently, we shall disallow the environmental remediation expense claim in its entirety and reduce the O&M claimed expenses by $139,000, the amount attributed to amortization of the expense.

1. **Storm Damage Expense**
2. **Positions of the Parties**

UGI’s original position was that, based on a five-year average of “qualifying expenses from major storm events occurring during the period 2013 through 2017,” the Company’s average annual storm expense claim is $275,000. The Company subsequently revised the claim upwards in its rebuttal testimony, removing the expenses incurred in 2013 from its average and replacing this with the partial year expenses incurred in 2018 to calculate the five-year average, resulting in a five-year historic storm expense average of $301,000. UGI St. 2 at 17 and UGI St. 8-R at 22-23.

UGI took the position that the use of the Company’s actual expenses for 2018 in the calculation of the five-year historic average would best reflect the Company’s actual average expenditures and would not result in over-recovery of expenses from ratepayers. The Company asserted that the actual 2018 figures for storm damage expense, while reflecting a partial year, may only be said to be “inaccurate” to the degree they may need to be adjusted upward based on additional expenses occurring in the remaining months of the 2018 fiscal year. The actual 2018 storm damages figures, if incorrect at all, could only understate the actual storm expense for 2018. Therefore, the Company charged that failure to use the actual 2018 storm damage expenses to calculate the five-year historic average would understate the Company’s storm damage expenses based on the Company’s own calculation of the five-year historic average. UGI M.B. at 55-57 (citing Tr. at 123-124).

I&E contended that UGI’s storm damage expense claim of $253,229, based on the average of five years’ actual expenses including the year 2013 is the more appropriate calculation of expenses. I&E disputed the use of the Company’s year 2018 storm damage in the five-year historic average, on the basis that the 2018 figures are for a partial year, and therefore, should not be included in a calculation of a historic five-year average of actual expenses. I&E maintained that the calculation should be based upon five full years of historic expenses, including the year 2013. I&E categorized the Company’s 2018 partial-year storm damage expense figure as an “estimate” which should be disregarded for purposes of a five-year historic average of actual expenses. I&E MB at 43 and I&E St. No. 1-SR at 43-44.

The OCA posited that the appropriate calculation of storm damage costs should be based on a five-year normalization of the 2017 storm cost of $570,000 which reduces UGI’s storm expense to an annualized level of $114,000. OCA M.B. at 31; OCA St. 1 at 20; and OCA St. 1, Sch. LKM-13. The OCA explained that its rationale is based upon viewing the Company’s presented activity for the five-year period 2013 through 2017. The OCA proposed the use of the multi-year average to normalize storm expenses that have a high degree of variability from one year to the next. In the OCA’s calculation, the normalization is intended to “smooth out spikes and dips in the costs that occur from year to year” and to “throw out” storm expenses incurred for the year 2014 on the theory that the 2014 expenses would improperly skew the average upward. OCA St. 1 at 20.

1. **Recommended Decision**

The ALJs agreed with UGI on this issue, recommending approval of UGI’s claim for storm damage expenses in the amount of $301,000. The ALJs found UGI’s arguments in favor of normalization of the five-year period from 2014 to 2018 persuasive, determining that UGI’s claim reflects actual storm damage expense accrued in 2018. The ALJs rejected both I&E and the OCA’s recommendations as understating UGI’s storm damage expense in 2018, and consequently understating the Company’s historic five-year average of actual storm damage expense. R.D. at 40-41.

1. **Exceptions and Reply**

In its Exception No. 7, I&E challenges the ALJs’ calculation of the Company’s five-year historic average of actual expenses on the grounds that the use of the partial figures for year 2018 in the calculation was improper, since the Company’s expenses for 2018 do not reflect the entire year’s figures. I&E Exc. at 15-16. The OCA, in its Exception No. 2, also challenges the ALJs’ calculation of the Company’s five-year historic average of actual expenses. The OCA criticizes the ALJs’ inclusion of the year 2014 expense figures, which the OCA maintains represents a historic aberration in storm activity that must be dropped from the calculation to arrive at an accurate annual average of storm damage expense. OCA Exc. at 15-16.

In its Reply, UGI reiterates its position and rejects the proposed calculations of both I&E and the OCA, as irreflective of the actual storm damage expenses incurred by the Company when calculated using the five-year historic average of actual expenses incurred. The Company challenges I&E’s position that the Company’s actual storm damage expenses for the partial year 2018 would not produce an accurate five-year historic average of actual costs, since the 2018 figures, if used, can only accurately state or understate, not overstate, the Company’s actual storm damage expenses for year 2018. UGI R. Exc. at 17-18.

1. **Disposition**

In light of the record evidence, we agree with the ALJs’ recommendation, and therefore, shall allow the UGI claim for storm damage expenses in the amount of $301,000, calculated based on a five-year history average of actual expenses, based on the years 2014 through 2018. Consequently, we shall deny I&E Exception No. 7 and OCA Exception No. 2.

We find that the actual costs incurred by the Company for storm damage during the year 2018, although a partial year, accurately reflect the actual storm damage costs to be calculated using the five-year historic average of actual costs. We are not persuaded by I&E’s rationale that expenses incurred for a partial year are *per se* inaccurate for purposes of averaging five-years’ actual costs. I&E does not dispute that the Company’s 2018 figures pertaining to actual expenses and concedes that the figures do not overstate the Company’s 2018 expenses. In fact, in this case, precluding the Company from using actual figures of expenses during the most recent fiscal year, 2018, would direct a calculation that *understates* the Company’s actual expenses. Further, we reject the OCA’s position that it is inappropriate to calculate a five-year historic average based on the actual storm damage expenses incurred by the Company over the period from 2014 to 2018. The OCA’s proffered calculation would underestimate the average actual expense incurred by the Company for storm damage and is rejected.

Based on the forgoing, we shall allow the UGI claim for storm damage expenses in the amount of $301,000**.**

1. **Rate Case Expense**
2. **Positions of the Parties**

UGI sought allowance for a rate case expense in the amount of $676,000 and proposed to amortize it over a three-year period, resulting in a normalized claim of $225,000 per year. UGI St. 2-R at 5-6.

Regarding the appropriate period to amortize the expense to allow for normalization of the expense, UGI asserted that because the Company has not filed a base rate increase since 1996, a period of twenty-two years, it proposed a calculation which would not rely on historic frequency of filing. According to UGI, there are recognized exceptions to the general rule of historic frequency to appropriately determine the normalization period. UGI M.B. at 57 (citing *Pa. Pub. Util. Comm’n v. Emporium Water Company*, Docket No. R-2014-2402324 (Order entered January 28, 2015) (*Emporium*)).

UGI argued that the present case could be decided under our decision in *Pa. Pub. Util. Comm’n., v. PPL Electric Utilities Corporation,* Docket No. R-2012-2290597, *et al*., (Order entered December 28, 2012 (*PPL 2012 Order*)), which granted PPL’s request for a two-year period for normalization of rate case expense despite PPL’s historic frequency of seeking a base rate increase every three years. In the PPL case, UGI continued, the Commission was persuaded that PPL’s major capital improvement program addressing aging infrastructure warranted an accelerated normalization period for the rate case expense and granted PPL’s request for a two-year period. UGI contended that under the PPL standard, in view of UGI’s own major capital investment program, and in light of the Company’s stated future likelihood of filing a base rate case every three years, the Commission should grant UGI’s request for an accelerated three-year period in which to amortize the expense. UGI M.B. at 57-58.

I&E opposed the Company’s rate case expense contending that it should be normalized over a period of five years for a normalized expense claim of $135,000 per year. I&E asserted that consistent with *Emporium*, the Commission determination should rely upon some historic evidence of the Company’s filing frequency. I&E rejected the Company’s proposed three-year normalization period both because it does not relate to UGI’s historic filing frequency, and because the Company’s assertion that it will likely file a rate case every three years is purely speculative. I&E proposed that the Commission rely on the historic frequency model and exercise discretion to arrive at a reasonable amortization period, given the fact that UGI’s historic filing frequency would otherwise impose a long period in which to normalize the expense. I&E M.B. at 44-45; I&E St. 1 at 11; I&E St. 1-SR at 8-9.

Based on I&E’s calculation of all cases filed by the company since 1992, resulting in an average historic frequency of every 103 months, or an amortization period of more than eight years, I&E proposed that the Commission make a reasonable downward adjustment of the period to a five-year amortization period. I&E St. 1 at 11 (citingI&E Exh. No. 1, Sch. 2); and I&E St. 1-SR at 7-8.

1. **Recommended Decision**

The ALJs agreed with I&E on this issue, recommending adoption of UGI’s rate case expense claim in the amount of $676,000, to be normalized over I&E’s recommended normalization period of five years. R.D. at 40-41

The ALJs rejected UGI’s proposal of a three-year normalization period. They concluded, that while it is true, as UGI argued, that history is not the sole basis for determining the time period for normalization of the rate case expense, UGI had not adequately supported its proposal of a three-year period. The ALJs were not persuaded that substantial evidence supported granting a three-year period based on speculation that UGI will file base rate cases every three years. *Id.*

1. **Exception and Reply**

In its Exception No. 8, UGI objects to the ALJs’ determination of a five-year amortization period and contends that it should be permitted to amortize the rate case expense over the proposed three-year period. UGI maintains that the ALJs failed to find record evidence that UGI’s ongoing capital improvement costs warrant establishing an amortization period without regard to historic frequency of the Company’s base rate filing. UGI Exc. at 36-37.

In its Reply, I&E argues that the ALJs properly determined the amortization period in reliance upon evidence of the Company’s historic frequency of filing. I&E asserts the ALJs’ reasonable moderation of the otherwise lengthy period is an appropriate adjustment which properly results in an annual amortized expense of $135,000 over five years, as opposed to UGI’s proposal to amortize an expense of $225,000 per year over three years. I&E R. Exc. at 23-24.

1. **Disposition**

Based upon our review of the record established in this proceeding, we shall decline to adopt the ALJs’ recommendation and shall grant UGI’s Exception on this issue. This proceeding is premised on the FPFTY and the recognition that certain expenses may be based on future expectations. Consistent with our determination in the *PPL 2012 Order,* the normalization period for rate case expense is one of those expenses. We agree with UGI that the ALJs did not properly consider the Company’s planned acceleration of its capital expenditures in determining the appropriate normalization period.

The Company has shown that its Long-Term Infrastructure Improvement Plan (LTIIP) plan has significantly increased capital spending in order to repair, replace or improve qualifying distribution asset categories such as poles, underground and overhead conductor and transformers. Pursuant to its LTIIP, the Company will be spending over $8 million per year on these capital projects in each of the years following the FPFTY, which over a three-year period would amount to $24 million in capital expenditures. UGI has established that this $24 million expenditure would approximate a $3 million revenue requirement shortfall and would require the Company to seek relief pursuant to a base rate case. UGI St. 2-RJ at 4-5*.*

The record evidence supports a finding that a long period between rate base proceedings is highly unlikely and that the Company’s proposed use of a three-year normalization period for rate case expense is appropriate. Accordingly, we shall adopt the proposed rate case expenses in the amount of $676,000 and permit amortization of this expense over a three-year period, resulting in a normalized claim of $225,000 per year.

## **F. Employee Expenses**

1. **Salaries and Wages Net of Employee Additions**
2. **Positions of the Parties**

UGI requested an allowance of expense in the amount of $4,993,000 for salary and wage expenses, net of employee additions, which included an annualization adjustment to reflect end of test year conditions in the amount of $34,000. The $34,000 adjustment was attributed to anticipated annual increases to salaries and wages occurring during FPFTY. UGI supported the claim for the adjustment through its broader argument that the FPFTY should reflect end-of-the year conditions and not an average test year approach, which would omit wage increases occurring over the course of the average test year. UGI M.B. 25-34, 59.

I&E concurred with UGI’s request for allowance of salary and wage expense, net of employee additions, in the amount of $4,959,000, but disputed UGI’s requested allowance of the annualization adjustment of $34,000. I&E argued against allowance of FPFTY end-of-year salaries and wages, on the basis that an accurate representation of expenses actually incurred in that twelve-month period would not include anticipated FPFTY end-of-year pay increases. I&E M.B. at 46; I&E St. 1 at  16; I&E St. 1-SR at 12.

I&E rejected UGI’s year-end methodology, which annualizes the anticipated expenses the Company will pay across the twelve months that make up the FPFTY. I&E maintained that annualization of the end-of-year salaries and wages, that include all increases would allow the Company to recover in rates more than it requires for the test year utilized. I&E St. 1-SR at 13; I&E M.B. at 15-24, I&E St. 3 at 3-13.

1. **Recommended Decision**

The ALJs agreed with UGI on this issue and accepted UGI’s end-of-year methodology. The ALJs’ were persuaded by UGI’s argument that the FPFTY should reflect end-of-the year conditions. The ALJs recommended that we allow UGI’s claim of salary and wage expense, net of employee additions, in the amount of $4,993,000.

1. **Exceptions and Reply**

In its Exception No. 8,I&E reiterates its rationale for opposition to UGI’s methodology for annualization adjustment to recoup costs incurred over the course of the FPFTY. I&E Exc. at 16-17. The OCA, in its Exception No. 3, similarly opposes the ALJs’ allowance of expense based on the end-of-year annualization adjustment of $34,000. OCA Exc. at 7.

In reply, UGI notes that the positions of I&E and the OCA would preclude UGI from recouping the additional expenses incurred *via* salary and wage increases which occur over the course of the FPFTY. UGI maintains that the positions of I&E and the OCA would cause regulatory lag between the Company’s rates and the expenses incurred during the first year the rates are in effect, defeating the plain language and intent of Act 11 to permit the use of a “fully projected test year.” UGI R. Exc. at 3-7.

1. **Disposition**

We agree with the ALJs’ recommendation on this issue, approving UGI’s end-of-year methodology and providing for an annualization adjustment to recoup costs incurred over the course of the FPFTY. We are likewise persuaded by UGI’s argument that the FPFTY should reflect end-of-the year conditions.

Therefore, we shall allow UGI’s claim of salary and wage expense, net of employee additions, in the amount of $4,993,000 (*i.e.*, $4,959,000 + $34,000).

1. **Employee Additions**
2. **Position of the Parties**

UGI requested an allowance of $382,000 for expenses relating to three new employee positions. UGI’s claim included salaries, wages, and benefits for three new positions: a general manager, a new business engineer, and a business support engineer, as well as an adjustment for annualization of newly added positions into the FPFTY expenses, consistent with UGI’s broader argument that the FPFTY should reflect end-of-the year conditions. UGI M.B. at 60; UGI St. 3 at 13-14.

I&E concurred in UGI’s claim for expense allowance of $318,000 for employee additions but challenged the expense allowance of $64,000 for UGI’s annualization adjustment for compensation for the three positions in the FPFTY. I&E St. 1 at 19. I&E reasserted its prior arguments in opposition to UGI’s end-of-year methodology in calculating an annualization adjustment for expenses incurred during the FPFTY. I&E maintained that the FPFTY expense allowance should be based on the actual amounts incurred across the FPFTY period and not an annualization of the end-of-year projections. *Id*.; I&E St. 1-SR at15. I&E noted that the Company assumes the positions will be filled *by* December 1, 2018; but, its claim is based on a full year’sworth of expense (*i.e.*, salaries, wages, and incentive compensation) for the positions. I&E St. 1 at 18 (citing UGI St. 3 at 13-14).

The OCA also opposed UGI’s end-of-year methodology and proposed an adjustment to the payroll expense to reflect expected date of employment. OCA St. 1 at  17-18; OCA St. 1, Schedule LKM-9.

1. **Recommended Decision**

The ALJs agreed with UGI on this issue. The ALJs again noted their acceptance of UGI’s end-of-year methodology to calculate expenses with an adjustment for annualization whereby the FPFTY reflects actual end-of-the year conditions. The ALJs recommended that the Commission accept UGI’s claim of expenses for employee additions in the amount of $382,000. R.D. 42-43.

1. **Exceptions and Reply**

In its Exception No. 9, I&E disagrees with the ALJs’ recommendation for allowance of expense in the amount of $64,000 attributable to UGI’s end-of-year methodology adjustment for annualization of the expense total of $318,000 attributable to the expense of employee additions. I&E’s opposition is based on the fundamental opposition to UGI’s end-of-year methodology’s adjustment for annualization of a given expense. I&E Exc. at 17-18. Similarly, in its Exception No. 3, the OCA objects to the ALJs’ allowance of expense attributable to UGI’s use of the end-of year methodology which adds an adjustment for annualization of the underlying expense of employee additions. OCA Exc. 7-9.

In Reply, UGI rejects the positions of I&E and the OCA on the same fundamental grounds previously argued regarding the employee expenses, net of employee additions. UGI reiterates that I&E and the OCA would preclude UGI from recouping the additional expenses which are incurred over the course of the FPFTY. UGI maintains that I&E’s position would cause regulatory lag between the Company’s rates and the expenses incurred during the first year the rates are in effect, defeating the plain language and intent of Act 11 to permit the use of a “fully projected test year.” UGI R. Exc. at 3-8.

1. **Disposition**

We agree with the ALJs’ recommendation on this issue and the approval of UGI’s end-of-year methodology providing for an annualization adjustment to recoup costs incurred over the course of the FPFTY. We are likewise persuaded by UGI’s argument that the FPFTY should reflect end-of-year conditions.

Therefore, we shall allow UGI’s claim in the amount of $382,000 (*i.e.*,$318,000 + $64,000) for employee additions of salary and wage expense, net of employee additions, in the amount of $4,993,000.

Before concluding this issue, because we are approving estimated projected expenses to be memorialized into the Company’s base rate, it is in the public interest that we monitor the Company’s future actual expenditures related to the allowed expense to ensure the accuracy of the projected expenses. Because UGI’s claim for expenses related to the three new employee positions is factored into UGI’s calculation of rates using the FPFTY, we shall require UGI to file annual reports with the Secretary’s Bureau and the Commission’s Fixed Utility Financial Analyst Supervisor in I&E by December 1 following the end of each fiscal year for the next five years, or until the implementation of new base rates in a subsequent rate case within this same time frame. The annual reports shall delineate the actual annual expenses incurred by the Company associated with the hiring of these three new employees, as well as any reduction in expenses if any positions are eliminated.

1. **Outside Services Employed**
2. **Positions of the Parties**

UGI’s initial filing included a claim for allowance of expense in the amount of $191,000 for Miscellaneous Outside Services Employed. UGI’s claim included “recruiting and staffing services, certain legal expenses not included elsewhere, various printing and photography services, unclassified IT analytical consulting, and other miscellaneous outside professional services.” UGI M.B. at 60; UGI Book I, Attachment II-D-7(b).

UGI admitted accounting errors in incorrectly attributing the bulk of the expenses; however, it maintained that substantial evidence exists on the record to support the costs delineated for outside services employed as follows: $17,000 in costs associated with management development programs organized by the human resource department; $19,000 in printing costs that are budgeted to Account 923 but are booked to the actual accounts when the printing jobs are processed; $91,000 in other professional services costs across various groups which support UGI; and a worker’s compensation claim of $39,000 that the Company has budgeted in Account 923. UGI St. No. 4-R at 9. In sum, UGI maintained that, at a minimum, the company should be allowed to claim an expense in the amount of $166,000. UGI M.B. at 60-61; UGI St. 4-RJ at 8.

I&E maintained that UGI failed to provide substantial record evidence to support the claim for outside services employed for either the initial FPFTY claim for $191,000 or the adjusted FTY claim for $171,000. With respect to UGI’s proffered breakdown of expenses for outside services employed totaling $166,000, I&E asserted that the breakdown is insufficient and, therefore, the Company has not provided substantial evidence to support a finding that the expense was prudently incurred. As such, I&E recommended an allowance of $21,000 based on the historic average of expenses. I&E St. 1 at 22.

1. **Recommended Decision**

The ALJs recommended that the Company be permitted to recover $75,000 of its total claim of $166,000. The ALJs concluded that substantial evidence was offered to support the following: $17,000 of costs associated with management development programs organized by the human resource department; $19,000 of printing costs that are budgeted to Account 923 but are booked to the actual accounts when the printing jobs are processed; and $39,000 that the company has budgeted in Account 923 for the worker’s compensation claim. The ALJs recommended denial of the expenses claimed in the amount of $91,000, on the basis that the claimed amounts for other professional services costs across various groups supporting UGI was not adequately supported or explained in the record. Therefore, the ALJs recommended approval of UGI’s claim for expenses in the amount of $75,000 for outside services employed. R.D. at 43-44.

1. **Exception and Reply**

In its Exception No. 10, I&E concurs with the ALJs’ recommendation to deny UGI’s claim for $91,000 in expenses which were not adequately supported by record evidence. However, I&E further maintains that the ALJs erred in finding that substantial evidence of record supported UGI’s remaining claim for $75,000. I&E argues that because the Company has offered insufficient evidence to support the amounts claimed, the Commission should calculate the expenses based upon a three-year historic average from 2015-2017. I&E Exc. 18-19.

In reply, UGI asserts that the ALJs’ appropriately recommended approval of the portion of the expenses claimed which was supported by substantial evidence of record. UGI asserts that I&E’s calculation based on historic averages should be rejected as it would rely on expense data which UGI has shown to have understated UGI’s expenses during the periods due to an accounting error. UGI R. Exc. at 18.

1. **Disposition**

We agree with the ALJs’ recommendation to grant UGI’s request for allowance of expenses in the amount of $75,000 for outside services employed. Notably, UGI does not dispute the ALJs’ finding regarding this reduced level of expenses claimed. Nonetheless, UGI has offered substantial record evidence to support $75,000 of the total claim of $166,000, specifically the $17,000 associated with the management development programs, the $19,000 in printing costs budgeted to Account 923 but booked to the actual accounts when the printing jobs are processed, and the $39,000 budgeted in Account 923 for the worker’s compensation claim. Additionally, we agree with the ALJs’ recommendation to deny the additional $91,000 in expenses relating to other professional services costs across various groups which support UGI because it was not adequately supported in the record.

Therefore, we shall deny I&E’s Exception No. 10 and adopt the ALJs’ recommendation and allow UGI’s claim for expenses in the amount of $75,000 for outside services employed.

1. **Employee Activity Costs**
2. **Positions of the Parties**

UGI requested an allowance for expenses claimed in the amount of $11,848 for employee activities. Most of this expense is attributable to the Company’s annual picnic. UGI claimed the expenses are prudent for recognizing the employees’ hard work and dedication, as well as to boost employee interaction and morale. The Company asserted that the claimed employee activities provide benefits to UGI’s customers through enhanced customer service, resulting from the improved employee communication and productivity. UGI maintained that the employee activities are integral to the provision of service to its customers. UGI M.B. at 60-61; UGI St. 4-R at 10. UGI also noted that the Commission has an Employee Appreciation Day, for the purpose of boosting employee engagement and morale. UGI M.B. at 62.

I&E asserted that UGI’s claim for employee activities is not necessary for the provision of safe and reliable service to ratepayers. Additionally, I&E contended that the claimed amount cannot be justified as a business meeting qualifying as an allowable expense in a rate proceeding. Thus, I&E recommended denying the claimed allowance. I&E M.B. at 49-50; I&E R.B. at 35; I&E St. 1 at 25; and I&E St. 1-SR at 19.

1. **Recommended Decision**

The ALJs agreed with UGI’s position and recommended that the Commission allow UGI’s claim for expenses in the amount of $11,848 for employee activities. The ALJs concluded that UGI’s annual picnic is an employee recognition event based upon evidence that the picnic is used by the Company for recognition of special employee milestones and to recognize employees that have gone above and beyond service expectations. R.D. at 46 (citing Tr. at 127 andUGI St. 4-R at 10).

The ALJs’ analysis turned on application of Commission precedent pertaining to employee activity expenses. The ALJs first concluded that employee activity costs are reasonable and necessary in the provision of utility service to customers. R.D. at 45 (citing *Pa. Pub. Util. Comm’n. v. Citizens Utilities Water Co. of Pa.*, Docket No. R-00953300C0001-0072, 1996 WL 350828 (Order entered March 29, 1996). The ALJs further found that a utility could claim employee activity as an expense where the employee activity is for the purpose of employee recognition. R.D. at 45-46 (citing *Pa. Pub. Util. Comm’n. v. York Water Co.*, 62 Pa. P.U.C. 459 (1986) (*York Water*) and *Pa. Pub. Util. Comm’n v. Columbia Water Company*, Docket No. R-2013­2360798 (Order entered January 23, 2014) (*Columbia Water*)).

1. **Exception and Reply**

In its Exception No. 11, I&E asserts that shareholders of the Company, rather than ratepayers, should bear the burden of funding employee activity expenses, regardless of whether the Company uses the activity as an opportunity to recognize its employees. I&E Exc. at 19-21.

In reply, UGI notes that I&E’s position contradicts Commission precedent establishing the legal standard under which employee activity expenses may be claimed for inclusion in the rate base. UGI R. Exc. at 18-19.

1. **Disposition**

Based on the record evidence, we concur with the finding of the ALJs that UGI’s annual picnic is an employee recognition event which the utility may properly claim as an expense for inclusion in the rate base. In *York Water*,the Commission granted the utility’s expense claim for a company banquet but did not grant the utility’s expense claim for a company picnic. The distinction made in *York Water* between the company picnic and the company banquet, was based upon the conclusion that the company picnic did not stand on the same footing as the company banquet, since it involved no element of employee recognition. Similarly, in *Columbia Water*, the ALJ disallowed employee recognition expenses because the utility did not provide specific information about the year-end banquet to demonstrate that it qualifies as an employee recognition dinner.

We find that the ALJs appropriately applied Commission precedent in the present case, concluding that UGI’s picnic was an employee recognition event and recommending allowance of UGI’s claim for employee activity expenses. Therefore, we shall adopt the ALJs’ recommendation to allow UGI’s claim in the amount of $11,848 for employee activity expenses. I&E’s Exception No. 11 is denied.

1. **Allocated Stock Options and Restricted Stock Awards**
2. **Positions of the Parties**

UGI requested allowance of a claim in the amount of $77,000 in Allocated Stock Options expense and $112,000 in Restricted Stock Awards expense. These expenses are attributable to incentive compensation, employee pay that is contingent upon performance, or results achieved. UGI St. 4-R at 13. UGI explained that its use of incentive compensation programs is only part of its total compensation package and that the Allocated Stock Options and Restricted Stock Awards are only a part of its incentive compensation program. *Id.* at 12. UGI submitted that the incentive compensation is market-driven and necessary to obtain and retain quality employees. According to the Company, the employees who are eligible to receive incentive compensation under these plans are pivotal to establishing and executing UGI’s operating goals. The Company contended that these goals are directly related to the provision of service and customer-focused goals for the entire corporation. *Id.* UGI further asserted that incentive compensation programs which are reasonable and provide a benefit to ratepayers are recoverable in their entirety. UGI M.B. at 64.

I&E averred that UGI’s total claim for Allocated Stock Options and Restricted Stock Awards should be denied. I&E M.B. at 50-52; I&E St. 1 at 27-28. I&E asserted that a benefit available only to high-level executives based on stock prices and/or earnings targets rather than service goals that benefit ratepayers should not be allowed. I&E St. 1 at 28. Further, I&E represented that because the stock component of UGI’s incentive program is based on a financial metric, the incentive program should be disqualified as an allowable expense. I&E M.B. at 52 (citing Tr. at 109-110). I&E additionally relied upon *Pa. Pub. Util. Comm’n v. Roaring Creek Water Company,* 81 Pa. P.U.C. 285 (1994), as authority for the proposition that the Commission has, in the past, rejected management bonuses that are primarily based on financial metrics to determine payouts. I&E R.B. at 49.

1. **Recommended Decision**

The ALJs recommended that UGI’s request for allowance of a claim in the amount of $77,000 in Allocated Stock Options expense and of $112,000 in Restricted Stock Awards expense be denied. The ALJs agreed with I&E’s position that under applicable precedent, where the incentive compensation program was not aimed at enhancing the productivity and efficiency of the utility, the program cost should be excluded from operating expenses. Here, the ALJs determined that the employees receiving the incentives are not proximately responsible for serving customers and the program appears more focused on awarding executives for financial rather than operational success. Finding that UGI’s incentive compensation program had no proximate relationship to provision of service to UGI customers, the ALJs recommended that UGI’s claim for these expenses be denied in total. R.D. at 49-50.

1. **Exception and Reply**

In its Exception No. 6, UGI submits that the ALJs’ rejection of this claimed expense in the amount of $189,000 in Allocated Stock Options and Restricted Stock Options, is based on the ALJs’ fundamental factual error regarding the employees who are eligible to earn the options. UGI maintains that the record reflects that the employees who would be the recipients of the benefits at issue have direct responsibility for customer service. Additionally, UGI asserts that incentive compensation is needed to attract and retain employees who serve key roles in ensuring safe and reliable service to customers. UGI Exc. at 31-34.

Further, UGI asserts that its incentive compensation identifies both financial and operational metrics to be eligible, and the Company’s Management Employees have goals included in their metrics directly tied to provision of service, such as safety, reliability and customer service. UGI maintains it has demonstrated that its incentive compensation plan, as a whole, includes financial and operating metrics and goals which directly benefit UGI’s customers. UGI Exc. at 31-34.

I&E’s Reply to UGI Exception No. 6, rejects UGI’s argument that the ALJs erred as a matter of fact in finding that the UGI employee eligible for the incentive compensation did not have direct responsibility for customer service. I&E reiterates its position that UGI’s claim for expenses related to incentive compensation are not supported on the record. I&E R. Exc. at 20-21.

1. **Disposition**

Upon review, we shall grant UGI’s Exception No. 6. We find that the Company has provided substantial evidence of record to demonstrate that the incentive compensation program as a whole includes both financial and operating metrics and goals which benefit customers. For example, the Company has presented testimony that safety, reliability and customer service are all metrics utilized in the cash incentive program for eligible employees. *See* UGI St. 4-RJ at 9-10. Additionally, UGI has shown that the eligible employees have direct responsibilities for customer service and regulatory compliance or are otherwise responsible for ensuring safe and reliable service to customers. *See e.g.*, UGI St. 1 at 1-2; and UGI St. 3 at 1. Moreover, we acknowledge that the incentive compensation appears necessary to attract and retain employees in a competitive market who serve key roles in ensuring safe and reliable service to customers. UGI St. 4-R at 12.

Where, as here, the incentive program as a whole establishes that the employees’ eligibility to receive the benefit is based on performance duties and metrics directly related to the provision of service, the fact that the program includes a financial metric does not disqualify it from allowance as an expense for inclusion in the rate base. We find that because UGI’s incentive program is reasonable, prudently incurred, and is not excessive in amount, UGI is permitted to fully recover this expense. Furthermore, our decision to recover this expense is consistent with our prior decisions approving incentive compensation programs that are focused on improving operational effectiveness. *See e.g.,* *PPL 2012 Order* at 26. Therefore, we shall grant UGI’s request for allowance of a claim in the amount of $77,000 in Allocated Stock Options expense, and $112,000 in Restricted Stock Awards expense.

1. **Depreciation Expense**
2. **Positions of the Parties**

UGI claimed an annual depreciation expense for the FTY in the amount of $4,265,854 and for the Rebuttal FPFTY in the amount of $5,333,752. I&E St. 3-SR at 13. The Company calculated its annual depreciation expense claim for the FPFTY by taking the calculated annual depreciation expense plus the amortization of net salvage and subtracted an amount charged to clearing accounts. UGI REV. Ex. A, Sch. D-21.

As discussed above, the depreciation rates have been established pursuant to the Joint Stipulation under ¶ 7. We have approved this provision within the Joint Stipulation as being in the public interest. However, both I&E and the OCA recommended adjustments to the Company’s depreciation expense that aligns with their average rate base methodology for calculating the FPFTY. Again, UGI submits that the Commission should accept its end-of-year methodology.

1. **Recommended Decision**

Consistent with their recommendation that UGI be permitted to utilize end-of-year methodology in its FPFTY, the ALJs recommended that the Commission adopt UGI’s claim for depreciation expense. R.D. at 51-52.

1. **Exceptions and Reply**

In its Exception No. 12, I&E contends that the Commission should adopt an annual depreciation expense of $5,290,062 based on the FPFTY average rate base methodology. I&E incorporates the arguments from its Exception No. 2, *supra*, advocating for average rate base methodology. I&E Exc. at 21-22.

Similarly, in its Exception No. 4, the OCA objects to the ALJs’ ruling and submits that I&E’s recommendation should be adopted so that the depreciation expense claim reflects the average plant in service in the FPFTY. OCA Exc. at 9-10.

UGI replies that the ALJs properly adopted the end of year FPFTY methodology and that the Exceptions of I&E and the OCA should be denied. UGI R. Exc. at 7-8.

1. **Disposition**

For the reasons set forth in our disposition of the issue pertaining to End of Year vs. Average Rate Base Methodology, *supra*, we find that the ALJs properly permitted UGI to use the end-of-year methodology in its FPFTY. Accordingly, we shall deny the Exceptions of I&E and the OCA on this issue and adopt UGI’s annual depreciation expense for the FTY in the amount of $4,265,854 and for the Rebuttal FPFTY in the amount of $5,333,752.

1. **Other Post Employment Benefits**

During the proceeding, UGI disclosed that it had been over collecting on Other Post Employment Benefits (OPEB) since the Company’s last base rate proceeding in 1996. UGI submitted that in the 1996 rate case settlement, the Company was authorized to recover $0.484 million per year for its annual OPEB costs and was also directed to account for the difference between the net periodic post-retirement benefit expense under Statement of Financial Accounting Standards (SFAS) 106 and the amount recovered in rates. The difference was to be recorded as a regulatory asset (or liability) and be recovered or refunded in future rate proceedings. According to UGI, the OPEB fund has been generating more income than its expenses and the Company has accumulated an over-collection in the amount of $7.9 million over the last twenty-two years since its last rate case. UGI St. 4-R at 17.

The Company proposed to refund this over-collection to customers over twenty years by returning $0.395 million annually to its ratepayers. *Id.* (citing UGI Rev. Sch. D-14). UGI submits that the 20-year period is similar to the current recovery mechanism period and is consistent with the 20-year period established in 52 Pa. Code § 69.351 (regarding recovery of the OPEB costs that investor-owned utilities deferred after the adoption of SFAS No. 106). UGI St. 4-R at 17-18.

The ALJs noted that neither I&E nor the OCA raised objections to the Company’s proposal. Additionally, I&E indicated that it does not object to returning the over-collection over a shorter period of time. According to I&E, it is easier to return over collected monies already in the possession of the Company over a shorter period of time than it is to collect the over-collection over a period of years from the ratepayers. I&E would also not object to the addition of interest to the over-collection. R.D. at 52.

In the recommendation, the ALJs noted that the opposing parties did not object to the Company’s proposal and recommended that the Commission accept UGI’s proposal to refund the over-collection on OPEB of $7.9 million by an amount of $0.395 million annually to its ratepayers over twenty years. The ALJs also emphasized that the issue of interest on the over-collection had not been analyzed in this proceeding and thus did not recommend the addition of interest to the over-collection. R.D. at 53.

No Party filed Exceptions on this issue. We believe the ALJs’ recommendation in this matter is just and reasonable. Accordingly, the ALJ’s recommendation that permits UGI to provide a refund to its ratepayers by an amount of $0.395 million annually over twenty years is hereby adopted.

1. **Power Supply**
2. **Positions of the Parties**

The Company has made a power supply expense claim in the amount of $1,933,000. In response, I&E recommended that this expense be increased by approximately $19,500 to $1,953,000 based on an average rate base methodology adjustment. I&E St. 3-SR at 22. UGI objected to I&E’s proposed adjustment.

1. **Recommended Decision**

The ALJs agreed with UGI and rejected I&E’s proposed use of the average rate base methodology to calculate the FPFTY. Consistent with their analysis throughout this proceeding, the ALJs recommended that the Commission accept the Company’s claimed power supply expense in the amount of $1,933,000. R.D. at 53.

1. **Exception and Reply**

In its Exception No. 13, I&E reasserts its arguments opposing the use of the FPFTY end-of-year methodology. I&E reasserts that its average rate base methodology should be adopted and UGI’s power supply expense claim should be increased by $19,500. I&E Exc. at 22. In its Reply, UGI argues that the ALJs properly adopted the end of FPFTY methodology and that I&E’s Exception should be denied. UGI R. Exc. at 7-8.

1. **Disposition**

For the reasons set forth in our disposition of the issue pertaining to End of Year vs. Average Rate Base Methodology, *supra*, we find that the ALJs properly permitted UGI to use the end-of-year methodology in its FPFTY. Accordingly, we shall deny I&E’s Exception on this issue and adopt UGI’s power supply expense claim in the amount of $1,933,000.

1. **Electrical Engineering and Operations Center**

As explained in our discussion of Rate Base, *supra*, we found that the Operations Center appears to be in the preliminary stages and will not be in service during the FPFTY. Thus, we directed an adjustment to UGI’s plant-in-service claim to remove the costs of the Operations Center from the proposed rate base.

In their Recommended Decision, the ALJs also adjusted UGI’s expense claim to remove the $13,000 associated with the relocation expense and the $225,000 in depreciation expense associated with the proposed new Operations Center in the FPFTY. R.D. at 53-54 (citing UGI St. 2-RJ at 2). No Party filed Exceptions on this issue. Based on our review of the record, we conclude that the ALJs’ recommendation on this issue is just and reasonable. Accordingly, we shall approve the removal of the expense claims for the Operations Center as set forth in the Recommended Decision.

# Fair Rate of Return

## **A. Capital Structure**

**1. Positions of the Parties**

Each of the Parties to this Proceeding concurred that UGI’s capital structure consists of 45.98% long-term debt and 54.02% common equity, as set forth in the Joint Stipulation. UGI M.B. at 73; OCA M.B. at 8; I&E M.B. at 13.

**2. Recommended Decision**

The ALJs recommended the adoption of the Parties’ proposed capital structure. R.D. at 57.

**3. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. We find that the ALJ’s recommendation is just and reasonable. Accordingly, we shall adopt a capital structure for UGI of 45.98% long-term debt and 54.02% common equity as recommended by the ALJ.

## **B. Cost of Long Term Debt**

**1. Positions of the Parties**

UGI proposed a 4.69% forecasted embedded long-term debt cost rate for the FPFTY. UGI M.B. at 74.

I&E and the OCA indicated that they had no objection to UGI’s proposed long-term debt cost rate. Additionally, I&E opined that UGI’s claimed cost rate of long‑term debt is reasonable and representative of the industry. I&E M.B. at 70; OCA M.B. at 52.

**2. Recommended Decision**

The ALJs recommended the adoption of UGI’s proposed long-term debt cost rate.

**3. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. Finding the ALJ’s recommendation to be reasonable, we adopt it without further comment. Accordingly, we shall adopt a long-term debt cost rate for UGI of 4.69%.

## **C. Cost of Common Equity**

In the instant proceeding, UGI, I&E and the OCA presented a position on a reasonable rate of return on equity (ROE). The OSBA did not take a position. The remaining Parties’ positions were generally developed through comparison groups’ market data, costing models, reflection or rejection of risk and leverage adjustments and a management performance adjustment, as will be further addressed, *infra*. The following table summarizes the cost of common equity claims made and the methodologies used by the Parties in this proceeding:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Party** | **DCF** | **CAPM** | **RP** | **CE** | **ROE** |
| **UGI** | 10.55% | 11.03% | 11.25% | 12.55% | 11.25% |
| **I&E** | 8.62% | 8.98% historic, 8.00% forecasted |  |  | 8.62% |
| **OCA** | 7.93-8.31% | 7.08% |  |  | 8.50% |

**1. Proxy Groups**

To estimate a utility’s cost of equity, a proxy (or barometer) group of similar companies is used. A proxy group is generally preferred over the use of data exclusively from any one company because it has the effect of smoothing out potential anomalies associated with a similar company and is therefore a more reliable measure. I&E St. 2 at 8; OCA M.B. at 58.

**a. Positions of the Parties**

UGI determined its proxy group of ten electric companies based on the following criteria:

1. The companies must have publicly-traded common stock;

2. The companies are contained in The Value Line Investment Survey and are classified in the Electric Utility East group;

3. The companies are not currently the target of an announced merger or acquisition; and

4. The companies are not engaged in the construction of a nuclear generating plant or have not recently cancelled the construction of a nuclear generating plant.

UGI St. 5 at 3-4.

The OCA utilized the same ten companies as UGI. Therefore, the OCA submitted that UGI’s proxy group, as utilized by OCA’s witness Mr. Rothschild, is reasonable and should be accepted. OCA M.B. at 58.

On the other hand, I&E determined its proxy group of twelve companies by applying the following criteria to Value Line’s East, Central, and West Electric Utility groups

1. Fifty percent or more of the company’s revenues must be generated from the regulated electric utility industry;

2. The company’s stock must be publicly traded;

3. Investment information for the company must be available from more than one source, which includes Value Line;

4. The company must not be currently involved/targeted in an announced merger or acquisition;

5. The company must have five consecutive years of historic earnings data;

6. The company must be operating in a state that has a deregulated electric utility market.

I&E St. 2 at 8. I&E stated that five of UGI’s selected companies did not meet I&E’s criteria. *Id.* at 62.

In response to the above, UGI submitted that the appropriate criterion should be based on the percentage of electric assets to total assets, rather than whether fifty percent or more of the regulated revenue is generated from the regulated electric utility. According to UGI, this measure best describes how the potential returns on capital used in a utility’s operations will be achieved on the total business. UGI St. 5-R at 11-12.

**b. Recommended Decision**

The ALJs found I&E’s argument that the percentage of regulated revenues is a better criterion than the percentage of regulated assets to be persuasive. The ALJs reasoned that the percentage of cash flow a company receives from a business line would appear to be the most direct indication of the company’s primary business. Therefore, the ALJs excluded two companies from UGI’s proxy group because they do not receive 50% of their regulated revenues from regulated utility operations. The ALJs termed the remaining eight companies UGI’s “Altered Proxy Group.” R.D. at 64.

**2. Discounted Cash Flow (DCF) Model**

The DCF method applied to a 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) at 56; *Pa. PUC v. PPL Electric Utilities Corp*., Docket No. R-00049255 (Order entered December 22, 2004) (*2004 PPL Order*) 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.

**a. Positions of the Parties**

UGI proposed a DCF cost rate for its electric proxy group that consisted of three components: (1) a dividend yield, (2) a growth rate, and (3) a leverage adjustment. UGI’s resulting proposed cost of common equity under the DCF method of 10.55%, which is calculated as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Dividend + | Growth + | Leverage = | DCF Cost Rate |
|  |  |  |  |  |
| Electric Group | 3.73% | 5.75% | 1.07% | **10.55%** |

UGI M.B. at 79.

UGI used the six-month average historical dividend yield of 3.62% for its electric proxy group and adjusted it by eleven basis points to account for the prospective nature of dividend payments, *i.e.*, higher expected future dividends, and arrived at the 3.73% adjusted dividend yield for the electric group. UGI St. 5 at 19. UGI claimed that this number is likely understated because it is based largely on historic information that does not reflect declines in public utility stock prices in the aftermath of the TCJA. UGI M.B. at 79.

Having reviewed several methods of calculating investor expected growth rates, UGI submitted that analysts’ forecasts of growth rates represent the best indicator of expected growth. According to UGI, the range of such growth rates was 4.33 to 6.06% for its electric proxy group. Based on this, UGI determined that a 5.75% growth rate was appropriate on the basis that improved economic growth supports a DCF growth rate near the higher end of the range. UGI. M.B. at 79-80.

UGI also argued that a leverage adjustment should be added to its DCF cost rate. UGI explained that a leverage adjustment is designed to adjust the DCF cost rate for the different percentage of debt in the capital structure calculated at market values of equity and long-term debt (the values used by investors) as compared to the percentage of debt in the capital structure at book value (the values used in the ratemaking process) to account for the greater financial risk created by a higher debt ratio when that cost rate is applied to a book value capitalization in utility proceedings. According to UGI, the Commission has applied the leverage adjustment in cases where it believes market conditions have resulted in an understated DCF cost rate. *See e.g. 2004 PPL Order*. UGI submitted that such conditions exist in this case. UGI pointed out that the DCF cost rate for its proxy electric group without a leverage adjustment is 9.48% (*i.e.*, a 3.73% dividend yield plus a 5.75% growth rate). UGI argued that this is well below the average allowed return on equity for electric utilities in 2017. As such, UGI asserted that an unadjusted DCF greatly understates the cost of common equity because the proportion of market value common equity in the electric group’s capitalization was significantly higher than its proportion measure at book value. Accordingly, UGI proposed to add a leverage adjustment of 107 basis points (*i.e.*,1.07%) to its DCF cost of common equity calculation. UGI M.B. at 80-85.

I&E employed the standard DCF model, k = D1/P0 + g, where k is the cost of common equity, D1 is the dividend expected during the year, P0 is the current price of the stock, and g is the expected growth rate of dividends. Through the methodologies outlined in the testimony of I&E witness Anthony Spadaccio, I&E calculated that the DCF methodology produces a cost of common equity of 8.62%. I&E M.B. at 71.

I&E argued that a representative dividend yield must be calculated over a time frame that avoids problems of both short-term anomalies and stale data series. I&E’s dividend yield calculation placed equal emphasis on the most recent spot and the 52-week average dividend yields, resulting in an average dividend yield of 3.74%. I&E St. 2 at 21-22.

I&E stated that the expected growth rates for its own proxy group ranged from -1.12% to 6.84%, with an average of 3.88%. For the purpose of determining the growth estimate, I&E eliminated all proxy companies that had negative projected growth rates because it believed that growth projections for some of the companies in its proxy group were extremely inconsistent and would have unnecessary and unwarranted negative impacts on its DCF analysis. Based on this, I&E determined a new adjusted average of 4.88%, which it argued was appropriate to use for the growth rate component of the DCF calculation. I&E St. 2 at 22-23.

I&E submitted that UGI’s proposed leverage adjustment should be rejected because investors base their decisions on book value debt and equity ratios for regulated utilities, and not on market values, rendering any adjustment unnecessary. I&E also submitted that recent Commission precedent supports rejecting a utility’s request for a leverage adjustment. I&E St. 2 at 41-44.

The OCA proposed a DCF cost of equity range of between 7.93% and 8.31%. The OCA utilized a constant growth DCF analysis and conducted a non-constant growth DCF analysis as a check on its results. The OCA’s constant growth analysis employed the formula k=D/P + (br +sv), where “k,” “D,” and “P” are as defined in I&E’s DCF analysis, *supra,* and “br+sv” represents the growth rate. Additionally, “b” represents the dividend earnings retention rate, “r” represents the rate of return on common equity investment, “v” represents the fraction of funds raised by the sale of stock that increases the book value of the existing shareholders’ common equity, and “s” represents the rate of continuous new stock financing. The OCA explained that its non-constant growth DCF analysis accounts for growth rates that change over time and determines the return on investment expected by investors based on an estimate of each separate annual cash flow the investor expects to receive. The OCA’s non-constant growth DCF method indicated a cost of equity of between 7.10% and 7.63%. The OCA submitted that this provides a reasonable check on its DCF recommendation. OCA M.B. at 58-63; OCA St. 3 at 28-39.

Based on the average market stock price, the OCA calculated a dividend yield of 3.73% and a cost of equity of 7.93%, implying a growth rate of 4.2%. Additionally, based on the spot stock price on March 31, 2018, the OCA calculated a dividend yield of 4.00% and indicated a cost of equity of 8.31%, implying a growth rate of 4.31%. OCA Schedule ALR 4.[[6]](#footnote-6)

Like I&E, the OCA submitted that UGI’s proposed leverage adjustment should be rejected. The OCA reasoned that leverage adjustments distort the natural market dynamic between a regulated utility’s stock price and its allowed rate of return. OCA M.B. at 64-65.

**b. Recommended Decision**

As noted above, the ALJs removed two companies from UGI’s proxy group, resulting in UGI’s “Altered Proxy Group.” The ALJs noted that each of UGI, I&E, and the OCA reached fairly similar results when calculating the dividend yield and that there was not significant conflict on this component of the DCF model. Because the OCA’s calculations were based on the most recent observations, the ALJs recommended the use of the average of the OCA’s dividend yield but adjusted it for UGI’s “Altered Proxy Group.” Therefore, the ALJs recommended a dividend yield of 3.95%. Additionally, the ALJs calculated UGI’s “Altered Proxy Group” to have growth rates ranging from 5.2% to 6.5%, resulting in an average growth rate of 5.85%. The ALJs recommended the use of this growth rate. However, the ALJs recommended that UGI’s proposed leverage adjustment be denied. The ALJs agreed with the OCA and I&E that there is no need to include an artificial upward adjustment to the DCF. Further, the ALJs noted that recent Commission precedent supports rejecting a utility’s request for a leverage adjustment in a base rate proceeding. More specifically, the ALJs pointed out that in PPL Electric Utilities’ (PPL) 2012 rate case proceeding in *Pa. Pub. Util. Comm’n., v. PPL Electric Utilities Corporation*, Docket Nos. R-2012-2290597, *et al.*, (Order entered December 28, 2012 (*2012 PPL Order*), we rejected PPL’s requested leverage adjustment, noting that while we have granted leverage adjustments in a few select cases, this does not mean such adjustments are warranted in all cases. Based on a dividend yield of 3.95% and an average growth rate of 5.85%, the ALJs recommended a DCF cost of common equity of 9.80%. R.D. at 69-70, 73-75, 88.

**c. Exceptions**

I&E and the OCA each excepted to the ALJs’ recommended growth rate, while UGI excepted to the ALJs’ finding that it should not be allowed a leverage adjustment.

**i. Growth Rate**

In its Exception No. 14, I&E objects to the ALJs’ recommendation to use the 5.85% average growth rate of UGI that is based on UGI’s Altered Proxy Group. I&E opines that the Commission should find that the subject companies I&E used in its own proxy group were properly included and that there is no credible evidence in the record to support their exclusion. According to I&E, the ALJs’ use of UGI’s Altered Proxy group excludes companies with low growth rates and inflates the DCF results. I&E also points out that the ALJs granted UGI a 5.85% growth rate when UGI itself proposed a lower growth rate of 5.75%. Additionally, I&E reasons that UGI’s 54.02% equity in its rate structure far outweighs the most recent S&P Global Return on Capital, Return on Equity averages of 48.90% in 2017, 48.91% in 2016, and 49.54% in 2015, thereby indicating that UGI has far less risk than the average electric utility. Therefore, I&E submits that the Commission should adjust the ALJs’ recommended growth rate down from 5.85% to 4.88%. I&E Exc. at 22-25.

In its Exception No. 5B, the OCA contends that the ALJs failed to adopt a sustainable growth rate. The OCA posits that long-term sustainable growth is caused by retention and reinvestment of earnings. According to the OCA, neither UGI’s proposed growth rate, nor the growth rate recommended by the ALJs consider the retention rate, *i.e*. the level of retained earnings that are kept by the company and directly reinvested. In contrast, the OCA submits that the “b x r” term in its DCF equation, outlined, *supra,* computes sustainable growth because it measures only the growth which a company can expect to achieve when its earned return on book equity remains in equilibrium. Therefore, the OCA asserts that its proposed growth rate range of 4.20% to 4.31% should be adopted instead. OCA Exc. at 11-13.

In response to the above, UGI claims that the Commission should deny the Exceptions of both I&E and the OCA. First, UGI challenges the OCA’s claim that the Commission should consider the retention rate when calculating the DCF. UGI points out that the OCA has presented this argument multiple times over many years but has not cited to any instance where the Commission has adopted its “b x r” formulation. UGI submits that if the OCA’s retention rate criteria are adopted, they would artificially reduce stock prices down to book value. UGI R. Exc. at 9.

Next, in reply to I&E’s Exceptions, UGI submits that the ALJs did not exclude certain companies from UGI’s Altered Proxy Group based on the companies’ low growth rates. Instead, UGI points out that in creating the Altered Proxy Group in the Recommended Decision, the ALJs adopted I&E’s own proposed criterion that the percentage of revenues devoted to utility operations is preferable to UGI’s use of the percentage of regulated assets in determining a proxy group. UGI R. Exc. at 9-10.

**ii. Leverage Adjustment**

In its Exception No. 1A, UGI objects to the ALJs’ finding that a leverage adjustment is not warranted. According to UGI, the ALJs, I&E, and the OCA each understated the Company’s cost of common equity. UGI remains of the opinion that a leverage adjustment is proper because the Company has a stock price above its book value, has an embedded cost of debt different from the marginal cost of debt, and has a market value or capitalization of its equity that is greater than the book value of its equity. Therefore, UGI maintains that the DCF cost rate based on market prices must be adjusted to reflect the greater financial risk created by a higher debt ratio when the cost rate is applied to a book value capitalization. UGI Exc. at 9-10.

UGI also takes issue with the ALJs’ citation to the *2012 PPL Order* to support their finding. According to UGI, the Commission declined to adopt a leverage adjustment in that proceeding where it adopted an unadjusted return on equity of 10.28%. UGI Exc. at 10 (citing *2012 PPL Order*)at 91. In contrast, UGI notes that the ALJs in the instant proceeding relied upon their recommended unadjusted cost of common equity of only 9.8% in recommending that a leverage adjustment be disallowed. UGI argues that in determining whether a leverage adjustment is warranted, the question is not whether UGI’s cost of common equity, inclusive of an adjustment for excellent management performance is sufficient, but whether the unadjusted DCF cost rate understates the cost of common equity. UGI emphasizes its position that because its DCF cost rate is understated, a leverage adjustment is necessary. UGI Exc. at 10-11.

In Reply, I&E submits that the ALJs correctly concluded that no leverage adjustment was necessary in this case. I&E restates, *inter alia,* that recent Commission precedent supports the rejection of a leverage adjustment. I&E argues that the ALJs correctly cited to the *2012 PPL Order* as one such example. I&E points out that in the *2012 PPL Order,* we stated that the award of such an adjustment is at the discretion of the Commission on a case-by-case basis. I&E asserts that in this case, such an adjustment is not warranted for the reasons it discussed in its testimony in this proceeding. I&E R. Exc. at 4-5.

Similarly, the OCA restates that UGI has not presented any valid reason why such an artificial upward adjustment is necessary or consistent with traditional ratemaking. The OCA remains of the opinion that if a leverage adjustment is added, it will distort the natural market dynamic between a regulated utility’s stock price and its allowed rate of return. OCA R. Exc. at 3-4.

**d. Disposition**

We shall adopt the recommendation of the ALJs and reject each of the Parties’ Exceptions, consistent with the following discussion.

**i. Dividend Yield**

As noted above, UGI, I&E, and the OCA all had similar results in their calculation of the dividend yield component of the DCF model. Further, none of the Parties excepted to the ALJs’ recommendation. Accordingly, we find the ALJs’ recommendation to use an average dividend yield of 3.95%, based on UGI’s Altered Proxy Group, to be reasonable and shall adopt it. We highlight the ALJs’ comment that this dividend yield is based on the most recent available observations in the record before us.

**ii. Growth Rate**

We find no merit in either I&E’s arguments or those of the OCA that the ALJs erred in setting a growth rate of 5.85% in the calculation of the DCF cost of equity. Instead, we are of the opinion that this growth rate represents a reasonable estimate of investor expected growth within the array of earnings per share growth rates shown by the analysts’ forecasts utilized by UGI and adjusted for the Altered Proxy Group established by the ALJs. As economic growth is expected to accelerate with the future implementation of the TCJA provisions, we find it appropriate to set a DCF growth rate near the upper bound of the range established by UGI, *supra,* again adjusting for the Altered Proxy Group. In addition, we find that UGI has successfully rebutted the arguments of the opposing Parties on this issue. Therefore, we will adopt a growth rate of 5.85% in our calculation of the DCF cost of equity.

**iii. Leverage Adjustment**

On the other hand, we find the arguments of both I&E and the OCA persuasive that UGI’s requested leverage adjustment is not reasonable and should be denied. As we noted in our *2012 PPL Order,* the fact that we have granted leverage adjustments in a few select cases in the past does not mean that such adjustments are warranted in all cases. Rather, the award of such an adjustment is not precedential but discretionary with the Commission. *2012 PPL Order* at 91. In PPL’s 2012 rate case, PPL sought a leverage adjustment in the range of 70 to 118 basis points based on a perceived risk related to its market to book ratio. In the present matter, UGI’s recommended leverage adjustment of 107 basis points falls in this range and UGI seeks a leverage adjustment on the same grounds as did PPL. Thus, we find that the instant case is similar to that addressed in the *2012 PPL Order* and we are unpersuaded by UGI’s arguments to the contrary. Moreover, as discussed, *infra,* a 9.85% cost of equity is a reasonable amount for UGI. Therefore, we conclude that an artificial adjustment in this proceeding is unnecessary and contrary to the public interest. Accordingly, we decline to include a leverage adjustment in our calculation of the DCF cost of equity.

**iv. DCF Cost of Common Equity**

Having adopted a dividend yield of 3.95% and a 5.85% growth rate, and having rejected the inclusion of a leverage adjustment, we shall adopt the ALJs’ recommendation, which establishes an unadjusted DCF cost of common equity of 9.80%. All Exceptions to the contrary are denied.

**3. Capital Asset Pricing Model (CAPM)**

The CAPM uses the yield on a risk-free interest-bearing obligation (such as those issued by the U.S. Treasury) plus a rate of return premium that is proportional to the systematic risk of an investment. To compute the cost of equity with the CAPM, three components are necessary: a risk-free rate of return (Rf), the beta measure of systematic risk (β), and the market risk premium (Rm-Rf) derived from the total return on the market of equities reduced by the risk-free rate of return. The CAPM specifically accounts for differences in systematic risk (*i.e.*, market risk as measured by the beta) between an individual firm or group of firms and the entire market of equities. UGI St. 5 at 34.

UGI, the OCA, and I&E each used the following standard CAPM formula:

k = Rf + β(Rm – Rf)

Where: k= the cost of equity and the remaining terms are as defined above.

As discussed further, *infra¸* while the DCF method is the primary method used to determine the cost of common equity, the results of the CAPM model are used as a comparison to the DCF model.

**a. Positions of the Parties**

In performing its CAPM analysis, UGI determined the risk-free rate to be 3.75% based on current and forecasted Treasury Notes and Bonds yields. UGI asserted that longer term forecasts of interest rates on Treasury Notes and Bonds should be made when selecting the risk-free rate of return in the CAPM model given the Federal Open Market Committee’s (FOMC) decision to address historically low interest rates with a more aggressive approach to future increases in interest rates. UGI also calculated an 8.03% premium for the risk/market premium component of the CAPM analysis, based upon the average historical data and forecasted returns. UGI gave additional weight to the more recent historical data to recognize the fact that interest rates are forecasted to trend upwards in the future. Additionally, UGI included a 1.02% size adjustment to its CAPM analysis, using a leverage adjusted beta of 0.78, to recognize the Company’s smaller size and resultant increased risk profile. According to UGI, generally accepted technical literature indicates that smaller firms have higher capital costs than larger firms. Therefore, UGI calculated a CAPM cost of common equity of 11.03% for its electric proxy group. UGI M.B. at 86-88; UGI St. 5 at 34-38.

I&E calculated both a historic and a forecasted CAPM and utilized a beta of 0.68 based on the average betas for its electric proxy group companies as provided in the Value Line Investment Survey. For its historic CAPM, I&E chose to use the risk-free rate of return from the projected yield on 10-year Treasury Notes. I&E reasoned that the use of a 10-year Treasury Note was more preferable than using short-term T-Bills or 30‑year Treasury Bonds because the 10-year note mitigates the shortcomings of the two alternatives. I&E noted that historically, the geometric average for the yield on the 10‑year Treasury Note has been 5.21%. I&E also used a historical return for the S&P Composite Index as a benchmark for the expected return on the overall stock market. I&E explained that the geometric average for the historical return of the S&P Composite Index is 10.80%. Therefore, I&E calculated a historic CAPM cost of equity of 8.98%. I&E St. 2 at 20, 25-26.

For its forecasted CAPM, I&E determined the risk-free rate to be 3.16% based on the average of all yield forecasts for the yield on the 10-year Treasury Note, as can be seen in Blue Chip Financial Forecasts. To arrive at a representative expected return on the overall stock market, I&E observed Value Line’s 1700 stocks and the S&P 500. Based on these observations, I&E calculated a forecasted return on the overall market of 10.33% and a forecasted CAPM cost of equity of 8.00%. I&E St. 2 at 26-27.

In response to I&E’s CAPM analysis, UGI’s witness Mr. Moul submitted that this analysis was understated due to (1) I&E’s use of the yield on a 10-Year Treasury Note in lieu of a 30-year Treasury Bond; (2) I&E’s use of out of date measures of the total market return; (3) I&E’s use of historical geometric means, and not arithmetic means, to calculate total market return; (4) I&E’s failure to use leveraged adjusted betas; (5) I&E’s failure to make a size adjustment. UGI St 5-R at 25-30.

The OCA also performed a CAPM analysis as a check on its constant growth DCF analysis. The OCA determined a market implied beta of 0.81 for its electric proxy group. The OCA determined a CAPM cost of equity of 7.08%. OCA St. 3 at 40‑43.

**b. Recommended Decision**

The ALJs recommended a historic CAPM cost of common equity of 10.18% based on the calculation of I&E but adjusted for the use of an arithmetic mean based on the testimony of UGI’s witness Mr. Moul. The ALJs recommended a forecasted CAPM of 9.83% based on the calculation of I&E but with updated measurements provided by Mr. Moul. Consistent with their recommendation regarding UGI’s proposed leverage adjustment to its DCF cost of equity calculation, the ALJs rejected UGI’s leverage-adjusted beta. Additionally, the ALJs rejected UGI’s size adjustment, finding that there is no need to adjust for firm size in utility rate regulation. R.D. at 78-81, 88-89.

**c. Exceptions**

UGI, I&E, and the OCA each filed Exceptions to certain of the ALJs’ recommendations regarding the CAPM.

In its Exception No. 1C, UGI submits that the ALJs’ CAPM findings are inconsistent with the undisputed evidence of rising interest rates, such that the forecasted CAPM cannot be reasonably lower than the historic CAPM. According to UGI, the forecasted CAPM should have been 10.07% using the correct forecasted interest rates and 11.09% with UGI’s proposed size adjustment. Therefore, UGI claims that the minimum reasonable CAPM result is the historic 10.18% number. UGI Exc. at 8-9.

UGI also argues that the ALJs erred by declining to use UGI’s proposed risk-free rate of return and by declining to adopt UGI’s proposed size adjustment to account for the Company’s small size. UGI asserts that it demonstrated that the appropriate risk-free rate of return is 3.95% using 30-year Treasury Bonds rather than the 10-year Treasury Notes proposed by I&E. According to UGI, the 10-year Treasury Notes are susceptible to federal policy actions, which makes them a less reliable proxy for the risk-free rate of return in comparison to 30-Year Treasury Bonds. Additionally, UGI argues that regardless of whether financial literature supports or rejects the use of a size adjustment, Pennsylvania law requires the Commission to consider a public utility’s size. UGI Exc. at 13-15.

In its Replies to UGI’s Exceptions, I&E submits that although it excepted, *infra,* to the ALJs’ use of an arithmetic mean for the CAPM historical calculation, the ALJs otherwise properly adopted a historic and forecasted CAPM based on the calculations of I&E. Additionally, I&E argues that the ALJs properly rejected UGI’s proposed risk-free rate of return and proposed size adjustment. I&E R. Exc. at 7-9.

In its Replies to Exceptions, the OCA points out that UGI’s primary argument with the ALJs’ adoption of a 9.83% forecasted CAPM is that UGI’s risk-free rate based on 30-year Treasury Bonds was rejected. The OCA submits that the ALJs’ decision to recommend the adoption of I&E’s proposed use of a 10-year Treasury Note is supported by the record evidence and should be upheld. OCA R. Exc. at 5-6.

In its Exception No. 15, I&E objects to the ALJs’ recommendation to use the arithmetic mean for the historic CAPM calculation. I&E reasons that the geometric mean is appropriate in calculating the historic CAPM because it normalizes the returns or yields while the arithmetic mean is more susceptible to being influenced by outliers. I&E Exc. at 25-26.

In its Exception 5C, the OCA submits that the ALJs’ CAPM result of 9.83% is overstated. The OCA asserts that its own recommended CAPM cost of common equity of 7.08% should be utilized. The OCA also supports I&E’s position that the arithmetic mean should not be used for historic CAPM purposes. OCA Exc. at 13-16.

In its Replies to the Exceptions of I&E and the OCA, UGI asserts that the use of the arithmetic mean is an accepted and appropriate method to calculate the total market return under the CAPM model and should be approved. According to UGI, unlike the geometric mean, the arithmetic mean provides an unbiased estimate, provides the correct representation of all probable outcomes, and has a measurable variance. UGI R. Exc. at 10-11.

**d. Disposition**

On consideration of the positions of the Parties and the record evidence in this proceeding, we shall adopt the ALJs’ recommendation regarding the calculation of the CAPM cost of common equity consistent with the following discussion.

We agree with I&E and the ALJs that using the yield on the 10-year Treasury Note provides a better measure of the risk-free rate of return than using the yield on the 30-year Treasury Bond, as recommended by UGI. In our view, using the 10‑year Treasury Note balances the shortcomings of the short-term T-Bill and the 30‑year Treasury Bond. Although long-term Treasury Bonds have less risk of being influenced by federal policies, they have substantial maturity risk associated with the market risk. In addition, long-term Treasury Bonds bear the risk of unexpected inflation.

However, we disagree with the positions of I&E and the OCA that the geometric mean should be used in the calculation of the historical CAPM. Instead, we shall apply the use of the arithmetic mean to this calculation. The record indicates that the arithmetic mean conforms to the single period specification of the CAPM and that it provides the correct representation of all probable outcomes and has a measurable variance. The arithmetic mean provides an unbiased estimate and also best describes expected future returns which is the objective of the CAPM. On the other hand, the use of the geometric mean consists merely of a rate of return taken from two data points which would have no measurable variance (*i.e*., the dispersion of the returns cannot be calculated with a geometric mean). Although a geometric mean will capture the growth from an initial to a terminal value, it cannot provide a reasonable representation of the market premium in the context of the CAPM because the model requires a single period return expectation of investors. *See* UGI St. 5-R at 27-28.

With regard to the forecasted CAPM, the record supports UGI’s assertion that certain measurements used by I&E in its calculation are out of date. Namely the record indicates that in I&E Exhibit No. 2, Schedule 11, which lists the forecasted dividend yield, growth rate and required rate of return on the market as a whole, I&E utilized outdated Value Line estimates and S&P 500 returns in its calculation of the average expected market return of 10.33%. UGI provided more current dividend yield and growth rates for Value Line and the S&P 500, which result in an updated expected return on the overall stock market of 12.97%. We note that I&E did not except to the ALJs’ finding regarding the outdated and updated values.

Finally, we reject UGI’s request for a leverage adjustment and a size adjustment in the calculation of the CAPM cost of equity. As previously noted, we find no basis in this proceeding to add a leverage adjustment. Additionally, the record indicates that in advocating for a size adjustment, the technical literature UGI cited to is not specific to the regulated utility industry. Further, UGI has not presented any evidence to support application of a non-utility study regarding a size adjustment for risk to a utility setting. *See* I&E St. 2 at 45-46.

Based on the above, we shall adopt the ALJs’ recommended use of a historic CAPM of 10.18% and a forecasted CAPM of 9.83%. These are calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Historic CAPM** | | | |
| k= | Rf + | β | (Rm -Rf) |
| = | 5.85%+ | 0.68 | (12.21%-5.85%) |
| = | **10.18%** | | |

|  |  |  |  |
| --- | --- | --- | --- |
| **Forecasted CAPM** | | | |
| k= | Rf + | β | (Rm -Rf) |
| = | 3.16%+ | 0.68 | (12.97%-3.16%) |
| = | **9.83%** | | |

**4. Risk Premium (RP) Model and Comparable Earnings (CE) Model**

UGI also proposed using the RP method and the CE method to aid in arriving at the appropriate cost of equity. UGI reasoned that using more than one method results in a better measurement of the cost of equity than using a single method, which can provide an incomplete measure of the cost of equity depending on extraneous factors that may influence market sentiment. I&E and the OCA each disagreed with UGI’s use of the RP and CE methods.

The RP method is based upon the fundamental principle that an equity investor in a given company has a greater risk than a bond holder in the same company because interest on bonds are paid before any return is received by the equity investor, and the bond holder receives a return of its capital before an equity investor receives any return of capital in the event of bankruptcy or the dissolution of the subject company. The RP method determines the cost of equity by summing the expected public utility bond yield and the return of equities over bond returns (i.e. the “equity premium”) over a historic period, as adjusted to reflect lower risk of utilities compared to the common equity of all corporations. UGI M.B. at 85-86.

The CE method estimates a fair return on equity by comparing returns realized by non-regulated companies to the returns that a public utility with similar risk characteristics would need to realize in order to compete for capital. According to UGI, because regulation is a substitute for competitively determined prices, the returns realized by non-regulated firms with comparable risks to a public utility provide useful insight into investor expectations for public utility returns. The firms selected for the CE method should be companies whose prices are not subject to cost-based price ceilings (*i.e.*, non‑regulated firms) so that circularity is avoided. The CE method utilizes the concept of opportunity cost, wherein investors will likely dedicate their capital to the investment offering the highest return with similar risk to alternative investments. UGI St. 5 at 39; I&E St. 2 at 15.

**a. Positions of the Parties**

UGI calculated an equity risk premium of large company stocks over long‑term corporate bonds based on historical data between 1926 and 2013. UGI determined the RP cost of common equity to be 11.25% as follows:

|  |  |  |
| --- | --- | --- |
| Interest Rate | Risk Premium | Cost Rate |
| 4.75% + | 6.50% = | 11.25% |

UGI explained that the interest rate in its calculation is an estimated interest rate for A‑rated public utility bonds, while the risk premium in its calculation is the average of historical risk premiums over long-term corporate bonds. UGI stated that because the current investing climate involves interest rates that are increasing significantly from historic lows in the aftermath of a recession, it used a 6.50% risk premium which is between the average risk premiums associated with low interest rates and average interest rates. UGI M.B. at 86.

In its CE analysis, UGI used both historical realized returns and forecasted returns for non-utility companies. UGI asserted that it is appropriate to consider a relatively long measurement period (approximately ten years) in the CE approach in order to cover conditions over an entire business cycle. UGI’s CE analysis produced a cost of common equity of 12.55%. UGI St. 5 at 40-41.

I&E submitted that neither the RP method nor the CE method should be used in determining an appropriate cost of equity in a base rate proceeding. I&E pointed out that the RP method is a simplified version of the CAPM model. However, I&E noted that while the CAPM directly measures the systematic risk of the company through the use of beta, the RP method does not measure the specific risk of the company. As to the CE method, I&E charged that it is not market-based and relies upon historic accounting data. Further, I&E contended that under the CE method, the most problematic issue is determining what constitutes comparable companies. I&E St. 2 at 15.

The OCA claimed that the Commission should give little, if any weight to UGI’s RP and CE analyses. The OCA argued that UGI’s RP analysis calculates an equity risk premium that is out of line with market data and academic studies. Similarly, the OCA averred that UGI’s CE analysis did not address the cost of equity at all and focused on companies that are not public utility companies. OCA M.B. at 68-69.

Therefore, I&E and the OCA recommended using the DCF method as the primary method to determine the cost of common equity and using the CAPM method as a comparison to the DCF results. Both I&E and the OCA pointed out that the DCF method has historically been the Commission’s preferred method of setting common equity cost rates. I&E M.B. at 71-72; OCA M.B. at 55-56, 62.

**b. Recommended Decision**

The ALJs adopted the positions of I&E and the OCA that the DCF method should be the primary method used to determine the cost of common equity, and that the results of the CAPM should be used as a comparison to the DCF results. The ALJs found no reason to deviate from these preferred methods in this proceeding. Therefore, the ALJs recommended against the use of the RP and CE methods proffered by UGI. Further, the ALJs noted that the companies analyzed under the CE model are too dissimilar to a regulated public utility company. R.D. at 60, 76, 81-82.

**c. Exception and Replies**

In its Exception No. 1B, UGI contends that the ALJs failed to properly utilize the RP method and the CE method as a check against the results of the DCF model. UGI submits that the RP analysis, in particular, demonstrates that the DCF cost rate is understated by as much as 1.45%. According to UGI, where both the CAPM and RP methods suggest that the unadjusted DCF cost rate is understated, the Commission should adopt a cost of common equity that is higher than the unadjusted DCF cost rate. UGI Exc. at 11-13.

In reply, I&E argues that the ALJs properly limited the weight given to the RP and CE methods while relying on the DCF methodology. I&E restates that the DCF method applied to a proxy group of similar utilities has historically been the primary determinant utilized by the Commission. I&E R. Exc. at 5-7.

Likewise, in its Replies to Exceptions, the OCA asserts that the ALJs correctly held that the DCF and the CAPM methods are the preferred methods for establishing UGI’s cost of equity. The OCA contends that UGI’s arguments in its Exceptions are without merit. OCA R. Exc. at 4-5.

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

Nonetheless, we reject UGI’s proposed use of the RP method and the CE method as an aid in arriving at the appropriate cost of common equity. With respect to the RP method, the record evidence indicates that UGI’s equity risk premium calculations are not in line with market data, academic studies and surveys of CFOs and global managers. For example, the Campbell and Harvey Survey of CFOs (2014) showed an average equity risk premium estimate of 3.73%, which is much lower than the 6.50% risk premium used by UGI. *See* OCA St. 3 at 56‑57. Additionally, the record indicates that the RP method determines the rate of return on common equity indirectly by observing the cost of debt and adding an equity risk premium to it. In contrast, the DCF measures equity more directly through the stock information, using equity information.

With respect to the CE method, as noted above, this cost of equity method utilizes data for non-regulated firms. Thus, by its very nature, determining which companies are comparable is entirely subjective. In addition, the record indicates that the companies UGI utilized in its CE group results in the selection of companies such as Coca-Cola Company, Kellogg Company, and Walmart Stores, Inc. *See* I&E St. 2-SR at 25. 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. Further, our review of the record corroborates the OCA’s assertion that in conducting its CE analysis, UGI failed to address the cost of equity. Instead, it considered the returns on book equity that were achieved and are expected to be achieved by Value Line in the next 3 to 5 years.

In light of the above, we shall adopt the positions of I&E and the OCA and shall base our determination of the appropriate cost of equity on the results of the DCF method and shall use the CAPM results as a comparison thereto. As both Parties noted, the use of the DCF model has historically been our preferred methodology. This was recently affirmed in *Pa. PUC, et. al v. City of Dubois-Bureau of Water*, Docket No. R‑2016‑2554150, *et. al.* (Order entered March 28, 2017). Like the ALJs, we find no reason to deviate from the use of this method in the instant case. Accordingly, we shall deny UGI’s Exceptions on this issue.

**5. Additional Risk Considerations**

**a. Positions of the Parties**

UGI identified several additional risk considerations, which it claimed warrant the approval of a higher rate of return on common equity. Namely, UGI averred that the current financial climate, as demonstrated by rising interest rates on risk-free investments and investors’ expectations in the wake of the TCJA, increase the risk associated with common equity investments such that a sufficient premium over risk-free investments must be offered in order to attract these investments. According to UGI, the TCJA significantly impacts the Company’s risk profile because it significantly decreases the Company’s pre-tax interest coverage, thereby reducing its credit quality and significantly increasing the amount of investor-supplied capital to fund infrastructure programs, further reducing the Company’s credit quality. UGI M.B. at 88-89.

UGI also argued that the volatility rating of common stock investments, as measured by the Volatility Index increased substantially between 2017 and 2018. Therefore, UGI argued that as the current level of volatility risk associated with common stocks is markedly higher than in prior periods, the return on common equity must also be higher than in prior periods to attract sufficient capital investments. UGI M.B. at 89-90.

Additionally, UGI claimed that by failing to recognize the average equity returns authorized by electric utilities across the United States, I&E and the OCA’s analyses are flawed and represent poor public policy. Accordingly, UGI submitted that adopting the position of either I&E or the OCA with regard to UGI’s allowed rate of return on common equity would signal to potential investors that the financial strength of Pennsylvania public utilities may be faltering, and that Pennsylvania is pulling away from its prior support for accelerated infrastructure investment. UGI M.B. at 90-91.

I&E submitted that UGI’s assertion that the TCJA will have significant negative impacts on the Company’s credit quality was already rejected by the Commission in *Tax Cuts and Jobs Act of 2017* *Temporary Rates Order*, Docket No. M‑2018-2641242 (Order entered May 17, 2018) (*May 2018 Tax Order*). I&E St. 2 at 30‑37.

The OCA argued that UGI’s claim of additional risk factors is not warranted. Namely, the OCA submitted that despite increased market volatility at the end of 2017 and early 2018, the favorable times for raising capital (including for regulated companies) remain and the cost of capital is low such that upward adjustments to UGI’s cost of equity are not necessary. OCA St. 3 at 9-10.

**b. Recommended Decision**

The ALJs declined to consider the additional risk factors identified by UGI as a reason to increase the Company’s allowed return on common equity. The ALJs reasoned that the factors identified by UGI require a degree of speculation, rendering precise quantification of the potential impacts to be difficult at best. The ALJs also noted the 10.00% return on common equity rate, discussed, *infra,* that they are recommended is already significantly higher than the rates recommended by I&E and the OCA. R.D. at 82-83.

**c. Exceptions**

In its Exceptions, UGI submits that the ALJs erred by failing to consider unrebutted evidence regarding increased risks faced by UGI which justify a higher rate of return on common equity. UGI claims that the ALJs ignored that the Company’s small size increases its business and financial risk, warranting a higher cost of common equity. UGI also restates, *inter alia*, its arguments regarding the increased volatility of common stock investments and the negative effects the TCJA will have on the Company’s credit quality. UGI Exc. at 15-17.

In its Replies to Exceptions, I&E opines that the ALJs properly recommended against the consideration of the additional risk factors identified by UGI in setting a rate of return on common equity. According to I&E, UGI’s arguments are not credible, nor are they supported by the record evidence in this proceeding. I&E R. Exc. at 9-11.

In its Replies to Exceptions, the OCA submits that there is no valid reason for artificially inflating the return on equity results. According to the OCA, the current economic climate is one of a continued and long-term period of low capital costs. Thus, the OCA contends that UGI’s claims of uncertainty and increased financial risk based on the current economic environment are speculative and unsupported. Accordingly, the OCA concurs with the ALJs’ recommendation that the additional risk factors identified by UGI should not be considered in determining the appropriate return on equity in this proceeding. OCA R. Exc. at 6-7.

**d. Disposition**

Based upon the evidence of record, we agree with the recommendation of the ALJs and will not consider the additional risk factors identified by UGI in establishing the appropriate cost of common equity. We find that UGI’s claim that the volatility of common stock investments has increased markedly since 2017, which warrant’s a higher cost of equity, is not supported by the record. Rather, the record indicates that it is important to consider the level of the Volatility Index in the context of other market data and the overall market. In this regard, high stock prices (as indicated by price-to-earnings ratios), low credit spreads, and high U.S. capacity utilization indicate that investors’ increased volatility expectation is not leading to a higher cost of equity. *See* OCA St. 3 at 22.

In addition, as I&E noted, we stated in our *May 2018 Tax Order* that we did not deem it appropriate to permit utilities to retain TCJA savings due to, *inter alia,* a perceived risk of possible negative outlooks from credit rating firms. *May 2018 Tax Order* at 16-17. Our same reasoning applies here in rejecting UGI’s request for a higher return on equity. Further, the record indicates that although the change in the federal corporate income tax rate from 35% to 21% reduced UGI’s pre-tax interest coverage from 5.32 times to 4.56 times, UGI’s five-year average pre-tax interest coverage of 5.47 times was significantly higher than the 3.56 times for UGI’s electric proxy group and the 3.15 times for the S&P Public Utilities, indicating a lower credit risk for UGI. Moreover, it is important to note that each company in UGI’s electric proxy group is subject to the policies of the TCJA. Therefore, UGI’s projected interest coverage value of 4.56 times that results from the TCJA is already significantly higher than the measurement of 3.56 times for the electric proxy group, which does not reflect any considerations of downward pressure that the TCJA will bring upon it. *See* UGI St. 5 at 8, 12-13; I&E St. 2 at 33-34.

We find that the ALJ’s recommendation to reject the various UGI‑recommended additional adjustments is reasonable, appropriate, and in accordance with the record evidences adopted. Accordingly, we shall adopt the ALJ’s recommendation and deny the UGI’s Exceptions on this issue.

**6. Management Effectiveness Adjustment**

**a. Positions of the Parties**

UGI included a twenty-basis point management effectiveness adjustment to its return on equity claim. Both I&E and the OCA oppose any allowance for management effectiveness.

UGI 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. According to UGI, it has demonstrated strong performance in the area of management effectiveness. In support of its claim, UGI noted that it has focused on a number of areas and programs to enhance and improve the quality and effectiveness of the service it provides to its customers, including, *inter alia,* (1) a voluntary Long Term Infrastructure Improvement Plan (LTIIP) to accelerate the replacement and repair of aged and aging infrastructure, (2) a voluntary Energy Efficiency and Conservation (EE&C) Plan designed to educate and encourage the efficient use of electricity and smart appliance purchase decisions by UGI’s customers, (3) programs focusing on enhancing customer satisfaction, and (4) workforce safety and training initiatives. UGI highlighted that it has been consistently recognized for its high customer satisfaction by J.D. Power. UGI asserted that its efforts to improve its operations in ways that strengthen reliability, enhance customer satisfaction, respond to customer needs, and reinforce public and employee safety go beyond what it is required to do under the Code and warrant recognition through an addition to its cost of common equity. UGI M.B. at 99-102.

I&E contended that if management points are awarded, at all, it should be done on a case-by-case basis. However, I&E took the position that no utility should reap additional rewards for programs funded by ratepayers for meeting the Company’s statutory obligation under Section 1501 of the Code to provide safe and reliable service. I&E M.B. at 73-74.

The OCA echoed the position of I&E and asserted that the record evidence in this proceeding does not support UGI’s request for a management effectiveness adjustment. Further, the OCA submitted that a management bonus is not a factor for reasonable investment decision making and that the cost of equity for UGI should be based only on the return equity investors demand to invest in companies with similar risk to UGI. OCA M.B. at 66-67.

**b. Recommended Decision**

The ALJs recommended that UGI be given a twenty-basis-point addition to its cost of common equity due to management effectiveness. The ALJs concluded that UGI presented substantial evidence of management effectiveness in a number of areas. The ALJs stated that they were particularly persuaded by UGI’s claim that it is consistently recognized for high customer satisfaction. The ALJs pointed to the record evidence that UGI has finished in first or second place in the J.D. Power award for customer satisfaction among utilities in each of the past five years and has won the award seven times in the past fifteen years. The ALJs also noted that UGI has outperformed the overwhelming majority of all Pennsylvania EDCs with regard to the benchmark levels the Commission has set forth for service reliability. Further, the ALJs pointed out that no party has disputed or otherwise challenged UGI’s claims about its initiatives or accomplishments. R.D. at 86-87

**c. Exceptions and Replies**

In its Exception No. 16, I&E restates its position that no utility should reap additional rewards for programs designed by the Company to simply meet its statutory obligations under Section 1501 and that if any management points are awarded, it should be done on a case-by-case basis. I&E submits that although Section 523 of the Code obligates the Commission to consider a utility’s management effectiveness when setting rates, Section 523 also permits the Commission to consider additional relevant and material evidence. In this regard, I&E submits that the ALJs failed to consider several factors that should prohibit UGI from receiving its requested adjustment. More specifically, I&E argues, *inter alia,* that UGI chose to file its base rate proceeding before it completed its full analysis of the impact of the TCJA, that it chose not to implement a reconcilable surcharge mechanism to return the tax savings it realized from the TCJA back to ratepayers, and that it attempted to manipulate its Quarterly Earnings Report (QER) to reflect a substantially lower return on equity than what it was actually earning.[[7]](#footnote-7) I&E Exc. at 26-28

In its Exception No. 6, the OCA restates 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 argues that a management effectiveness adjustment should only be awarded in truly exceptional circumstances. The OCA submits that UGI failed to demonstrate that such circumstances exist in the present case. Additionally, the OCA takes the position that the ALJs’ recommended rate of return on common equity is already well above what the record evidence supports. Therefore, the OCA contends that adding an additional twenty basis points to an already overinflated return on equity is neither reasonable or fair to UGI’s ratepayers, nor is it required for the Company to attract capital. OCA Exc. at 17-19.

In response to the above, UGI submits that the Commission should deny I&E and the OCA’s Exceptions on this issue. According to UGI, the OCA ignores the plain language of Section 523 of the Code, which states that the Commission may reward utilities for their performance through rates, including via rate of return premiums. In addition, UGI argues that both the OCA and I&E ignore the unrebutted evidence of UGI’s management effectiveness. Further, UGI contends that I&E’s argument regarding the Company’s QERs is an attempt to resurrect an issue the ALJs properly concluded is both irrelevant to the instant proceeding and is more appropriately resolved in other proceedings. UGI R. Exc. at 13-14.

**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 UGI that its management performance related to its implementation of a voluntary LTIIP, a fully voluntary EE&C Plan, programs focusing on enhancing customer satisfaction, and initiatives related to workforce safety and training is laudable and warrants consideration as a factor in our final cost of equity allowance. The unrebutted record evidence indicates that UGI has been consistently recognized for high customer satisfaction. Additionally, UGI has consistently exceeded its benchmark service reliability metrics for Customer Average Interruption Duration Index (CAIDI), System Average Interruption Frequency Index (SAIFI), and System Average Interruption Duration Index (SAIDI). The record indicates that UGI exceeded its 2016 CAIDI, SAIFI, and SAIDI benchmark levels of reliability by 26.0%, 24.1%, and 44.3% respectively. UGI M.B. at 102-105; UGI St. 1 at 11.

In light of the above, we are of the opinion that UGI has demonstrated its commitment to, and focus on, providing and improving its provision of safe, reliable and quality distribution services to its customers. As such, we find that the management efforts UGI has highlighted in the record evidence in this proceeding support an additional upward adjustment to the Company’s rate of return in recognition of its management effectiveness. However, we shall not grant the full twenty-basis point adjustment requested by UGI and recommended by the ALJs. Instead, we shall apply a five-basis point (*i.e.*, 0.05%) adjustment to UGI’s rate of return on equity. In our view, this adjustment is 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.

**7. 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, RP, and CE. UGI relied on each of these methodologies in presenting its recommended rate of return on equity of 11.25%. This figure is inclusive of the 0.20% management effectiveness upward adjustment that UGI requested. UGI also noted that while it originally proposed a cost of common equity of 10.95%, it adjusted it upward to 11.25% based on its consideration of the impacts of the TCJA on UGI’s risk profile. UGI M.B. at 77-78.

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 UGI 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.

As a result of its DCF analysis, I&E recommended a cost of common equity of 8.62%. I&E M.B. at 71.

The OCA recommended an 8.50% return on common equity primarily based on the DCF model, including a full range of indicators of dividend yields and growth rates intended to reflect what investors actually use and consider. The OCA submitted that current market conditions support this return because the cost of capital in today’s market remains low. OCA M.B. at 54, 64.

**b. Recommended Decision**

The ALJs restated their recommendation that, consistent with Commission precedent, they would utilize the DCF method to set UGI’s rate of return on common equity and that they would utilize the CAPM as a comparison. The ALJs also restated that under the DCF method, their recommended dividend yield of 3.95% and growth rate of 5.85% produces a result of 9.80%. According to the ALJs, this appears reasonable as compared to their recommended forecasted CAPM of 9.83% and historic CAPM of 10.18% percent. Therefore, using the DCF result of 9.80% and the additional 0.20% management effectiveness adjustment that they recommended should be granted, the ALJs recommended a rate of return on common equity of 10.00% for UGI. The ALJs declined to add any further upward adjustments requested by the Company, finding this return to be reasonable. The ALJs pointed out that the average equity return for electric utilities was 9.75% in the first quarter of 2018, as compared to the average authorized equity return of 9.74% for all of 2017. R.D. at 89.

**c. Exceptions and Replies**

In its first Exception, UGI submits that the ALJs’ proposed cost of common equity is too low. According to UGI, the principle errors in the ALJs’ recommended 10.00% cost of common equity are their rejection of a DCF leverage adjustment, reliance on an erroneous CAPM analysis as a check on the DCF result, failing to consider the RP and CE methods, and failing to recognize additional risk factors UGI identified which indicate a rising cost of common equity, each of which are discussed, *supra*. Therefore, UGI remains of the opinion that it should be authorized to earn a 11.25% return on common equity, inclusive of a management effectiveness adjustment. UGI Exc. at 6-7.

In the alternative, UGI asserts that if the Commission does not adopt its proposed 11.25% return on common equity, the Commission should adopt a return on common equity of no less than 10.40%, which is inclusive of a 0.20% adjustment for management effectiveness. UGI points out that the Commission authorized this return on common equity for PPL in the *2012 PPL Order.* According to UGI, financial and market conditions at the time of the *2012 PPL Order* are very similar to conditions today. For example, UGI points out that the average return on A-Rated Public Utility Bonds in December 2012 was 4.00% and that the average return on A-Rated Public Utility Bonds in August 2018 was 4.20%. Accordingly, UGI asseverates that it should be authorized a return on common equity that is equal or greater to that awarded to PPL in 2012. UGI Exc. at 7-8, 18.

In its Replies to UGI’s Exceptions, I&E contends that the ALJs correctly rejected the Company’s arguments pertaining to cost of common equity and to purported financial conditions increasing its risk profile. However, I&E submits that the ALJs’ recommended cost of equity is not too low, as UGI suggests, but rather, is too high and should be reduced to I&E’s recommended 8.62%. I&E R. Exc. at 2-3, 11.

In its Replies to UGI’s Exceptions, the OCA submits that the ALJs were correct in their findings regarding the leverage adjustment, the CAPM determinations, the principal reliance on the DCF and CAPM as a check, and the rejection of UGI’s additional risk factors. Therefore, the OCA submits that UGI’s Exceptions on this issue should be rejected. However, the OCA remains of the opinion that its own proposed 8.50% return on equity is appropriate and continues to oppose any additional management effectiveness adjustment. OCA Exc. at 2-3.

In its Exception No. 17, I&E objects to the ALJs’ recommendation and restates that UGI should be afforded the opportunity to earn a return on equity of 8.62%. I&E Exc. at 28.

In its Exception No. 5D, the OCA submits that the 9.80% return on equity recommended by the ALJs should not be adopted. The OCA restates its position that the long-term, sustained low cost of capital should be reflected in UGI’s authorized return on equity and should be viewed as the “new normal.” Therefore, the OCA remains of the opinion that UGI should be authorized to earn an 8.50% return on common equity. OCA Exc. at 16-17.

In response to I&E and the OCA’s Exceptions, UGI restates that it has demonstrated that its cost of common equity of 11.25% is appropriate, and that the cost of common equity must be at least 10.40%. However, UGI submits that in concluding that UGI should be authorized to earn a return on common equity of 10.00%, the ALJs correctly utilized a 5.85% growth rate and adopted a 20-basis point adjustment for management effectiveness. Additionally, UGI contends that the Commission should reject the OCA’s arguments in its Exceptions that a long-term, sustained low cost of capital environment should be reflected in the Commission’s common equity determination. UGI Exc. at 8, 11-13.

**d. Disposition**

As previously noted, we have adopted the ALJs’ recommendation to use an unadjusted DCF cost of common equity rate of 9.80%. We also explained that, consistent with Commission precedent, we shall use the DCF method as the primary method in establishing UGI’s cost of common equity and shall use the results of the CAPM method as a comparison to our DCF results. Having adopted the ALJs’ recommended historic CAPM of 10.18% and forecasted CAPM of 9.83%, we likewise agree with the ALJs that the cost of common equity of 9.80% that is calculated using the DCF method is reasonable. Additionally, we have determined that UGI should receive a five-basis point upward adjustment to its cost of common equity because it has demonstrated management effectiveness. This is in lieu of the twenty-basis point adjustment recommended by the ALJs. Accordingly, we shall set a cost of equity rate of 9.85%, inclusive of the management effectiveness adjustment. We note that the ROE we are authorizing for UGI is higher than the average equity returns for electric utilities in 2017 and the first quarter of 2018 identified by the ALJs, *supra,* and is also higher than the ROEs recommended by I&E and the OCA. In consideration of the above, each of the remaining UGI requested ROE adjustments are rejected as unreasonable.

## **D. Overall Rate of Return**

**1. Positions of the Parties**

UGI claimed that it should be permitted to earn an 8.24 % overall rate of return, including an 11.25% return on common equity. UGI M.B. at 1.

I&E recommended that UGI should be afforded the opportunity to earn an overall rate of return of 6.82%. This recommended overall rate of return is comprised of a weighted average of a 4.69% rate of return on long-term debt and an 8.62% rate of return on equity. I&E M.B. at 74.

The OCA proffered that the Commission should allow UGI the opportunity to earn an 8.5% return on common equity and a 6.75% overall return on its rate base. OCA M.B. at 69.

**2. Recommended Decision**

The ALJs recommended an overall authorized rate of return for UGI of 7.56%. This is based upon their determination that UGI should be permitted to earn a 10.00% rate on common equity and the capital structure and cost of debt agreed upon by the Parties. The ALJs opined that this overall rate of return will result in rates that are just and reasonable. The ALJs outlined this weighted average cost of capital as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Description** | **Capitalization Ratio** | **Embedded Cost** | **Rate of Return** |
| Long-Term Debt | 45.98% | 4.69% | 2.16% |
| Common Equity | 54.02% | 10.00% | 5.40% |
| *Total* | *100.00%* |  | *7.56%* |

R.D. at 89-90.

**3. Exceptions and Replies**

Consistent with its first Exception to the ALJs’ recommended cost of common equity, UGI submits that the ALJs’ recommended overall rate of return is too low and that the Commission should permit an overall rate of return of 8.24%. UGI Exc. at 6-18.

In its Exception No. 17, I&E submits that as a result of their recommendation to grant UGI a 10.00% cost of equity, the ALJs’ recommended overall rate of return is contrary to the weight of the record evidence and is against the public interest. I&E maintains its position that UGI should be authorized an overall rate of return of 6.82%. I&E Exc. at 28.

In its Exception No. 5D, the OCA submits that the long-term, sustained low cost of capital environment should be considered such that UGI should be afforded the opportunity to earn an overall rate of return of 6.75%. OCA Exc. at 17.

Each Party’s Replies to Exceptions on this issue are based on their Replies to Exceptions regarding the cost of common equity, *supra.*

**4. Disposition**

For the reasons discussed above, we have modified the ALJs’ recommendation as to the appropriate cost of common equity for UGI. This, in turn, modifies the ALJs’ recommended overall rate of return. The following table summarizes our final determinations regarding UGI’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 UGI of 7.48%.

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **Ratio** | **Cost Rate** | **Weighted Cost** |
| **Debt** | 45.98% | 4.69% | 2.16% |
| **Equity** | 54.02% | 9.85% | 5.32% |
| **Total** | 100.00% |  | 7.48% |

1. **Taxes**

## **2018 Tax Adjustment – Issue of Retroactive and Single Issue Ratemaking**

1. **Legal Standards**

Pursuant to the TCJA, commencing January 1, 2018, the corporate Federal Income Tax (FIT) rate was reduced to 21% from the prior effective rate of 35% upon which current customer rates are based. In its requested rate increase, UGI has included proposed rates that have been amended to reflect the TCJA’s reduction in the corporate tax rate from 35% to 21%. Both I&E and the OCA proposed that the net tax savings associated with the reduction in the FIT rate for the time period of January 1, 2018, through the effective date of UGI’s new rates be returned, or flowed back, to customers. One of the legal issues in this case is whether directing UGI to flow back the TCJA tax savings constitutes impermissible retroactive or single issue ratemaking.

The process of establishing base rates is generally forward looking, without “line by line examination of the relative success or failure of the utility to have accurately projected its particular items of expense or revenue.” *P**hiladelphia Electric Co. v. Pa. PUC*, 502 A.2d 722, 727 (Pa. Cmwlth. 1985). As such, single issue ratemaking is generally prohibited when it impacts a matter normally considered in a base rate case. At the same time, the Commonwealth Court has acknowledged that Commission has the authority and discretion to use a Section 1307 automatic adjustment clause to address easily identifiable expenses that are beyond a utility’s control, “such as tax rate changes or changes in the cost of fuel”, *Popowsky v. Pa. PUC*, 869 A.2d 1144, 1160, so long as it is not used to “dissemble the traditional rate-making process.” *Pa. Industrial Energy Coalition v. Pa. PUC* (*Pennsylvania Industrial*), 653 A.2d 1336, 1349 (Pa. Cmwlth. 1995).

Pennsylvania law also provides that a utility should be able to rely upon the lawfulness of rates previously deemed just and reasonable after a full Commission investigation, hearing and adjudication. This is known as the doctrine of Commission-made rates. It is a fundamental concept of public utility law that “a commission-made rate furnishes the applicable law for the utility and its customers until a change is made by the commission.” *Cheltenham & Abington Sewerage Co. v. Pa. PUC*, 25 A.2d 334, 337 (Pa. 1942). Nonetheless, an exception to these rules has been recognized where the expenses are extraordinary and nonrecurring. *P**opowsky v. Pa. PUC*, 695 A.2d 448, 450 (Pa. Cmwlth. 1997); *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket No. R-00038805 (Order entered Aug. 5, 2004) (*Aqua 2004 Order*). Also, in the context of a general rate increase proceeding, such as here, the Commission is obligated to consider the effect of [the 7-month suspension period] in finally determining and prescribing the rates to be thereafter charged and collected . . . .” 66 Pa. C.S. § 1308(d).

1. **Positions of the Parties**

UGI averred that its supplemental filing fully reflects all impacts of the TCJA on a prospective basis. UGI M.B. at 108. UGI stated that I&E and the OCA propose a reduction in tax expense of $212,000 to be refunded to customers outside of base rates. I&E proposes that this amount be flowed back to ratepayers through a Section 1307 surcharge mechanism, and the OCA proposes that this amount be passed through to ratepayers through a mechanism similar to a surcharge. *Id*. (citing I&E St. 1 at 33-35; OCA St. 1 at 14). UGI argued that such a further reduction in rates violated long-standing rules against single issue and retroactive ratemaking, was unwarranted given that the Company’s current rate of return is not excessive or unreasonable and would be poor public policy. UGI M.B. at 108.

UGI contended that the I&E and the OCA 2018 adjustments violated the rules against single issue and retroactive ratemaking. UGI stated that the proposed base rate increase in this proceeding will be effective in October 2018 for service rendered on and after October 27, 2018, and is based on data and information for an FPFTY ending September 30, 2019. UGI also stated that the test year and the rates developed from it reflect a full year’s impact of all aspects of the TCJA. UGI averred that the additional adjustment I&E and the OCA propose would impermissibly reduce rates for a single issue, *i.e*., the 2018 tax impact of the TCJA, without any examination of any other elements of the ratemaking formula and would also retroactively reduce UGI’s rates. UGI acknowledged existing legal precedent where single issue/retroactive ratemaking can occur for certain extraordinary and non-recurring items and events between rate cases; however, UGI argued that the proposed adjustment fails to qualify for this exception. UGI M.B. at 111.

The OCA’s position was that the 2018 tax savings resulting from the TCJA must be returned to ratepayers. The OCA averred that the Company’s revised filing fails to include an adjustment or proposal to flow back the excess income tax collection from January 1, 2018, to the date the rates from this proceeding will go into effect. The OCA asserted that it was appropriate and necessary to “authorize the return of tax savings to ratepayers as soon as possible” because, as a result of the tax rate reduction, existing rates are unjust and unreasonable. OCA M.B. at 37; OCA St. 1 at 13, 14. Based on the Commission’s *Tax Cuts and Jobs Act of 2017 Temporary Rates Order*, Docket No. M-2018-2641242 (Order entered March 15, 2018) (*March 2018 Tax Order*) and the *May 2018 Tax Order*, the OCA argued that returning the 2018 tax savings to customers would not constitute single issue ratemaking. OCA M.B. at 40; OCA St. 1S at 6.

I&E also relied on the *March 2018 Tax Order* and the *May 2018 Tax Order* in support of its position that flowing back the tax savings to customers would not represent impermissible retroactive or single issue ratemaking. I&E M.B. at 57-61. I&E recommended that the Company be required to flow back to ratepayers, via a reconcilable Section 1307 surcharge mechanism, the net tax savings associated with the reduction in the FIT rate for the period January 1, 2018, through the date when new rates from this proceeding are expected to become effective. I&E M.B. at 61-62.

1. **Recommended Decision**

The ALJs concluded that directing UGI to flow back the TCJA tax savings did not constitute impermissible retroactive or single issue ratemaking and was fair, just, and reasonable under the unprecedented circumstances in this case. R.D. at 105. The ALJs initially determined that the 40% reduction in the corporate tax rate in 2017 qualified as an extraordinary one-time event that was unlikely to be repeated, because the tax cut has no historical precedent and may, in fact, be one of the largest single tax cuts in United States history. R.D. at 103. The ALJs pointed to the *May 2018 Tax Order* in support of their finding that the Commission considered the TCJA to be an extraordinary and substantial, non-recurring reduction in utility expenses which warranted an immediate flow back of the windfall to ratepayers of utility companies that did not currently have a pending base rate case before the Commission. R.D. at 104. The ALJs quoted the following from the *May 2018 Order*:

While ratemaking is generally *prospective* in nature, an exception to this rule applies in the case of expenses that are extraordinary, substantial and nonrecurring. In this regard, we agree with the OCA that the TCJA tax savings represent “an extraordinary and substantial, non-recurring reduction in utility expenses that should be treated outside of a general rate proceeding and flowed back to ratepayers.” Therefore, in the Commission’s judgment, there is no legal impediment to our present consideration of the substantial tax savings from the TCJA and we need not await a base rate case filing to address its effect on the justness and reasonableness of consumer rates.

R.D. at 103-104 (quoting *May 2018 Order* at 15) (citations omitted). The ALJs noted the Commission observed that UGI had a pending base rate case and that a determination on flow back should wait until that case was concluded. R.D. at 104 (citing *May 2018 Order* at 21).

Based on the evidence in this proceeding, the ALJs determined that UGI should also be directed to flow back the TCJA savings to ratepayers, consistent with the reasons the Commission set forth in its *May 2018 Order*. The ALJs found that UGI would receive an unprecedented windfall if it retained the TCJA tax savings, which resulted from a one-time massive reduction in the federal corporate tax rate and could not have been anticipated by any utility company regardless of whether the company had a pending base rate case. Because this is an issue of first impression, the ALJs concluded that the Parties will not realize the credit impact of the TCJA tax savings flow back until the flow back occurs. The ALJs stated that if there is an adverse credit impact to UGI that is directly attributable to the TCJA tax savings flow back, the Commission provided the following guidance on this issue in the *May 2018 Order*:

Similarly, the Commission does not deem it appropriate to permit utilities to retain TCJA savings due to a perceived risk of possible negative outlooks from credit rating firms. Once again, if a utility’s cash flow is of concern, a general rate increase is the appropriate vehicle to address such a concern. But, as pointed out by I&E, an increased cash flow realized because a utility is permitted to retain revenues resulting from customers paying a “phantom 35%” income tax rate would not be lawful or appropriate. I&E Comments at 4. Indeed, while utilities are entitled to recover in rates all reasonable and prudently incurred expenses, there is no warrant for the recovery of taxes or other expenses from consumers that are not incurred. *Barasch v. Pa. PUC*, 493 A.2d 653 (Pa. 1985). Accordingly, the Commission declines to allow rates for non-existent tax expenses for the purpose of artificially augmenting a utility’s cash flow.

R.D. At 104-105 (quoting *May 2018 Order* at 16-17). Accordingly, the ALJs reasoned that UGI could file a subsequent rate case with the Commission and include in that case a line item for any negative consequences of the TCJA tax savings flow back. R.D. at 105.

1. **Exception and Replies**

UGI avers that the ALJs erred in directing the Company to refund to customers the 2018 impacts of the TCJA. First, UGI argues that the ALJs’ decision disregards judicial precedent prohibiting retroactive and single issue ratemaking except under specific circumstances. UGI Exc. at 23. UGI contends that the changes in federal tax law resulting from the TCJA are neither extraordinary nor non-recurring. UGI avers that a change in the tax law is not extraordinary, because Congress regularly amends, extends, and adds to existing tax laws and regulations. UGI also avers that the TCJA is not a one-time, non-recurring event, as the tax law changed effective January 1, 2018, and will remain in effect unless it is changed by Congress. UGI Exc. at 24. UGI argues that instead of finding that the TCJA impacts were both extraordinary and non-recurring, the ALJs improperly relied on the amount of the impact, and whether the amount was extraordinary, in finding that the impact was also non-recurring. UGI states that such a finding is inconsistent with the Commission’s decision in the *Aqua 2004 Order* in which the Commission denied Aqua’s claimed annual amortization of deferred pension costs that was based on a substantial decline in the value of the equity investments made by the pension plan. UGI Exc. at 25. UGI also submits that the ALJs’ conclusion that the amount of the tax decrease justifies the use of single issue and retroactive ratemaking is factually incorrect, because the impacts of the TCJA are substantially less than the storm damage expense resulting from a March 2018 storm within UGI’s service territory. *Id*. at 25-26.

Second, UGI argues that the ALJs did not conduct any analysis of UGI’s current earnings, thereby ignoring controlling precedent that requires the Commission to examine a utility’s current earnings before determining that single issue ratemaking is appropriate. *Id*. at 26 (citing *Popowsky v. Pa. PUC*, 683 A.2d 958 (Pa. Cmwlth. 1996); *Pennsylvania Industrial*). UGI avers that a requirement to consider current earnings is further supported by the Commission’s earlier orders regarding the 2018 impacts of the TCJA, because in each instance where the Commission directed companies not currently in a rate case to flow back the TCJA impacts, each order included a finding that the utility was currently overearning. UGI Exc. at 27 (citing *Tax Cuts and Jobs Act of 2017 – PPL Electric Utilities Corporation*, Docket No. R-2018-3000775, at 3 (Order entered May 17, 2018)). UGI states that the ALJs did not find that UGI was overearning under existing rates, and the record does not support such a finding. UGI Exc. at 27.

UGI continues that the ALJs erred by relying on the Commission’s prior orders related to the TCJA, as these orders did not require companies in the midst of Section 1308(d) general rate increase proceedings to implement an immediate rate reduction or negative surcharge. UGI states that the Commission specifically directed that the effects of the TCJA be addressed in each company’s individual base rate proceeding. UGI Exc. at 27-28 (citing *May 2018 Tax Order* at 20-21). UGI contends that despite the Commission’s directive, only the Company provided any evidence of its 2018 earnings, and this evidence shows that UGI is currently earning far less than a fair rate of return in 2018. UGI cites to Revised UGI Electric Exhibit A – Future, Schedule A-1, Line 19, as demonstrating that UGI’s rate of return at present rates for the FTY, when accounting for the impacts of the TCJA, was 4.83% and its return on common equity was 4.96%. UGI Exc. at 28.

In its Replies to Exceptions, the OCA avers that the ALJs properly found that UGI should refund to customers the 2018 savings resulting from the TCJA. First, the OCA states that the ALJs properly classified the TCJA savings as both extraordinary and nonrecurring and, therefore, determined that flowing back the TCJA savings to customers did not constitute impermissible retroactive or single issue ratemaking. OCA R. Exc. at 8. The OCA submits that the significant changes in the tax law that took effect January 1, 2018, could not have been anticipated and the changes in utilities’ tax expenses resulting from the TCJA are substantial. The OCA notes that its witness Morgan testified that the TCJA is a “significant decrease in the tax rate . . . or a 40% decrease in the tax rate.” *Id*. at 9 (citing OCA St. 1S at 6). The OCA indicates that while the TCJA is a new tax rate that is ongoing, the overcollection of taxes is a one-time, nonrecurring event that will end when the Company’s rates begin to reflect the 21% tax rate, rather than the old 35% tax rate. OCA R. Exc. at 9-10. In support of its position, the OCA cites to the *May 2018 Tax Order* in which it indicates that the Commission concluded there is “no legal impediment” to consideration of the TCJA’s impact on the justness and reasonableness of rates. OCA R. Exc. at 10 (citing *May 2018 Tax Order* at 15).

Second, the OCA states that the ALJs properly evaluated all relevant criteria in the context of this proceeding in finding that the TCJA savings constituted a windfall to the Company. The OCA avers that the ALJs’ decision is consistent with the *May 2018 Tax Order*, which directs utilities with pending base rate cases to address issues concerning the TCJA savings in the context of those base rate cases. OCA R. Exc. at 11. The OCA asserts that the record demonstrates that the earnings UGI presented do not support the Company’s position that it is unreasonable to require the flow back of the TCJA savings. The OCA notes that I&E’s witness Wilson disagreed that the Company’s rate of return at present rates for the FTY was 4.83% and stated that there was “apparent manipulation by the Company to portray lower historic rate of return figures.” OCA R. Exc. at 12 (citing I&E St. 1 at 32, 33). The OCA also notes that I&E witness Kubas testified that UGI’s rate of return was higher than the Company indicated. OCA R. Exc. at 12 (citing I&E St. 5 at 7).

The OCA continues that while the Company contends it did not receive a windfall because of the TCJA, the record shows that UGI calculated $212,677 as the amount of 2018 tax savings to be returned to customers. OCA R. Exc. at 12 (citing OCA St. 1 at 14; I&E St. 1 at 34; UGI St. 9-R at 2). The OCA cites to the testimony of its witness Morgan and I&E witness Wilson that UGI explained “the estimated tax savings was calculated by multiplying the effective tax rate pre- and post-enactment of the TCJA against actual earnings before taxes for January - February 2018 plus budgeted earnings before taxes for March - September 30, 2018.” OCA R. Exc. at 12-13 (citing OCA St. 1 at 14; I&E St. 1 at 34). The OCA also cites to the testimony of its witness Morgan that “[w]hen there is a significant decrease in the tax rate, from 35% to 21% . . . allowing a utility to retain the savings would result in a windfall to shareholders.” OCA R. Exc. at 13 (citing OCA St. 1-S at 6-7). Accordingly, the OCA avers that the ALJs properly determined that “[f]lowing back the windfall amounts is fair, just and reasonable.” OCA R. Exc. at 13 (citing R.D. at 105).

I&E also addresses this issue in its Replies to Exceptions, averring that the ALJs properly recommended that UGI refund to customers the 2018 impacts of the TCJA. First, I&E argues that the ALJs properly applied the two-part test applicable to retroactive and single issue ratemaking. I&E R. Exc. at 15. I&E agrees with the ALJs’ conclusion that the 40% reduction in the corporate tax rate in 2017 is an unprecedented, extraordinary one-time event that is unlikely to be repeated. I&E states that the ALJs’ decision is also consistent with the language in the *May 2018 Tax Order* that the TCJA represented an extraordinary and substantial, non-recurring reduction in utility expenses that warranted an immediate flowback of the windfall to ratepayers. I&E R. Exc. at 16.

Second, I&E avers that the ALJs considered all the evidence presented concerning the Company’s earnings and properly found that the 2018 tax overcollections resulting from the TCJA are a windfall to UGI and should be flowed back to ratepayers. I&E R. Exc. at 17. I&E states that the ALJs provided proof of their thorough analysis of the evidence presented by all Parties in Table I in the Appendix to the Recommended Decision. *Id*. at 17-18. I&E also states that UGI’s argument that only the Company provided evidence regarding the Company’s 2018 earnings completely ignores the entirety of I&E’s direct and surrebuttal testimony, I&E Sts. 1 through 5 and I&E Sts. 1‑SR through 5-SR. I&E R. Exc. at 18. I&E points out that its final recommendation of a revenue increase of only $818,000 was based on I&E’s comprehensive analysis of UGI’s HTY, FTY, and FPFTY, as well as its present and proposed proforma earnings. *Id*. (citing I&E R.B., App. A, Table I). I&E continues that its witness Kubas also presented extensive testimony regarding UGI’s attempts to manipulate its Quarterly Earnings Reports to represent that it was earning a much lower return on equity than it actually was. I&E R. Exc. at 18 (citing I&E Sts. 5 and 5-SR).

1. **Disposition**

Based on our review of the record, the ALJs’ decision, and the Parties’ positions, we agree with I&E[[8]](#footnote-8) and the ALJs that UGI should be required to implement a negative surcharge to return to customers the net tax savings associated with the reduction in the FIT rate for the time period of January 1, 2018, through the effective date of UGI’s new rates. We also find it appropriate to include interest on the roughly $212,000 net tax savings.

We concur with the ALJs’ determination that directing UGI to flow back the TCJA tax savings did not constitute impermissible retroactive or single issue ratemaking, reasoning that the 40% reduction in the corporate tax rate in 2017 qualified as an extraordinary one-time event that was unlikely to be repeated. This decision is consistent with the *May 2018 Tax Order* in which the Commission considered the TCJA to be an extraordinary and substantial, non-recurring reduction in utility expenses. In reaching this conclusion, the ALJs considered all the relevant evidence in this proceeding, including the exhibits and testimony of the Company, the OCA, and I&E, in finding that the TCJA savings constituted a windfall to the Company.

Earlier this year, this Commission assessed the impact of the TCJA on existing utilities’ rates and determined that, because of the decrease in the corporate tax rate, existing rates were no longer just and reasonable. *March 2018 Tax Order* at 3. We concluded that the tax savings and associated reductions in utility revenue requirements should flow back to consumers on a current basis and directed certain utilities, not including UGI, to implement a negative surcharge to recognize the TCJA changes. Those utilities also were required to establish deferred regulatory liability accounts to record the tax savings associated with the TCJA from January 1, 2018 through June 30, 2018. We directed that those accounts accrue interest at the residential mortgage lending rate specified by the Secretary of Banking in accordance with the Loan Interest and Protection Law, 41 P.S. §§ 101, *et seq*. *May 2018 Tax Order* at 17-18.

For those utilities, like UGI, that had pending rate cases or were planning to file rate cases on or before August 1, 2018, we expressed an expectation that the utilities and the parties in those proceedings would address the effect of the federal tax rate reduction on the justness and reasonableness of the consumer rates charged during the term of the suspension period. We consolidated those utilities’ temporary rates tariff filings with the pending rate cases for hearing and disposition so that the parties could address the TCJA’s impacts in the context of the overall reviews of the utilities’ rates and rate structures. *May 2018 Tax Order* at 20. In particular, we expressed an expectation that a utility with a pending rate case, and the parties to that rate case, would address whether a retroactive surcharge or other measure was necessary to account for the tax rate changes that became effective on January 1, 2018. *May 2018 Tax Order* at 20-21.

In this proceeding, we conclude that UGI is required to implement a negative surcharge to return to customers the net tax savings associated with the reduction in the FIT rate for the time period of January 1, 2018, through the effective date of UGI’s new rates. In its testimony on this issue, I&E recommended that the return of that money should also include interest at the residential mortgage lending rate specified in the Loan Interest and Protection Law over a one-year period, commencing on the dates the new rates become effective. *See* I&E St. 1 at 33-34; I&E St. 1-SR at 36. Based on our review of the ALJs’ Recommended Decision, it appears that the ALJs adopted I&E’s recommendation that UGI be required to implement a negative surcharge but failed to address the inclusion of interest. Accordingly, we find it appropriate to include interest on the roughly $212,000 net tax savings from January 1, 2018, through the effective date of UGI’s rates, consistent with our directive in the *May 2018 Tax Order* that utilities without pending base rate cases establish deferred regulatory liability accounts. Therefore, we shall direct UGI to refund its ratepayers a one-time credit per customer the 2018 tax savings of $212,677 resulting from the TCJA plus interest at the residential mortgage lending rate specified by the Secretary of Banking in accordance with the Loan Interest and Protection Law, 41. P.S. §§ 101, *et seq.* For these reasons, we shall deny UGI’s Exception No. 4 on this issue and adopt the ALJs’ recommendation, as modified, to reflect that interest shall be included on the net tax savings and refunded to customers via a one-time credit.

## **Excess Accumulated Deferred Income Taxes**

**1. Positions of the Parties**

UGI noted that the Company’s revenue requirement in this proceeding includes the amortization of a regulatory liability for excess accumulated deferred income taxes (EADIT), which represents the change in the Company’s ADIT balance resulting from the TCJA’s change in the corporate income tax rate from 35% to 21%. UGI St. 9-SD at 2-3. UGI provided that the reduction in the federal corporate income tax rate from 35% to 21% substantially reduced the value of ADIT on the Company’s books. For example, ADIT on a $1,000,000 book-tax depreciation difference would have been $350,000 under the old 35% federal tax rate ($1,000,000 x 35%). UGI M.B. at 120. Now, that same ADIT item is $210,000 at the new federal tax rate of 21% ($1,000,000 x 21%). *Id*. at 120-121. This “excess” ADIT is removed from the ADIT account (FERC Account 282) and recorded in Account 254 – Other Regulatory Liabilities. *Id*. at 121. In accordance with accounting and IRS requirements, this “excess” ADIT is recorded as regulatory liability on the Company’s balance sheet and amortized to the income statement and/or returned to customers over time using the IRS approved Average Rate Assumption Method (ARAM). The amortization begins at the reversal point when book depreciation exceeds tax depreciation. *Id*.

UGI stated that all Parties agree with the Company’s proposed treatment of EADIT to this point, but I&E and the OCA propose an additional adjustment to deduct the unamortized portion of EADIT from rate base. *Id.* UGI contended that the fundamental flaw in the I&E and the OCA proposals is that they seek to treat an expense item (federal corporate income taxes) as a capital expense and provide customers a return thereon. According to UGI, the proposal of I&E and the OCA violates ratemaking principles by deducting the unamortized balance of an operating expense (taxes) from rate base. The fact that EADIT has been deferred to the balance sheet should not affect this analysis. *Id*. at 122.

The OCA noted that deferred taxes are included in a utility’s revenue requirement at the existing income tax rate. The OCA stated that the deferred tax balances that assumed taxes would be paid at the 35% tax rate are now overstated, and UGI must determine the amount of EADIT that was created as a result of the TCJA tax rate reduction. OCA M.B. at 41; OCA St. 1 at 10. The OCA also stated that the Company has acknowledged that the TCJA affects deferred taxes. OCA M.B. at 41-42; UGI St. 9R at 3-4. The OCA noted that UGI witness McKinney stated that “[t]he difference in the ADIT balance from when it was at a 35% tax rate to its new 21% tax [rate], represents excess deferred federal income taxes.” OCA M.B. at 42; UGI St. 9-R at 3-4.

The OCA averred that UGI transferred EADIT to a regulatory liability account and then excluded the funds from rate base. OCA St. 1 at 11. The exclusion results in an increase in the rate base of approximately $11 million. OCA St. 1 at 13; OCA St. 1, Schedule LKM-5. The OCA stated that its witness Morgan explained why it is appropriate to include the regulatory liability in rate base, as follows:

[E]ven as they are now considered to be excess deferred taxes and transferred to a regulatory liability account, these funds are still restricted by the tax provision that now requires that they be flowed back to ratepayers using the ARAM. ARAM essentially restricts the flow back of the excess deferred taxes (the regulatory liability) before the tax benefits turn around.

Consequently, even though they are now placed in an account by another name, they are still treated as protected ADIT and have not been fully returned to ratepayers.

OCA St. 1 at 11.

The OCA averred that UGI witness McKinney claimed that, although “Commission precedent requires that amounts recorded as ADIT be deducted from rate base, excess deferred income taxes are not ADIT but are ‘excess’ deferred taxes.” OCA M.B. at 43; UGI St. 9-R at 9. The OCA also averred that UGI witness McKinney suggested “the regulated liability should be flowed through to customers through an amortization allowance without a return to customer on the unamortized balance.” OCA M.B. at 43; UGI St. 9-R at 5. The OCA disagreed with UGI on these points, noting that its witness Morgan explained, based on Federal tax policy, “just because the name of the account in which these funds are held has changed, ratepayers should not be penalized by not including the funds in the rate base given the funds are still restricted as if they were protected ADIT.” OCA M.B. at 43-44; OCA St. 1 at 13. The OCA noted that witness Morgan explained:

Even though the Company would like to characterize these funds as simply a regulatory liability, the fact is that the funds are not simply a regulatory liability. If they were simply a regulatory liability, the Commission would be free to flow the funds back to ratepayers quicker than the ARAM. Instead, tax regulations still control these funds.

OCA St. 1 at 13. The OCA therefore submitted that the amount of the EADIT regulatory liability should be reduced from rate base and that the Commission should reduce the Company’s rate base by $10.876 million to reflect the inclusion of the regulatory liability. OCA M.B. at 44; OCA St. 1, Schedule LKM-5.

I&E noted that the Company reclassified the protected EADIT to a regulatory liability, but it did not make the necessary corresponding reduction to its rate base. I&E M.B. at 63. I&E also noted that the Company acknowledged that Commission precedent requires that amounts recorded as ADIT be deducted from rate base, but that the Company argues that the excess deferred taxes are not ADIT; rather they are “excess” deferred taxes and the Company is not aware of any precedent under which excess deferred taxes are treated as a rate base deduction. I&E M.B. at 63. I&E further noted the Company’s argument that regulatory assets are not allowed to be added to rate base and that the Company believes that the same treatment should apply to regulatory liabilities. *Id*. at 63-64. In short, the Company believes it should be able to earn a return on the EADIT balance. *Id*. at 64.

I&E disagreed, noting that the EADIT monies were originally built into the rate formula to cover future income tax payments to the government. I&E M.B. at 64; I&E St. 1-SR at 38; UGI St. 9-R at 5. I&E contended that the fact that the EADIT is no longer due in future income tax payments but is now due to ratepayers via a refund over the remaining useful life of affected plant, does not change the fact that the Company has received this money from ratepayers in prior years, and the money has been available for infrastructure improvements. I&E M.B. at 64; I&E St. 1 at 38. I&E further contended that the original intent should be considered, and that because the funds were an interest-free loan from the government (taxes due at some point in the future) and now, due to the reclassification, the money is basically an interest-free loan from ratepayers, the ratepayers should not be required to pay the Company a return on this balance during the time it takes to refund the money to them. I&E M.B. at 64; I&E St. 1 at 38. I&E therefore recommended that the excess accumulated deferred income tax currently held by the Company be returned to ratepayers over a period equal to the remaining life of the affected assets per IRS regulation. Each year, the balance in the EADIT account will be ratably reduced until the entire amount is refunded to ratepayers.

The OSBA stated that the effect of the TCJA was to convert a portion of the ADIT from an interest-free loan from the government in the form of tax deferrals to an interest free loan from ratepayers. OSBA M.B. at 13 (citing I&E St. 1-SR at 37). The OSBA agreed with the OCA and I&E that EADIT should continue to serve as a credit to rate base in the same manner as ADIT. OSBA M.B. at 14-16. The OSBA stated that the OCA and I&E make simple, straight-forward arguments in support of their positions, explaining that the shifting of balances from ADIT to Excess ADIT accounts is essentially that of a change in the name of the account, that the benefits of the TCJA reduction in the tax rate have not been fully returned to ratepayers, and therefore there is no reason to penalize ratepayers by changing the rate base treatment of these amounts. OSBA M.B. at 14 (citing OCA St. 1 at 12-13. The OSBA also stated that I&E witness Wilson explained that the funds in the ADIT account, including those shifted to the EADIT account, were reflected in rates in prior years but not incurred by the company as cash tax costs, making the funds available for investment. The OSBA cited Ms. Wilson’s testimony which explains that these funds represented an interest-free loan from the government and now represent an interest-free loan from ratepayers. The OSBA therefore concluded that it is inappropriate for the Company to charge ratepayers for interest on these balances, and that the rate base treatment of EADIT should follow that of ADIT, and that EADIT should be recognized as an offset to rate base. OSBA M.B. at 14.

**2. Recommended Decision**

The ALJs agreed with the OCA, I&E, and the OSBA that the EADIT should be recognized as an offset to UGI’s rate base. R.D. at 105. The ALJs agreed that simply changing the name from one account to another does not somehow transform the nature of the monies in the new account. Calling some monies “Excess ADIT” instead of “ADIT” does not change the fact that the money in the original ADIT account was an offset to rate base. Similarly, placing the EADIT monies into a regulatory liability account does not transform those funds into money that should be included in the rate base. These funds were, and continue to be, ADIT funds because that is what the funds were collected for in the first place. Accordingly, the ALJs reasoned that they cannot allow UGI to hold these excess funds because the future tax liability on these funds is no longer due to the government. Therefore, the ALJs recommended that the Commission order these funds to be deducted from the rate base to reflect these factors. R.D. at 107. Since the ALJs have concluded that they will use the Company’s fully projected future test year numbers in making their various recommendations in this case, the amount of EADIT will be based upon the ending balance adjustment, which is the Company’s number of $11,213,000. Id. (citing OCA St. 1, Schedule LKM-5).

**3. Exceptions and Replies**

In its Exception No. 7, the OCA contends that the ALJs improperly recommended that the amount of EADIT to be deducted from UGI’s rate base be determined based upon end of year numbers. OCA Exc. at 19 (citing R.D. at 107). The OCA notes that UGI proposed to exclude EADIT funds from rate base, thus increasing the rate base upon which depreciation expense and return is calculated for revenue requirement purposes. OCA Exc. at 19 (citing OCA St. 1 at 12; OCA M.B. at 42). The OCA also notes that it proposed to include EADIT funds in rate base as a reduction. OCA witness Morgan explained that, based on Federal tax policy, “just because the name of the account in which these funds are held has changed, ratepayers should not be penalized by not including the funds in the rate base given the funds are still restricted as if they were protected ADIT.” OCA Exc. at 19 (citing OCA St. 1 at 13, OCA M.B. at 43). The OCA emphasizes its proposal to reduce the Company’s rate base by the amount of EADIT based on the average balance of $10.876 million. OCA Exc. at 19 (citing OCA St. 1, Schedule LKM-5).

The OCA provides that the ALJs agreed that “excess ADIT should be recognized as an offset to UGI’s rate base” and recommended “that the Commission order these funds to be deducted from the rate base.” However, the ALJs recommended that “the amount of excess ADIT will be based upon the ending balance adjustment which is the company’s number of $11,213,000.” OCA Exc. at 20 (citing R.D. at 105, 107). As discussed in the OCA’s Exception No. 1, the OCA contends that the ALJs’ recommendation to accept the end of year methodology is in error.

The OCA argues that as demonstrated by OCA witness Morgan, the amount of EADIT to be deducted from rate base should be based on the average balance, $10.876 million, which is calculated by averaging the balance at September 30, 2019 ($11.213 million) and the balance at September 30, 2018 ($10.538 million). OCA Exc. at 20 (citing OCA St. 1, Schedule LKM-5). The OCA submits that the Commission should reject the ALJs’ recommendation concerning the calculation of the amount of EADIT to be reduced from rate base and adopt the OCA’s proposed amount of $10.876 million. OCA Exc. at 20 (citing OCA St. 1 at 13).

In its Reply, UGI states that the Commission should adopt the ALJs’ conclusions regarding the use of the end of year FPFTY methodology as related to the calculation of the EADIT rate base deduction. UGI provides that to the extent that the Commission adopts the R.D.’s proposed rate base deduction for EADIT, which it should not, the OCA’s proposal to use the average rate base methodology to determine this amount should be rejected. UGI R. Exc. at 7 (citing UGI M.B. at 120-127, UGI R.B. at 54-55; UGI Exc. at 5).

In its Exception No. 5,UGI contends that its revenue requirement in this proceeding properly reflects the amortization of a regulatory liability for EADIT, which represents the change in the Company’s ADIT balance resulting from the TCJA’s change in the corporate income tax rate from 35% to 21%. UGI Exc. at 28-29 (citing UGI M.B. at 117). UGI notes that the R.D. adopted UGI’s proposed amortization, but erred when it also deducted the unamortized balance from rate base. UGI Exc. at 29 (citing R.D. at 105-107).

UGI provides that the recommended rate base adjustment is unprecedented, factually wrong, inconsistent and not in the public interest. UGI Exc. at 29 (citing UGI M.B. at 117-126; UGI R.B. at 54-55). UGI explains that, first, the R.D. violates basic ratemaking principles and long-standing precedent by exacting a return component on the unamortized balance of an expense amortization, in this case, by reducing rate base by the amount of the unamortized EADIT. UGI Exc. at 29 (citing UGI M.B. at 121-124). Second, UGI avers, the R.D. ignores the fact that UGI’s current rates were last set in 1996 based on plant and deferred tax balances at that time, whereas most of UGI’s EADIT accumulated from plant placed in service since that time. Third, according to UGI, the R.D. reflects only one aspect of the TCJA’s impacts on EADIT; it recommends to fully reflect the rate reduction for tax expense and to further reduce tax expense by the EADIT amortization amount but ignores the increase in rate base that should result from the reduction in ADIT. UGI Exc. at 29 (citing UGI M.B. at 125-26; UGI R.B. at 54-55). And finally, UGI avers that UGI demonstrated that the proposed adjustment was inconsistent with the goals of the TCJA and, therefore, not in the public interest. UGI Exc. at 29 (citing UGI M.B. at 126-27).

UGI avers that the ALJs’ finding that EADIT “monies were originally built into the rate formula to cover future income tax payments to the government” ignores the fact that UGI’s current rates were last set in 1996. UGI Exc. at 29 (citing R.D. at 105-06; UGI M.B. at 124-25). UGI explains that its ADIT balance in 1996 was $4.8 million and has grown to $23.5 million as of September 30, 2017. UGI explains further that while the EADIT was created from the reduction to the ADIT balance, ratepayers have not had to pay the deferred taxes underlying the balance since the majority of the EADIT was generated by property placed in service after the current rates were established. UGI Exc. at 29-30 (citing UGI St. 9-RJ at 4).

UGI contends that the R.D. would require UGI to return to customers, by way of a rate base deduction, deferred taxes that were never paid by customers, because they are not part of UGI’s existing rates. UGI argues that the R.D.’s mistake is further compounded by its suggestion that the EADIT funds “were, and continue to be, ADIT funds because that is what the funds were collected for in the first place.” UGI Exc. at 30 (citing R.D. at 107).

UGI states that the recommended rate base deduction fails to acknowledge that the Company has flowed through the impacts of the EADIT through a tax expense claim that is adjusted by the amortized EADIT amount. UGI notes that as the Company has proposed to flow through the principal of the EADIT by amortizing it over the life of the applicable plant in service, the Company’s tax expense claim falls below even the lower TCJA statutory tax rate of 21 percent. UGI contends that the R.D. unreasonably ignores the flow through of the EADIT amortization by including the full EADIT principal amount as an offset to rate base to the detriment of UGI. UGI provides that this would not only provide ratepayers a credit for expenses they never paid in rates but would also provide an unprecedented rate base deduction for an expense credit that is also being amortized to the ratepayers’ benefit. UGI Exc. at 30 (citing UGI M.B. at 125-126; UGI R.B. at 54). UGI argues that if the impacts of the TCJA are to be reflected in UGI’s rates, then all the impacts should be included, including the reduction in ADIT, not just the impacts that reduce rates. UGI Exc. at 30.

In its Reply, the OCA provides that the ALJs properly concluded that UGI’s rate base should be reduced to reflect EADIT. The OCA submits that the Commission should deny UGI’s Exception No. 5 and adopt the ALJs’ recommendation to reduce rate base to reflect EADIT. OCA R. Exc. at 15 (citing OCA Exc. at 19-20).

The OCA notes that in its Exceptions, UGI claimed that the ALJs improperly determined that EADIT should be recognized as an offset to rate base. OCA R. Exc. at 13-14 (citing UGI Exc. at 28-30). The OCA states that UGI argued the ALJs incorrectly found that EADIT funds “were, and continue to be, ADIT funds.” OCA R. Exc. at 14 (citing UGI Exc. at 30; R.D. at 107). The OCA provides that as OCA witness Mierzwa testified, “even though [the funds] are now placed in an account by another name, they are still treated as protected ADIT and have not been fully returned to ratepayers.” OCA R. Exc. at 14 (citing OCA St. 1 at 12-13). OCA witness Mierzwa explained:

I believe these funds should continue to be included in rate base as a reduction because, even though they are being transferred from the ADIT account to a regulatory liability account, they have not fully shed the restriction of the tax laws, and I would argue that they also have not lost their character as part of Federal tax policy. Federal tax policy made accelerated depreciation available to companies as an incentive to finance expansion. Accelerated tax depreciation means that businesses write-off (depreciate) assets quicker and since depreciation reduces taxes, the tax savings is a source of funds to the business. That source of funds can be used to pay off financing or for other general operational uses.

According to the Company, the funds which now make up the regulatory liability account are primarily made up of amounts that were recorded as protected ADIT. Protected ADITs were, for the most part, derived from the use of accelerated tax depreciation. Under Code Sec. 167 and Code Sec. 168 of Federal tax regulations, regulatory commissions are restricted from flowing the tax benefits of protected ADIT to ratepayers faster than the turn around of those tax benefits. Similarly, even as they are now considered to be excess deferred taxes and transferred to a regulatory liability account, these funds are still restricted by the tax provision that now requires that they be flowed back to ratepayers using the ARAM. ARAM essentially restricts the flow back of the excess deferred taxes (the regulatory liability) before the tax benefits turn around.

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Therefore, *just because the name of the account in which these funds are held has changed, ratepayers should not be penalized by not including the funds in rate base* given the funds are still restricted as if they were protected ADIT. It is important to note that the reason the ADITs were included in rate base was to recognize the fact that they provide a source of cost-free capital.

OCA St. 1 at 12-13 (emphasis added).

In response, I&E argues that the ALJs properly reduced UGI’s rate base to reflect EADIT associated with the TCJA. I&E contends that the EADIT currently held by UGI should be returned to ratepayers over a time period equal to the remaining life of the affected assets per IRS regulation. I&E recommends that UGI be required to reduce its rate base by $11,483,354 to reflect the EADIT balance which resulted as a reclassification of the portion of ADIT associated with the reduction in the federal income tax from the TCJA. I&E R. Exc. at 19-20.

In its Reply, the OSBA avers that EADIT is simply a recategorization of an ADIT balance that results from the TCJA. OSBA R. Exc. at 3 (citing OSBA M.B. at 12‑16; OSBA R.B. at 5-9). The OSBA contends that the ALJs correctly determined that EADIT should continue to be treated as an offset to rate base. OSBA R. Exc. at 3 (citing R.D. at 105-06). The OSBA explains that UGI’s first argument is that EADIT is not ADIT but is simply an unamortized expense (in this case, a negative expense), and that Commission policy does not assign a return to these accounts. The OSBA contends that this argument fails because it is based on the premise that the EADIT balance is more analogous to an unamortized expense amount than to ADIT. The OSBA contends that simple common sense refutes this conclusion. The OSBA reasons that the circumstances which give rise to EADIT are identical to those which give rise to ADIT, and it is therefore logical to treat the two balances consistently. The OSBA concludes that the R.D. sensibly reaches this conclusion. OSBA R. Exc. at 5 (citing R.D. at 107).

The OSBA notes that UGI argued that EADIT should not be an offset to rate base because most of the ADIT was accumulated after the Company’s last base rate case and was therefore allegedly never reflected in rates. OSBA R. Exc. at 5 (citing UGI R. Exc. at 29). The OSBA avers that the most obvious flaw in this line of reasoning is that it would apply equally well to both EADIT and ADIT. Thus, OSBA explains, if the Commission were to adopt this line of reasoning, it would similarly need to modify its longstanding policy for ADIT. The OSBA provides that if the Commission adopts this UGI specific argument, it would then need to evaluate every ADIT and EADIT offset in every utility base rate case from this case forward (based on the specific circumstances of each utility) to understand when the ADIT was accumulated relative to the most recent base rate proceeding. The OSBA notes that adopting the Company’s position would consequently create a regulatory quagmire. OSBA R. Exc. at 5.

According to the OSBA, the Company has, at least implicitly, been charging ratepayers for corporate income tax at a thirty-five percent statutory rate for many years, while actually paying taxes at a lower rate. The OSBA notes that this has provided UGI with cash to finance its business in the amount of ADIT. The OSBA reasons that normal regulatory policy therefore recognizes the benefit of this “free financing” by applying ADIT as an offset to rate base. The OSBA explains that, in effect, this rate base offset implies that the Company pays for this financing at its weighted average cost of capital. OSBA R. Exc. at 6 (citing OSBA R.B. at 6).

In response to UGI’s argument that the TCJA is intended to encourage more investment but that crediting EADIT to rate base will force UGI to rely more heavily on capital markets, the OSBA explains that ADIT is not free. The OSBA states that the rate base offset from ADIT implies that the financing cost is the Company’s weighted average cost of capital. The OSBA provides that UGI has made no demonstration that it is unable to obtain market financing for its additional capital spending at that rate. OSBA R. Exc. at 7 (citing OSBA R.B. at 6).

**4. Disposition**

As previously noted, the ALJs concluded that the plain language and policy of Act 11 permits UGI to base its FPFTY, and associated depreciation expense, on the use of a year-end rate base methodology. R.D. at 19-22. We agree with the ALJs’ conclusion regarding use of year-end rate base methodology, and we will be using the end-of-year methodology to calculate UGI’s EADIT. Accordingly, the OCA’s Exception No. 7 is denied.

Additionally, based on our review of the record and the Parties’ positions, we agree with the ALJs’ recommendation that the EADIT should be recognized as an offset to UGI’s rate base. Accordingly, we will deny UGI’s Exception No. 5.

The circumstances which give rise to EADIT are identical to those which give rise to ADIT, and these balances should be treated consistently. We note the testimony of OCA witness Morgan who stated, “just because the name of the account in which these funds are held has changed, ratepayers should not be penalized by not including the funds in the rate base given the funds are still restricted as if they were protected ADIT.” OCA St. 1 at 13. We also find value in I&E’s testimony on this issue. I&E witness Wilson stated that the fact that the EADIT is no longer due in future income tax payments but is now due to ratepayers via a refund over the remaining useful life of affected plant, does not change the fact that the Company has received this money from ratepayers in prior years, and the money has been available for infrastructure improvements. Witness Wilson explained that the original intent should be considered, and that because the funds were an interest-free loan from the government (taxes due at some point in the future), and now due to the reclassification, the money is basically an interest-free loan from ratepayers, the ratepayers should not be required to pay the Company a return on this balance during the time it takes to refund the money to them. I&E St.1 at 38.

Further, as the OSBA explained, both ADIT and EADIT are balances reflecting tax costs included in rates but not paid out by the Company. The only difference between ADIT and EADIT is that ADIT represents the balance of taxes included in rates that the Company will eventually need to pay to the government, and EADIT represents the balance of taxes included in rates which will no longer need to be paid to the government because of the TCJA and will be refunded to ratepayers. ADIT and EADIT are the same in that they represent taxes which have been paid by ratepayers, but which have not been paid to the government or refunded to customers. We agree with the OSBA that given the obvious and close parallels between ADIT and EADIT and the substantial differences between unamortized expense and EADIT, EADIT is not an unamortized expense and should be treated consistently with ADIT and therefore recognized as an offset to rate base. *See* OSBA R. Exc. at 4-5. For all of these reasons, we shall adopt the ALJs’ recommendation and deny the Parties’ Exceptions on this issue.

## **C. Act 40 of 2016**

**1. Positions of the Parties**

UGI stated that Act 40 requires utilities to compute a hypothetical consolidated tax savings adjustment (CTA), which would apply in the absence of Act 40, and to certify that 50% of the differential shall be used to support reliability or infrastructure related to the rate-base eligible capital investment as determined by the Commission, and 50% shall be used for general corporate purposes. UGI M.B. at 127 (citing 66 Pa. C.S. § 1301.1(b)). UGI averred that it has fully complied with Act 40’s use of funds requirements and that the OCA’s adjustment is merely an attempt to continue the CTA in a different form. UGI M.B. at 128. UGI argued that its witness Anzaldo fully explained the Company’s compliance with this provision by stating that the Company’s pro forma capital additions for reliability or infrastructure projects in the FTY are $10.950 million and for the FPFTY are $11.770 million, which is greater than 50% of the amount of what would have been the CTA under prior ratemaking principles. Witness Anzaldo also stated that the Company’s general corporate purpose expense will also exceed 50% of the tax benefit resulting from elimination of the CTA. *Id*. at 129-130 (citing UGI St. 2 at 25).

UGI submitted that its capital expenditure expense and general corporate purpose expense exceed the fifty percent thresholds referenced in 66 Pa. C.S. § 1301.1(b) by wide margins, and, thus, UGI is fully entitled to recover tax expense as authorized by Act 40 without reduction. UGI noted that as quantified in UGI St. 9, the Act 40 impact is $75,400. UGI M.B. at 130 (citing UGI St. 2-R at 13). UGI also noted that Section 1301.1(b) pertains to the “uses” of the differential and embodies the Legislature’s decision that fifty percent of those funds are to be invested in vital infrastructure and reliability, and the other fifty percent may be devoted to general corporate purposes. UGI stated that Section 1301.1(b) does not address any ratemaking issues. UGI M.B. at 132.

The OCA argued that the Company’s approach to calculating the use of consolidated tax savings did not comply with Act 40. OCA M.B. at 45. The OCA cited to its witness Morgan’s testimony that regarding the portion of Act 40 that requires that 50% of the calculated consolidated tax savings be earmarked to support reliability or infrastructure related to the rate-base eligible capital investment, the Company simply stated that its rate base claim in this case exceeds 50% of the consolidated tax savings. Witness Morgan stated that this does not show how the Act 40 savings is used or how it benefits ratepayers. *Id*. (citing OCA St. 1 at 23). The OCA submitted that rate base should not grow and earn a return (*i.e*. shareholder profit) using ratepayer supplied funds, as UGI proposes; rather, the rate base should grow only to the extent such growth is funded by investor supplied funds. OCA M.B. at 45.

**2. Recommended Decision**

The ALJs concluded that the language of Act 40 is clear and unambiguous and, therefore, agreed with UGI’s position. The ALJs found that the statute requires that 50% of the Act 40 savings be used for reliability or infrastructure purposes, while the other 50% of the Act 40 savings be used for general corporate purposes. The ALJs reasoned that Act 40 does not state any specific requirements within the listed subcategories and, as such, UGI was not required to show where the Act 40 savings would be spent. R.D. at 110. The ALJs recommended that the Commission approve UGI’s retention of the $75,400 Act 40 savings for the Company’s stated purposes.

**3. Exception and Reply**

The OCA avers that the ALJs erred in recommending adoption of UGI’s Act 40 proposal. The OCA states that in a rate case, the utility is required to perform a consolidated tax savings calculation to determine whether a “differential accrues” as a result thereof. OCA Exc. at 21 (citing 66 Pa. C.S § 1301.1). The OCA explains that UGI performed the required calculation, and the Act 40 savings amount is $75,400. OCA Exc. at 21 (citing UGI St. 2-R at 13). The OCA also explains that Act 40 then further provides, “for ratemaking purposes,” how these savings are to be used. OCA Exc. at 21 (citing 66 Pa. C.S. § 1301.1(b)). The OCA argues that Section 1301.1(b) specifically requires that the Company account for these funds when determining rates. The OCA also argues that Section 1301.1(b) is effective until December 31, 2025, indicating that the General Assembly included this provision to mitigate the rate impacts of Act 40 for ratepayers, at least for a period of time. OCA Exc. at 21. The OCA submits that its proposals as set out in witness Morgan’s testimony would accomplish these important objectives, whereas accepting UGI’s proposed use and treatment of these savings would ignore the express requirements of Act 40. *Id*. at 22 (citing OCA St. 1 at 23). The OCA maintains that there are several, separate, and distinct showings Act 40 requires that do not appear to be accurately captured in the R.D. OCA Exc. at 22 (citing R.D. at 110). The OCA contends that the ALJs’ interpretation renders Section 1301.1(b) meaningless and is contrary to the rules of statutory construction, which dictate that all provisions of a statute should be given effect. OCA Exc. at 22 (citing 1 Pa. C.S. § 1921(a)).

Additionally, the OCA argues that the ALJs did not recognize that ratepayer benefits must be shown under Act 40, at least through December 31, 2025. OCA Exc. at 23. The OCA noted witness Morgan’s testimony that 50% of the differential that Act 40 requires be used to support reliability of infrastructure related to rate base eligible capital investment should be used to offset rate base in this case. Witness Morgan stated that the rate base reduction supports infrastructure and reliability investment and reduces the burden of rate base eligible capital investment on ratepayers. OCA Exc. at 23 (citing OCA St. 1 at 24). Regarding the other required 50% of the Act 40 savings, the OCA submits that UGI’s “general corporate purpose” is to provide regulated electric utility distribution service in Pennsylvania. Accordingly, the OCA submits that the Act 40 savings for “general corporate purposes” should be directed to such uses as supporting capital expenditures necessary to execute utility business plans, paying off debt, funding construction projects, paying dividends, paying for maintenance and operating expenses, investing in utility plant in Pennsylvania, and providing a source of working capital. The OCA concludes that by failing to correctly implement the requirements of Act 40 in this proceeding, UGI has failed to meet its burden of proof under 66 Pa. C.S. § 315(a). OCA Exc. at 23-24.

In response, UGI avers that the OCA’s Exception should be denied, because the Company has complied with Act 40’s directives. UGI asserts that the OCA’s attempt to treat the entire amount of the hypothetical CTA as customer-supplied funds, similar to a contribution in aid of construction, and deduct it from rate base, is improper. UGI R. Exc. at 19. UGI also asserts that the OCA’s argument that UGI did not provide specific information concerning how the amounts would be used disregards the language of the statute, which does not contain such a requirement. *Id*. at 19-20.

**4. Disposition**

On June 12, 2016, Act 40 was signed into law, effective in sixty days or on August 11, 2016. Act 40 added Section 1301.1 to the Code and states as follows:

**1301.1. Computation of income tax expense for rate-making purposes.**

**(a) Computation.—**If an expense or investment is allowed to be included in a public utility’s rates for ratemaking purposes, the related income tax deductions and credits shall also be included in the computation of current or deferred income tax expense to reduce rates. If an expense or investment is not allowed to be included in a public utility’s rates, the related income tax deductions and credits, including tax losses of the public utility’s parent or affiliated companies, shall not be included in the computation of income tax expense to reduce rates. The deferred income taxes used to determine the rate base of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility’s parent or any affiliated entity. The income tax expense shall be computed using the applicable statutory income tax rates.

**(b) Revenue use.—**If a differential accrues to a public utility resulting from applying the ratemaking methods employed by the commission prior to the effective date of subsection (a) for ratemaking purposes, the differential shall be used as follows:

(1) Fifty percent to support reliability or infrastructure related to the rate base eligible capital investment as determined by the commission; and

(2) Fifty percent for general corporate purposes.

**(c) Application.**—The following shall apply:

(1) Subsection (b) shall no longer apply after December 31, 2025.

(2) This section shall apply to all cases where the final order is entered after the effective date of this section.

66 Pa. C.S. § 1301.1(a)-(c). The intended purpose of Section 1301.1 was to move away from Pennsylvania’s past practice of requiring a CTA to a public utility’s tax expenses when setting rates in a base rate proceeding.

Based on our review of the language of Act 40, the Recommended Decision, and the Parties’ positions, we agree with the ALJs that the language of the statute is clear and unambiguous. When the language of a statute is clear and unambiguous, an administrative agency must give effect to the unambiguously expressed intent of the legislature. 1 Pa. C.S. § 1921; *Bethenergy Mines v. Department of Environmental Protection*, 676 A.2d 711, 715 (Pa. Cmwlth. 1996). Section 1301.1(a) specifies how income tax expense is computed for ratemaking purposes in base rate cases, while Section 1301.1(b) specifies how utility operating income generated by the operation of Section 1301.1(a) must be used by the affected public utilities until December 31, 2025. Based on a plain reading of the statute, Section 1301.1(b) requires that 50% of the Act 40 savings be used for reliability or infrastructure purposes, and the other 50% of the Act 40 savings be used for general corporate purposes. The statute does not require public utilities to provide specific information concerning how the amounts would be used.

We find that UGI presented evidence to show that it has complied with Act 40’s requirements. UGI’s witness Anzaldo testified that the Company’s *pro forma* capital additions for reliability or infrastructure projects in the FTY are $10.950 million and for the FPFTY are $11.770 million, which is greater than 50% of the amount of what would have been the CTA under prior ratemaking principles, and that the Company’s general corporate purpose expense will also exceed 50% of the tax benefit resulting from the elimination of the CTA. UGI St. 2 at 25; UGI St. 2-R at 13. Accordingly, we concur with the ALJs’ recommendation and will approve UGI’s retention of the $75,400 Act 40 savings for UGI’s stated purposes. For these reasons, we shall deny the OCA’s Exception on this issue and adopt the ALJs’ recommendation.

1. **Rate Structure**

This section of the Opinion and Order addresses cost of service, rate design and rate structure allocation issues. When a utility files for a rate increase, it must file an allocated cost-of-service study (ACOSS) assigning 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).

## **A. Allocated Cost of Service Study**

**1. Positions of the Parties**

UGI stated that the fundamental purpose of an ACOSS is to aid 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 to calculate the rate of return provided by each class. Subsequently, each class’ rate of return is compared to a system average rate of return to determine if each rate class is either under-paying or over paying its allocated cost of service. This information is then used to determine how the proposed rate increase should be allocated among the rate classes with the goal of moving each rate class towards the system rate of return. This can be accomplished by assigning a greater than system average increase to classes paying less than their cost of service and assigning a less than average increase to classes paying more than the system average rate of return. UGI noted that other factors may be considered in revenue allocation, such as value of service and gradualism. However, UGI submitted that in *Lloyd,* the Commonwealth Court determined that cost of service is the “polestar” of ratemaking. UGI M.B. at 133-34.

UGI presented its ACOSS as UGI Electric Exhibit D-Cost of Service Study for the FPFTY ending September 30, 2019 and updated it to reflect the impacts of the TCJA as Revised UGI Electric Exhibit D-Cost of Service Study. UGI made further refinements in its Rebuttal Testimony based on certain proposed technical corrections and modifications of the OSBA and submitted its final ACOSS as UGI Electric Exhibit D – Cost of Service Study (REBUTTAL).[[9]](#footnote-9) UGI averred that on all major issues, its ACOSS was performed in accordance with the methodology PPL used in its 2012 rate case, which the Commission approved in the *2012 PPL Order*. UGI M.B. at 135-137.

UGI explained that it prepared its ACOSS by separating its costs into functional cost categories associated with electric distribution service (*i.e.,* primary distribution, secondary distribution, or customer accounts) and classifying these costs as customer or demand costs[[10]](#footnote-10) based on a “minimum system” method. This method identifies the portion of the costs required to serve a customer with minimum or no load (*i.e.,* customer costs), with the remaining portion of the costs allocated based on each rate class’ maximum non-coincident peak demand (*i.e.,* demand costs). UGI then allocated each functionalized and classified cost element to the rate class that benefits from the cost. UGI M.B. at 137-38; UGI St. 6 at 6-11. According to UGI, the “minimum system” method is generally favored because it is based on the specific design and operating characteristics of the Company’s distribution system and provides a more accurate and consistent measure of class cost responsibility than other approaches. UGI claimed that its methodology is also 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. Additionally, UGI submitted that this methodology is used by other Pennsylvania electric utilities and is consistent with Commission precedent in base rate proceedings. UGI M.B. at 138-39.

The OCA was the only party that opposed UGI’s ACOSS. Namely, the OCA took issue with UGI’s use of the “minimum system” method. According to the OCA, UGI’s ACOSS improperly classified upstream primary and secondary distribution plant as both customer-related and demand-related. In the OCA’s view, primary and secondary distribution plant are demand-related investments and classification of these costs as partially customer-related is not reasonable. The OCA also submitted that the “minimum system” method does not address customer density and does not account for those portions of each class’s peak load that can be met by the minimum system itself. Therefore, the OCA proffered an alternative ACOSS, which, it contended, more closely adheres to cost causation principles. More specifically, the OCA recommended that UGI should be required to classify one-hundred percent of its upstream primary and secondary distribution plant as demand-related. Further, the OCA proposed additional modifications to the allocation of costs in specific O&M accounts, reasoning that the amounts in these accounts are correlated to total sales of electricity and should be classified as fifty-percent energy related. OCA M.B. at 70-79.

I&E did not present testimony regarding UGI’s ACOSS and simply stated that it was of the opinion that UGI’s customer cost analysis is over inclusive. I&E M.B. at 75.

The OSBA noted that in its rebuttal testimony, UGI agreed with the vast majority of the proposed modifications of OSBA witness Mr. Knecht to UGI’s initial ACOSS, related to a series of technical errors and the splitting of GS-1 and GS-4 into separate classes. Therefore, the OSBA submitted that the Commission should adopt either Mr. Knecht’s ACCOSS or the revised ACCOSS of UGI. OSBA M.B. at 16-23.

**2. Recommended Decision**

The ALJs found that the revised ACOSS, as set forth in UGI Exhibit B-Cost of Service Study (Rebuttal) should be approved and that the OCA’s alternative ACOSS should be denied. The ALJs reasoned that UGI correctly argued that its ACOSS was performed in accordance and consistent with the ACOSS submitted by PPL in its 2012 rate case and approved in our *2012* *PPL Order.* Additionally, the ALJs found persuasive that the ACOSS presented by UGI, including its use of the “minimum system” method, adheres to the generally accepted methods of preparing a cost allocation study set forth in the NARUC Manual. Finally, the ALJs opined that although the recommendations proposed by the OCA may result in more favorable rate treatment for the residential class, they provide no basis for rejecting UGI’s ACOSS. R.D. at 119-20.

**3. Exception and Replies**

In its Exception No. 9, the OCA submits that the ALJs erred by recommending the adoption of UGI’s ACOSS. The OCA highlights that this will result in almost 100% of UGI’s current revenue increase claim being collected solely from the residential class. According to the OCA, this outcome is unreasonable and unsupported by a properly conducted ACOSS. The OCA remains of the opinion that its own proposed ACOSS more accurately follows the principles of cost causation. According to the OCA, its alternate ACOSS is consistent with the common practice of more than 30 other states. The OCA highlights that the major difference between its proposal and UGI’s is that UGI includes a customer component to its upstream primary and secondary distribution plant while the OCA asserts that such plant should be classified as 100% 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 24-27.

The OCA also submits that even if it is determined that some portion of primary and secondary distribution plant is customer related, UGI’s “minimum system” method is flawed. In this regard, the OCA reasons that UGI’s minimum system is a theoretical construct that fails to represent how the system is actually used in the day-to-day operations of the grid and which has a load carrying capability, referred to as the Peak Load Carrying Capability (PLCC). According to the OCA, failing to recognize the PLCC inherent in the hypothetical minimum system results in double allocation of primary and secondary upstream distribution costs to residential and other small customers. OCA Exc. at 27-30.

Additionally, the OCA argues that the “minimum system” method misallocates primary distribution conductors such that UGI extends its primary distribution system by the same number of feet to connect a large customer as it does a small customer. The OCA contends that this failure to account for the significant differences in the upstream distribution facilities associated with serving larger customers results in unfair treatment of the residential class and is inconsistent with the theory of cost causation. OCA Exc. at 30-31.

UGI rebuts that the OCA raises the same arguments in its Exceptions that have been repeatedly rejected by the Commission. In reply to the OCA’s contention that UGI’s upstream primary and secondary distribution plant should be classified as 100% demand related, UGI points out that the OCA raised this same issue in PPL’s 2012 rate case and the Commission rejected it in the *2012 PPL Order.* On the other hand, UGI emphasizes that the “minimum system” approach methodology it employed in the instant proceeding is the same methodology that was approved for PPL in the *2012 PPL Order.* UGI further restates that this is the same methodology used by all other Pennsylvania electric utilities. UGI R. Exc. at 21-22.

In its Replies to Exceptions, the OSBA points out that the use of the “minimum system” method was substantially litigated in several recent PPL proceedings, including the *2012 PPL Order.* Therefore, the OSBA reasons that this indicates that the Commission has a clear preference for this method. The OSBA submits that although it recognizes that the Commission’s recent cost allocation decisions for other utilities are not necessarily dispositive of this issue, the instant proceeding is not the case to consider rejecting UGI’s ACOSS methodology in favor of the OCA’s alternative proposal. Namely, the OSBA asserts that the OCA made no argument as to whether UGI’s cost causation characteristics differ from that of PPL or other utilities, nor has it offered any new or novel arguments as to why long-standing precedent should be reversed in this proceeding. Therefore, the OSBA submits that the ALJs correctly recommended the adoption of UGI’s ACOSS and correctly rejected the OCA’s alternative methodology as being inconsistent with both cost causation and Commission precedent. OSBA R. Exc. at 8-14.

**4. Disposition**

On consideration of the record evidence, we shall adopt the recommendation of the ALJs that UGI’s proposed ACOSS be approved. As noted above, I&E presented no testimony to challenge UGI’s ACOSS and the OSBA largely agreed with the Company but offered minor refinements, most of which were adopted by UGI. Thus, the only Party opposed to UGI’s recommended ACOSS was the OCA.

We have reviewed the OCA’s position and Exceptions on this issue and are not persuaded by the arguments it presented in support of its recommended alternative ACOSS methodology. As UGI and the OSBA pointed out, the OCA has presented its alternative ACOSS methodology in prior Commission proceedings and we have rejected it, including in our *2012 PPL Order.* The record indicates that on all major issues, UGI’s ACOSS was performed in accordance with PPL’s cost of service study methodology in its 2012 rate case and approved in our *2012 PPL Order.* The record also indicates that UGI’s witness Mr. Taylor performed both the PPL cost of service study in that proceeding and that of UGI in the instant proceeding. UGI M.B. at 135. We conclude that the OCA has not presented convincing arguments in this proceeding that would cause us to re-evaluate our determination in our *2012 PPL Order*.

Additionally, as UGI and the OSBA both highlighted, the Commission has affirmed the use of the “minimum system method” as the accepted approach to classify and allocate distribution system costs in several proceedings. *See 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*). Further, we find that UGI’s ACOSS is consistent with the NARUC Manual and more accurately reflects cost-causation principles than the ACOSS methodology proposed by the OCA. Accordingly, we shall deny the Exceptions of the OCA.

## **B. Revenue Allocation**

**1. Positions of the Parties**

UGI explained that its proposed revenue allocation is primarily driven by the cost to serve each rate class. UGI 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, UGI submitted that its proposed revenue allocation is consistent with regulatory practice and precedent, including *Lloyd,* and neutrally allocates revenues consistent with the cost to serve each class. According to UGI, the residential class currently pays far less than its cost of service, while all other classes pay significantly more than their cost of service. As a result, UGI decided to allocate the proposed increase to the residential class, with no net change for all other rate classes (proposing no increase to the GS, Rate LP, and Lighting classes) because their relative rates of return were significantly above the system average. UGI argued that even under this revenue allocation, the residential class would remain well below the system average rate of return. However, UGI averred that its proposal is reasonable and properly moves the rate of returns for all classes closer to the overall system average rate of return. UGI M.B. at 145-148.

Further, UGI noted that the modifications to its ACOSS suggested by the OSBA also affected the Company’s proposed allocation of revenue, resulting in the revenue originally allocated to the GS class being segmented between rates GS-1 and GS-4, as proposed by the OSBA’s witness Mr. Knecht. UGI submitted that certain modifications to its proposed revenue allocation, as suggested by the OSBA, were both reasonable and appropriate because they addressed the OSBA’ concerns without ignoring the cost to serve the residential class. Finally, UGI contended that the OCA’s alternative proposal, *infra*, allocates revenues in a manner that ignores the cost to serve each class solely to allocate less of the proposed revenue increase to the residential class and should be rejected. OCA M.B. at 148-50.

UGI’s proposal would result in the following indexed rate of returns by each class:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **UGI's Proposed Relative Rate of Returns ($000s)** | | | | | | |
|  | **Total Company** | **Residential** | **General Service-1** | **General Service-4** | **Large Power** | **Lighting** |
| **Total Revenue Increase as Proposed** | $8,092 | $7,987 | $620 | ($515) | $0 | $0 |
| **Percent Total Revenue Change** | 9.08% | 13.30% | 19.35% | -3.31% | 0.00% | 0.00% |
| **Proposed Rate of Return** | 8.24% | 6.13% | 6.12% | 17.30% | 14.50% | 18.91% |
| **Proposed Relative Rate of Return** | 100% | 75% | 74% | 210% | 176% | 230% |
| **Current Rate of Return** | 3.75% | -0.54% | -0.59% | 23.23% | 16.20% | 21.02% |
| **Current Relative Rate of Return** | 100% | -14% | -16% | 619% | 431% | 560% |

UGI Exhibit D-Cost of Service Study (REBUTTAL) at 6-7; UGI M.B. at 148. Additionally, UGI explained that its final proposed revenue requirement increase of $7.705 million, inclusive of all adjustments resulting from the Company’s Rejoinder Testimony, should be allocated according to the same principles and in the same manner set forth in the above table. UGI M.B. at 148, n.30.

I&E asserted that rather than merely focusing on the overall rate increase, gradualism and rate shock must be considered for individual components of a customer’s bill, and the customer charge in particular. Therefore, I&E requested that the Commission apply the concept of gradualism when making a final allocation in this proceeding. I&E M.B. at 76-77.

The OCA presented an alternative revenue allocation proposal based on its own ACOSS and argued that it should be adopted in lieu of the one proposed by UGI. The OCA submitted that is proposed revenue allocation is appropriate because it reflects movement toward the indicated cost of service, gradualism, and no decrease for any class at a time when rates are increasing. Conversely, the OCA submitted that UGI’s proposed revenue allocation is flawed because it fails to reflect the concept of gradualism and is based on an ACOSS that contains a number of deficiencies and cost mis-allocations. The OCA further argued that the OSBA’s proposal is similarly flawed. OCA M.B. at 79-83; OCA R.B. at 35-38.

The OCA’s proposed revenue allocation is as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **OCA Proposed Revenue Distribution** ($000) | | | | |
| **Rate Class** | **Present Rates** | **Proposed Rates** | **Increase** | **Percent** |
| Residential | $22,180 | $29,660 | $6,850 | 30% |
| General Service-1 | 1,548 | 1,879 | 331 | 21 |
| General Service-4 | 5,753 | 5,753 | 0 | 0 |
| Large Power | 5,817 | 6,728 | 911 | 16 |
| Lighting | 993 | 993 | 0 | 0 |
| Total | $36,291 | $45,013 | $8,092 | 22% |

OCA St. 4S at 10, Table 3S; OCA M.B. at 81.

The OSBA submitted that the Commission should adopt the OSBA’s revenue allocation which is based off of the ACOSS of OSBA’s witness Mr. Knecht. In this regard, the OSBA argued that the Residential and GS-1 customer classes are under-recovering their cost of service. Therefore, the OSBA recommended that an increase commensurate to that applied to the Residential class be assigned to the GS-1 class. At the same time, the OSBA argued that the GS-4 and Lighting classes should be assigned a revenue decrease, which would make substantial additional progress toward cost-based rates. OSBA M.B. at 23-25.

**2. Recommended Decision**

The ALJs determined that UGI’s proposed revenue requirement allocation among the various rate classes achieves significant progress in moving rate classes toward the system average relative rate of return and should be adopted. The ALJs elaborated that the actual approved numbers should be based on the proportionate adoption of the actual revenue requirement approved. Conversely, the ALJs concluded that because the OCA’s alternative allocation proposal was based on its own ACOSS, which the ALJs rejected in favor of the Company’s proposed ACOSS, the OCA alternative should be denied. Further, the ALJs found that I&E did not present any evidence to support its position. R.D. at 120-22.

**3. Exception and Replies**

In its Exception No. 10, the OCA takes issue with the ALJs’ reasoning that because they recommended that the OCA’s proposed ACOSS should be rejected, so too should the OCA’s proposed revenue allocation. The OCA restates its position that its alternative allocation proposal appropriately reflects movement toward the class cost of service and reflects gradualism. 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 32-34.

In its Replies to Exceptions, UGI avers that its revenue allocation considers factors other than the cost of service, including gradualism and is consistent with the Commonwealth Court’s directive in *Lloyd*. In contrast, UGI opines that the OCA’s Exception ignores that the OCA’s proposed revenue allocation was rejected because it was based on a flawed cost allocation study. UGI R. Exc. at 22.

In its Replies to Exceptions, the OSBA submits that the ALJs properly accepted UGI’s proposed revenue allocation over the OCA’s proposal. The OSBA reasons that UGI’s proposal is grounded in an ACOSS that is consistent with Commission precedent and cost causation principles and is not inconsistent with the principle of rate gradualism, particularly in light of the time that has passed since UGI last had a base rate proceeding. OSBA R. Exc. at 14-15.

**4. Disposition**

Based upon our prior determination and discussion, *supra,* with respect to the rejection of the OCA’s alternative ACOSS, we agree with the ALJs that UGI’s proposed revenue allocation should be approved. As the OCA’s revenue allocation recommendation is based upon its alternative ACOSS, which we have rejected, we conclude that its allocation proposal should similarly be denied. Additionally, we find that UGI’s revenue allocation proposal is consistent with *Lloyd* and moves all rate classes closer to cost of service in a reasonable manner. Additionally, while the OCA contends otherwise, we also find that UGI’s 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 “1.5X” rule, wherein the maximum average rate increase for any particular class should not exceed 1.5 times the system average increase. OSBA St. 1 at 19-20. In the instant case, UGI’s proposal for the revenue class is slightly above this, with a 1.66 factor (39.9% for the residential class over 24.1% for the system average). Nonetheless, we note that UGI has not had a base rate proceeding since 1996. As such, the residential class has almost certainly been subsidized over this entire period. Therefore, we do not consider UGI’s proposal to be unreasonable. Accordingly, we shall adopt the recommendation of the ALJs and deny the OCA’s Exception on this issue.

## **C. Rate Design**

UGI proposed the following customer, demand, and energy charges, which, it argued, properly reflect the fixed and variable costs of service associated with its proposed revenue allocation. UGI explained that its proposed rate design accounts for the impacts of the TCJA, as well as the revisions to UGI’s ACOSS and revenue allocation.

|  |  |  |  |
| --- | --- | --- | --- |
| **Rate Class** | **Customer Charge** | **Demand Charge** | **Volumetric Energy Charge(s)** |
| Rate Class-Residential | $14.00 | N/A | $0.03077/kWh |
| Rate GS-1-General Service | $14.00 | N/A | $0.04707/kWh |
| Rate GS-4-General Service | $15.00 | $3.59/kWh/month | $0.02222-0.01261/kWh |
|  | $2.20/kWh/month |  |
| Rate GS-5-General Service[[11]](#footnote-11) | $14.00 | N/A | $0.03077/kWh |
| Rate LP-Large Power | N/A | $135.80 (≤ 100 kW) | $0.01672 (first 100 hours of demand) |
|  |  |
| $0.94/kWh (101-400 kW) | $0.01518/kWh (Next 200 Hours of demand, not to exceed 200,000 kWh) |
|  |  |
| $0.69/kWh (>500 kW) |  |
|  | $0.01383/kWh (next 200 hours of demand, not to exceed 200,000 kWh) |
|  |  |
|  | $0.01295/kWh (excess) |

UGI M.B. at 151.[[12]](#footnote-12) UGI also proposed several revisions and additions to its tariff, wherein it seeks to simplify its rate design and eliminate certain rate schedules that are no longer necessary or appropriate. For example, with respect to the residential rate class, UGI proposed to eliminate its current declining block distribution energy charge and adopt a single block rate. UGI St. 8 at 8-11, 16. While the opposing Parties generally agreed with or did not oppose UGI’s proposed rate design, they took issue with specific customer, demand, and energy charges applicable to the various rate classes.

**1. Residential Charges**

**a. Positions of the Parties**

UGI proposed to increase the Rate R residential customer charge from $5.50 per month to $14.00 per month, representing an increase of $8.50 per month. UGI pointed out that its current customer charge is well below the corresponding charge for other Pennsylvania electric utilities, as well as Pennsylvania electric cooperatives. According to UGI, its ACOSS, which allows for the development of the total revenue requirement by functions and classifications, demonstrated that residential customers have a monthly customer cost of $31.84. UGI also highlighted that this analysis indicated that the PA PUC Customer Cost function, which includes only those fixed costs historically allowed by the Commission in a customer charge, resulted in a monthly customer charge of $19.01. Further, UGI argued that its customer charge substantially addresses the cost to serve the residential class at an amount that is less than the comparable charges for other utilities. Therefore, UGI asserted that its proposed customer charge of $14.00 is reasonable. UGI M.B. at 152-54.

Both I&E and the OCA opposed UGI’s proposal to increase its residential customer charge to $14.00.

I&E recommended a customer charge of $10.00 per month for Rate R and Rate GS-5, representing a monthly increase of $4.50 for each. Based on these recommended customer charges, I&E also recommended single block usage rates of $0.036576 per kWh for Rate R and $0.033927 per kWh for Rate GS-5. I&E argued that its recommendations take the concepts of rate shock and gradualism into consideration, while UGI’s proposal violates these concepts. I&E M.B. at 78.

The OCA submitted that UGI’s monthly residential customer charge should only be increased to $8.00 per month. According to the OCA, UGI should only include costs in its calculation of the customer charge that are costs required to connect and maintain a customer’s account. The OCA alleged that UGI’s current proposal includes costs that are not appropriate to include, and which fail to provide price signals necessary to promote energy efficiency and conservation. Additionally, the OCA echoed I&E’s contention that UGI’s proposal is excessive and fails to reflect the principle of gradualism. OCA M.B. at 83-88.

The OCA also submitted that UGI’s proposed monthly customer charge will disproportionally harm low-income and low-use customers because it will (1) increase Customer Assistance Program (CAP) bills to customers who use the average monthly bill component of CAP, (2) reduce the buying power of Low-Income Home Energy Assistance Program (LIHEAP) for UGI’s Customers, and (3) increase bills to low-income customers not participating in a UGI bill affordability program. According to the OCA, because low-income customers in UGI’s territory tend to be low-use customers, UGI’s increased customer charge will result in an increase in bills for those who can least afford to pay those rate increases. OCA M.B. at 88-93.

UGI argued that both I&E’s and the OCA’s proposed customer charges are flawed and should be rejected because they ignore controlling precedent by attempting to advance gradualism considerations ahead of the cost to serve the residential class. According to UGI, gradualism concerns cannot be considered a valid reason to adopt an $8.00 or $10.00 customer charge, as each bears little or no relationship to the cost of service.[[13]](#footnote-13) In UGI’s view, because customers pay the entire rate, the concept of gradualism should be applied to the entire rate increase, and not just the individual components of the rate design. Additionally, UGI submitted that the OCA’s concerns regarding the impact of UGI’s proposed customer charge on low-income customers are meritless. UGI claimed that its usage data indicates that low-income customers use more electricity than its average customers. Thus, UGI argued that low income customers, both CAP and non‑CAP, will pay less under UGI’s proposed $14 customer charge with the corresponding consumption charge than they would under the OCA’s proposed customer charge with its alternative corresponding consumption charge. UGI M.B. at 154-160.

**b. Recommended Decision**

The ALJs recommended that UGI be permitted to increase its monthly residential customer charge from $5.50 to $14.00. Although they recognized that such an increase was not insignificant, the ALJs opined that the requested increase was not unreasonable given the results of UGI’s ACOSS and the length of time since its last rate increase. The ALJs also opined that while it is important to consider the principle of gradualism when evaluating increases in rates, gradualism concerns should not override cost of service considerations. In this regard, the ALJs concluded that UGI demonstrated that the residential class has been significantly underpaying, relative to its cost of service for many years. The ALJs determined that UGI properly calculated and included relevant costs as part of its customer cost analysis. The ALJs found this analysis to be consistent with public utility accounting, theory and cost causation principles, and with Commission precedent with respect to utility ratemaking in the Commonwealth. R.D. at 126-27.

The ALJs also found that to the extent gradualism factors into the allocation and design of rates, it should be considered in the context of the entire increase to a customer class rather than to an individual element or component of the rate design. Further, the ALJs rejected the OCA’s argument that UGI’s proposed residential customer charge will have a disproportionate impact on low-income, lower‑usage customers. Instead, the ALJs found that UGI presented evidence to support its position that low‑income customers use more electricity than UGI’s average customers and that low‑income customers will pay less under UGI’s proposed charge, with the corresponding proposed consumption charge, than they would under the OCA’s proposed customer charge, with its proposed corresponding consumption charge. R.D. at 127-28.

**c. Exceptions and Replies**

In its Exception No. 18, I&E submits that in recommending that UGI be allowed to increase its monthly residential customer charge to $14.00, the ALJs failed to properly consider the concept of gradualism. I&E emphasizes its position that gradualism is especially important in this proceeding given the period of time since UGI’s last base rate case. I&E contends that while the ALJs’ recommendation to make progress in moving the rate classes toward the system average relative rate of return may seem reasonable at first glance, UGI’s decision to stay out for twenty-two years complicates the application of the ALJs’ recommendation because it imposes an unreasonable increase in rates. Namely, I&E notes that the Company’s proposed increase in the residential customer charge represents an increase of 155%. I&E also submits that contrary to the ALJs’ ruling, gradualism and rate shock must be considered for individual components of a customer’s bill, particularly the customer charge component. In this regard, I&E reasons that because every customer pays a customer charge, UGI’s large requested increase will disproportionally negatively impact low usage customers. Therefore, I&E argues that its own recommended increase in the residential customer charge from $5.50 to $10.00 is more reasonable and should be implemented. I&E Exc. at 29-32.

In its Exception No. 11, the OCA maintains that UGI’s ACOSS is significantly flawed. As a result, the OCA posits that the Company’s ACOSS is not a valid basis for calculating its residential customer charge. The OCA takes issue with the ALJs’ finding that UGI properly calculated and included relevant costs as part of its customer cost analysis. The OCA remains of the opinion that UGI’s customer cost analysis includes costs that are not appropriate to include in a customer charge, including costs for universal service and uncollectible accounts. The OCA restates that UGI is permitted only to include costs that are required to connect a customer and maintain a customer account and that indirect customer costs should not be included in the customer charge. Additionally, like I&E, the OCA also asserts that the ALJs failed to give sufficient weight to the concepts of rate shock and gradualism in light of the lengthy period of time since UGI last increased its residential customer charge. Therefore, the OCA submits that its own recommended increase in the residential customer charge from $5.50 to $8.00 should be adopted. OCA Exc. at 35-37.

Further, the OCA takes issue with the ALJs’ findings that low-income customers use more electricity than the average residential customer and that these customers will pay less under UGI’s proposed customer charge. According to the OCA, the data UGI submitted actually demonstrates that low-income customers are, in fact, low-use customers. The OCA argues that the Company’s claims the ALJs relied on in reaching their finding are based solely on the usage data of UGI’s CAP participants. In the OCA’s view, the term “CAP customers” is a specific subset of the more general term “low-income” customers and may not be used interchangeably. Finally, the OCA argues that the ALJs failed to address the harms, which the OCA claimed in its Main Briefs, that would result from an increased customer charge. OCA Exc. at 37-39.

In its Replies to Exceptions, UGI asserts that the ALJs properly found that its proposed $14.00 residential customer charge is just and reasonable, is fully supported by UGI’s ACOSS, is consistent with the cost to serve residential customers, and properly reflects gradualism principles. UGI refutes the arguments of I&E and the OCA that its proposed increase would adversely impact low income customers. UGI maintains that it demonstrated that its proposed customer charge is more beneficial to low-income customers than either the OCA’s proposal or that of I&E. Additionally, UGI submits that I&E and the OCA ignore that gradualism applies to rates as a whole and not to the individual components or rate design. Further, UGI points out that because the ALJs recommended a revenue increase that is less than what the Company requested, the actual customer charge will be reduced as a result of the scale back, discussed, *infra.* UGI R. Exc. at 22-23.

**d. Disposition**

Upon our consideration of the evidence of record herein, we shall adopt the ALJs’ recommendation on this issue.[[14]](#footnote-14) In this regard, we find that UGI’s proposal is supported by the results of UGI’s ACOSS, which utilizes the same methodology that has previously been approved by the Commission, and which we have adopted in the instant proceeding. The record indicates that the residential class has been significantly subsidized by the other customer classes, relative to its cost of service. Thus, we find that UGI’s proposal is consistent with *Lloyd,* which held that rate structures should be adjusted to reflect the cost of service to each rate class and to eliminate cross-subsidization.

With regard to the alternative proposals of I&E that UGI’s customer charge should be increased to $10.00, and the OCA that UGI’s customer charge should be increased to $8.00 to account for gradualism and the avoidance of rate shock, we find them to be without merit. Rather, we concur with the ALJs that, as set forth in *Lloyd,* gradualism concerns should not trump cost of service considerations. As such, we echo UGI’s assertion that gradualism concerns cannot be considered a valid reason to adopt either I&E’s proposed customer charge or that of the OCA. The record demonstrates that these alternative proposed charges do not adequately adhere to cost of service principles.

At the same time, however, we find that UGI’s proposed customer charge does take gradualism concerns into account. As noted earlier UGI’s proposal, which would increase the residential customer charge by $8.50 per month, is not an insignificant increase. Nonetheless, the record indicates that UGI’s proposal results in a total Rate R increase of only 13.6%. *See* UGI Exhibit E-Proof of Revenue (Rebuttal). As the ALJs observed, we must consider gradualism in the context of the entire increase to a customer class, rather than to an individual element or component of the rate design. Further, by this Opinion and Order, we are ultimately approving a lower revenue increase than that sought by the Company. Accordingly, UGI’s actual customer charge that results from this revenue increase will be reduced as a result of the scale back that will be applied, which we discuss below.

We likewise are not persuaded by the assertion of the OCA that UGI improperly includes certain costs in its customer cost analysis and that increasing the fixed monthly charge does not send meaningful price signals to UGI’s customers regarding energy usage and conservation. Rather, we conclude that the OCA’s attempt to remove certain costs from UGI’s customer cost analysis is inconsistent with public utility accounting theory, cost‑causation principles, and the economics of efficient rates for a utility that is a declining cost firm and is contrary to precedent with respect to electric utilities in Pennsylvania. In our view, the OCA’s proposed rate design improperly attempts to prohibit the recovery of certain fixed costs through a fixed charge, based upon its contention that a greater portion of costs should be recovered through energy charges. *See* OCAM.B. at 84-87.We further conclude that the OCA’s attempt to shift the recovery of fixed costs from a fixed charge to a variable charge actually distorts pricing signals.

Additionally, we find no merit in the arguments of I&E and the OCA that UGI’s requested increase will have a disproportionate negative effect on UGI’s low income customers. Rather, we find that UGI has successfully rebutted the OCA’s assertion that low-income customers are low use customers. Namely, UGI proffered the following tables in the record, which we find particularly persuasive. We are of the opinion that these tables corroborate UGI’s position that all segments of UGI’s low‑income customers, regardless of whether or not such customers are enrolled in CAP programs, use more electricity on average than non-low-income customers, and that UGI’s low-income customers will pay less for their service under UGI’s proposed rate design than under the OCA’s.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Annual Electric Usage in Kwh** | | | | |
| **Year** | **CAP Customers** | **All Low-Income Including CAP** | **Non-Low Income Customers** | **Non-CAP Low-Income Customers** |
| 2015 | 15,865 | 13,125 | 10,511 | 12,104 |
| 2016 | 15,040 | 12,752 | 10,214 | 11,800 |
| 2017 | 15,523 | 12,986 | 10,022 | 11,826 |

UGI R.B at 66

|  |  |  |  |
| --- | --- | --- | --- |
| **Low Income Non-CAP Bill Impact** | | | |
|  | $8/Month Charge | $14/Month Charge |
| Customer Charge | $8.00 | $14.00 |
| Variable Charge | $0.03808 | $0.03077 |
| Average Monthly Usage | 993 | 993 |
| Usage Charge | $37.79 | $30.54 |
| Total Distribution Charges | $45.79 | $44.54 |
| Monthly Difference |  | ($1.26) |
| Annual Difference |  | ($15.06) |

|  |  |  |
| --- | --- | --- |
| **CAP Participants Bill Impact** | |  |
|  | $8/Month Charge | $14/Month Charge |
| Customer Charge | $8.00 | $14.00 |
| Variable Charge | $0.03808 | $0.03077 |
| Average Monthly Usage | 1,293 | 1,293.00 |
| Usage Charge | $49.24 | $33.79 |
| Total Distribution Charges | $57.24 | $53.79 |
| Monthly Difference |  | ($3.45) |
| Annual Difference |  | ($41.42) |

UGI M.B. at 160.

For all of the above reasons, UGI’s proposed increase in its residential customer charge, which will be reduced by the scale back, is adopted, and the Exceptions of I&E and the OCA on this issue are denied.

**2. Non-Residential Charges**

**a. Positions of the Parties**

Initially, UGI proposed to maintain the existing rate design for the General Service class. However, in response to certain criticisms of the OSBA, UGI adopted minor modifications to its ACOSS, which necessitated modifications to its proposed rate design proposal for Rates GS-1 and GS-4. More specifically, the OSBA proposed a total revenue increase of $606,680 for Rate GS-1, along with a customer charge of $14.00 per month, which results in a distribution rate of $0.04707/kWh. UGI also proposed a total revenue decrease of $520,672 for Rate GS-4, along with a customer charge of $15.00 per month, which results in $0.02222/kWh for the first block (first 200 hours of demand), $0.01533/kWh for the second block (next 300 hours of demand) and $0.01261/kWh for the third block (all hours over 500) and demand charges of $3.59/kWh for the first block (first 20 hours) and $2.20/kWh for the second block (over 20 hours). UGI submitted that these rates align with the OSBA’s proposal, are reasonable, and should be approved. UGI M.B. at 161-62.

UGI proposed no changes to the rate design for its Rate LP, Large power customer class, its Lighting customer class, or its Rate HTP customer class on the basis that no portion of its proposed increase was allocated to these classes. UGI submitted that various proposed modifications by the OSBA to its Rate LP rate design should be rejected, arguing that the OSBA provided no evidence that the current rate design, without these changes, is unreasonable. UGI M.B. at 162-64.

Additionally, UGI noted that the OSBA recommended that UGI include a merchant function charge (MFC) to recover supply related uncollectibles for default service on the basis that shopping customers may be required to pay for uncollectible expenses associated with default service. However, UGI claimed that it is not feasible or reasonable to implement this charge at present because very few residential customers currently participate in the Company’s Choice program, which would make implementing the MFC cost-prohibitive in light of the Company’s current focus on implementing high impact IT projects. UGI pointed out that the OSBA did not rebut these facts and submitted that OSBA did not meet its burden to demonstrate that this proposed charge is just and reasonable or should be implemented. UGI M.B. at 164-65.

The OSBA noted that UGI already has separate Rate GS-1 and GS-4 tariff schedules and clarified that it recommended that UGI continue to segregate those classes for cost allocation purposes. The OSBA acknowledged that UGI has generally accepted its proposed modifications for these classes. Additionally, the OSBA submitted that it proposed a zero increase for the Rate LP class, but simply made certain recommendations following the logic of its recommendations for its GS-4 rate class. Finally, the OSBA refuted UGI’s argument that because the OSBA did not submit surrebuttal testimony regarding the MRC it did not meet its legal burden of proof to justify this proposed charge. The OSBA averred that it considered the Company’s testimony and agreed that it was reasonable for UGI to defer the implementation of the MFC. OSBA R.B. at 11-13.

**b. Recommended Decision**

The ALJs found UGI’s rate design proposals for the GS-1 and GS-4 classes to be reasonable and recommended that they be adopted. The ALJs noted that UGI’s proposals result from its revised ACOSS, which they recommended be adopted, and the modifications made therein based on input from the OSBA. The ALJs also agreed with UGI’s proposal not to allocate any of its proposed revenue increase to the LP class. The ALJs determined that the OSBA failed to present convincing evidence that the current rate design is unreasonable. Additionally, the ALJs recommended that UGI’s rate design proposals for its Lighting Customer and Rate HTP classes be adopted given that no other party addressed these rate classes in their briefs. Further, the ALJs determined that implementation of an MFC for supply-related uncollectibles for default service should not be recommended at this time. The ALJs highlighted the agreement of the OSBA that it is reasonable to defer implementation of an MFC. R.D. at 129-30.

**c. Disposition**

No Party filed Exceptions to the ALJ’s Recommended Decision on this issue. Accordingly, we agree with the ALJ’s recommendation that adopts UGI’s allocation and proposed rate design for non‑residential customer classes.

## **D. Scale Back**

**1. Positions of the Parties**

Since we are approving a lesser revenue requirement than that sought by UGI, an important consideration is the determination of how the proposed revenue allocation will be affected by the scale back in rates.

UGI argued that although it believes that its proposed rate case is just and reasonable and should be approved, as filed, to the extent the Commission approves a rate increase less than that proposed by the Company, the scale back should be applied proportionally based on UGI’s proposed revenue allocation. UGI posited that the proportional scale back would apply to both proposed increases and proposed decreases. Additionally, with regard to rate design, UGI claimed that the scale back should first be applied to any proposed increase to any usage charges, then to any proposed increase to demand charges, and then to any proposed increase to customer charges. Further, UGI averred that any scale back should be based on UGI’s proposed rates and not the reduced customer charge rates proposed by I&E and the OCA. UGI M.B. at 165.

I&E recommended that the usage rates for the GS-5 and Rate R classes should be scaled back sequentially to produce specific revenue levels for each class first, and then I&E’s recommended $10.00 customer charge for each class should be scaled back, if required. I&E contended that its scale back methodology is based upon the fact that the recommended decrease to UGI’s requested customer charge has the effect of increasing the usage rates at the fully requested revenue increase. Accordingly, I&E posited that usage rates should be scaled back prior to any scale back of the customer charge. I&E M.B. at 79-80.

The OCA recommended that the rate increase for each rate class should be scaled-back proportionally based on the increase for each rate class if the total rate increase approved by the Commission is less than that requested by UGI. OCA M.B. at 93.

The OSBA recommended that any scale back be a traditional proportional scale back applied only to those classes that are assigned rate increases. The OSBA argued that there is no overwhelming need to give classes that are already assigned a rate decrease any additional relief. OSBA M.B. at 31.

**2. Recommended Decision**

The ALJs recommended that if the Commission approves a lesser revenue increase than the one sought by UGI, it should reduce UGI’s customer charges and usage rates proportionally to the percent increase the Company originally requested. The ALJs also recommended the adoption of UGI’s request that any scale back should be based on its proposed rates and not the reduced customer charges proposed by I&E and the OCA. R.D. at 131.

**3. Exceptions and Replies**

In its Exception No. 9, UGI pointed out that all Parties concur, and the ALJs did not dispute, that the overall revenue increase should be scaled back across all rate classes on a proportional basis. However, UGI is of the firm opinion that within each class, the scale back should be first applied to any proposed increase to usage charges, then to any proposed increase to demand charge, and then finally to any proposed increase to the customer charges should be adopted. UGI further contended that only after making the first two reductions, and determining that additional revenue must be achieved, should the Commission then reduce the proposed customer charges back toward current charges. UGI Exc. at 37-38

UGI submits that the ALJs’ scale back proposal would result in a residential customer charge that is disconnected from the cost to serve UGI’s customers. In this regard, UGI contends that its proposed scale back more closely aligns with the actual fixed costs to serve the residential class than does the ALJs’ proposal. In addition, UGI takes the position that the proportional scale proposal recommended by the ALJs is inconsistent with the ALJs’ reasoning that UGI’s proposed customer charge is not unreasonable. UGI Exc. at 38.

In its Exception No. 19, I&E objects to the ALJs’ recommendation to reduce the customer charges and usage rates proportionally to the present increase originally requested. I&E submits that usage rates should be scaled back prior to any scale back of the customer charge and that any scale back methodology used should be based upon the customer charges ultimately granted by the Commission. I&E also objects to the ALJs’ recommendation that the scale back should be based on UGI’s proposed rates and not the reduced residential customer charges proposed by I&E and the OCA. I&E emphasizes its recommended service charge of $10.00 per month. I&E Exc. at 32-33.

In its Replies to Exceptions, UGI submits that I&E’s Exceptions on this issue should be rejected and UGI’s scale back proposal should be approved. UGI R. Exc. at 24.

Conversely, in its Replies to Exceptions, I&E submits that its own scale back proposal should be approved and that UGI’s Exceptions on this issue should be denied. I&E R. Exc. at 24-25.

In its Replies to Exceptions, the OCA argues that the ALJs properly concluded that the scale back in this proceeding should be applied proportionally to rates. According to the OCA, disproportionally applying the scale back such that the customer charge is not scaled back along with other rates is not appropriate. Thus, the OCA claims that the Exceptions of UGI and I&E should both be denied. OCA R. Exc. at 18-19.

**4. Disposition**

On consideration of the record evidence in this proceeding, we shall adopt the recommendation of the ALJs that UGI should scale back its rates proportionally to the percent increase UGI originally requested. Although we have determined that UGI has considered the principle of gradualism in setting its proposed rates and that UGI’s proposed customer charge is not unreasonable, we nonetheless note that UGI’s proposed increase to the customer charge is not insignificant. Therefore, we find that, as a matter of fairness, the customer charge should be scaled back along with the other rates. UGI’s Exception on this point is denied. At the same time, as we have rejected I&E’s proposed customer charge, we find that I&E’s Exception to the ALJs’ recommendation that the scale back should be based on UGI’s proposed rates and not the reduced customer charges proposed by I&E and the OCA is without merit. Thus, we shall adopt the ALJs’ recommendation.

1. **Miscellaneous Issues**
2. **Quarterly Earnings Report**
3. **Positions of the Parties**

I&E challenged UGI’s method of calculating its QER, which pursuant to 52 Pa. Code § 71, *et seq.*, is filed on a quarterly basis when UGI is not in a base rate proceeding.In particular, I&E objected to the Company’s use of FPFTY ratemaking adjustments in the calculation of past QER, the last of which was filed about nine months ago, on November 30, 2017. For relief, I&E requested that the Company be prevented from using any projected plant adjustments in future QERs, the next of which will not be filed until May 31, 2019. I&E St. 5 at 8, 15; I&E M.B. at 85-92.

I&E presented witness testimony recommending that UGI not be permitted to include net plant and corresponding annual depreciation expenses related to plant not yet in service, including FTY and FPFTY plant, in any future QERs. According to I&E, QERs are supposed to give the Commission the ability to monitor on a regular basis the financial performance and earnings of regulated utilities. I&E submitted that UGI’s inclusion of FTY and FPFTY net plant and annual depreciation expense in its QERs does not give the Commission an accurate picture of financial performance because plant investments claimed for the FTY ending September 30, 2018, and the FPFTY ending September 30, 2019, have not been made and are not reflective of the Company’s actual operations in the September 30, 2017, reporting period. I&E St. 5 at 8, 15.

I&E argued that the Company’s inclusion of FTY and FPFTY net plant and annual depreciation expense in its QERs resulted in the following dramatic decreases in its ROR and ROE: an overall ROR of 4.94% rather than a correct ROR of 10.17%; and an ROE of 5.22% rather than a correct ROE of 14.9%. I&E St. 5 at 1-15; I&E St. No. 5-SR at 1-30. I&E asserted that the inclusion of future net plant and annual depreciation expense artificially lowered its ROR and ROE and thereby presented a more dire financial picture of its financial status than if the proposed FPFTY plant were not included. I&E M.B. at 89-90.

UGI opposed I&E’s recommendations for three reasons. First, the Company asserted that the challenge to the QER calculation is outside the scope of a base rate proceeding and should be excluded from this case. Second, UGI proffered that I&E’s recommendation raised policy issues which should not be decided without input from other impacted regulated utilities. Third, the Company argued that the Company’s calculation of the QER is consistent with ratemaking practices in Pennsylvania and does not need to be altered. UGI M.B. at 166-186.

1. **Recommended Decision**

The ALJs found in favor of UGI on this issue and gave little weight to the testimony of I&E’s witness, who recommended that UGI not be permitted to include net plant and corresponding annual depreciation expenses related to plant not yet in service, including FTY and FPFTY plant, in any future QERs. The ALJs found that challenges to UGI’s QER calculation are not within the scope of a base rate proceeding and that there are more appropriate remedies for the determination on the appropriate calculation of the QER. R.D. at 133-134.

1. **Exception and Reply**

In its first Exception, I&E objects to the ALJs’ recommendation and submits that this issue is ripe for decision in the instant proceeding because QERs provide valuable information to the Commission regarding a utility’s current performance and earnings. In I&E’s view, the purpose of the QER cannot be achieved if utilities are permitted to include projected plant from an FPFTY in a QER covering a period of time in the past. I&E submits that such projected plant additions and the associated depreciation dramatically understate the return on equity and the overall rate of return in the reported period. I&E Exc. at 3-6.

In its Reply, UGI reiterates its argument that this issue should be excluded from this proceeding and should not be decided without input from other utilities and stakeholders which would be affected by any policy change. UGI R. Exc. at 24-25.

1. **Disposition**

Upon review, we shall deny I&E’s Exception No. 1 and adopt the well-reasoned recommendation of the ALJs. We agree that any Commission decision on whether projected plant additions should be included in future QERs would have no impact on either the amount of increase granted in this proceeding, or on the allocation or rate design of that increase. Base rate cases and QER filings are separate proceedings with distinct filing requirements. For example, Chapter 53 of our Regulations, 52 Pa. Code Chp. 53, governs base rate proceedings, whereas Chapter 71 of our Regulations, 52 Pa. Code Chp. 71, governs the filing of QERs. QERs are only filed when a utility is not involved in a base rate proceeding. 52 Pa. Code § 71.4(c). Although I&E has described the various different RORs and those produced in the QER, none of these rates will impact the outcome of this rate proceeding. Consequently, the ALJs appropriately determined that I&E’s challenge to the QER calculation is not within the scope of a base rate proceeding.

Further, we agree with the ALJs that there are more appropriate remedies for determining the applicable QER calculation. In our view, I&E’s recommendation would be more suitably addressed and considered in the context of a QER filing proceeding or in a state-wide proceeding where all utilities that may be affected by resolution of this issue would have an opportunity to participate. Indeed, there was evidence presented that there are other regulated utilities calculating the QER in a manner similar to UGI indicating possible support for a state-wide proceeding. UGI St. 1-R at 10.

I&E retains the option of filing a complaint following UGI’s submission of its QER. Alternatively, I&E may petition the Commission to initiate an industry-wide rulemaking proceeding, which would allow all interested participants to provide the Commission with comments on the impact of adopting I&E’s recommendations for QER reporting in base rate proceedings. *See, e.g.*, *Pa. Pub. Util. Comm’n v. Pennsylvania-American Water Co*., Docket No. R-00932670 (Order entered July 26, 1994) at 120 (adopting the ALJ’s conclusion that the issues raised by the OCA were outside the scope of a rate case and would be better addressed in a statewide rulemaking proceeding).

1. **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 adopt the Joint Stipulation, grant, in part, and deny, in part, the Exceptions filed by UGI, I&E and the OCA, deny the Exception filed by the OSBA, and adopt the ALJs’ Recommended Decision, as modified, consistent with this Opinion and Order; **THEREFORE,**

**IT IS ORDERED:**

1. That the Exception of the Office of Small Business Advocate, filed on September 13, 2018, is denied, consistent with this Opinion and Order.

2. That the Exceptions of UGI Utilities, Inc. – Electric Division, filed on September 13, 2018, 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 September 13, 2018, are granted, in part, and denied, in part, consistent with this Opinion and Order.

4. That the Exceptions of the Bureau of Investigation and Enforcement, filed on September 13, 2018, are granted, in part, and denied, in part, consistent with this Opinion and Order.

5. That the Recommended Decision of Administrative Law Judge Administrative Law Judges, Steven K. Haas and Andrew M. Calvelli, issued on August 24, 2018, is adopted as modified by this Opinion and Order.

6. That UGI Utilities, Inc. – Electric Division shall not place into effect the rates, rules, and regulations contained in Tariff – Electric PA. P.U.C. Nos. 6 and 2S, as filed.

7. That UGI Utilities, Inc. – Electric Division 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 $3.201 million, to become effective for service rendered on and after October 27, 2018.

8. That UGI Utilities, Inc. – Electric Division 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.

9. That UGI Utilities, Inc. – Electric Division 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.

10. That UGI Utilities, Inc. – Electric Division is hereby directed to:

a. Refund to its ratepayers via a one-time credit per customer the 2018 tax savings of $212,677 resulting from the Tax Cuts and Jobs Act of 2017 plus interest at the residential mortgage lending rate specified by the Secretary of Banking in accordance with the Loan Interest and Protection Law, 41. P.S. §§ 101, *et seq.*; and

b. File any necessary tariff or tariff supplement pursuant to 66 Pa. C.S. § 1307(a) to implement the refund directed in Ordering Paragraph No. 10.a., above.

11. That, within sixty (60) days of the Commission’s Final Order, UGI Utilities, Inc. – Electric Division, shall file with the Commission a compliance filing demonstrating that it has complied with Ordering Paragraph No. 10 above, which filing shall demonstrate the total amount refunded, the manner of refund, and the amount of refund per class of ratepayer.

12. That UGI Utilities, Inc.- Electric Division is directed to file annual reports at this Docket with the Secretary’s Bureau and with the Commission’s Fixed Utility Financial Analyst Supervisor of the Bureau of Investigation and Enforcement by December 1 following the end of each fiscal year for the next five years, or until the implementation of new base rates in a subsequent rate case within this same time frame, for the following:

1. The annual vegetation management expenses and the status of hiring an additional crew pertaining to the increased costs as a consequence of the Emerald Ash Borer;
2. The actual Customer Owned Service program expenses and the number of facilities transitioned to customer ownership; and
3. The actual annual expenses associated with the hiring of three new employees as well as any reductions in expenses if any positions are eliminated.

13. That UGI Utilities, Inc. – Electric Division is permitted to retain its Act 40 of 2016 savings in the amount of $75,400 for the uses as specified by UGI Utilities, Inc. – Electric Division in its submissions in this case.

14. That, upon acceptance and approval by the Commission of the tariff supplements filed by UGI Utilities, Inc. – Electric Division, consistent with its Final Order, the investigation at Docket R-2017-2640058 be marked closed.

15. That UGI Utilities, Inc. – Electric Division 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.

16. That the complaint filed by the Office of Consumer Advocate in this proceeding at Docket Number C-2018-2646178 be dismissed and marked closed.

17. That the complaint filed by the Office of Small Business Advocate in this proceeding at Docket No. C-2018-2647268 be dismissed and marked closed.

18. That the complaint filed by Matthew Josefwicz in this proceeding at Docket Number C-2018-2647099 be dismissed and marked closed.

19. That the complaint filed by Barbara McDade in this proceeding at Docket Number C-2018-3000056 be dismissed and marked closed.

**BY THE COMMISSION,**



Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: October 4, 2018

ORDER ENTERED: October 25, 2018

**Pennsylvania Public Utility Commission**

**v.**

**UGI Utilities, Inc. – Electric Division**

**Docket No. R-2017-2640058**

**Commission Tables Calculating Allowed Revenue Increase**

**Table I Income Summary**

**Table IA Rate of Return**

**Table IB Revenue Factor**

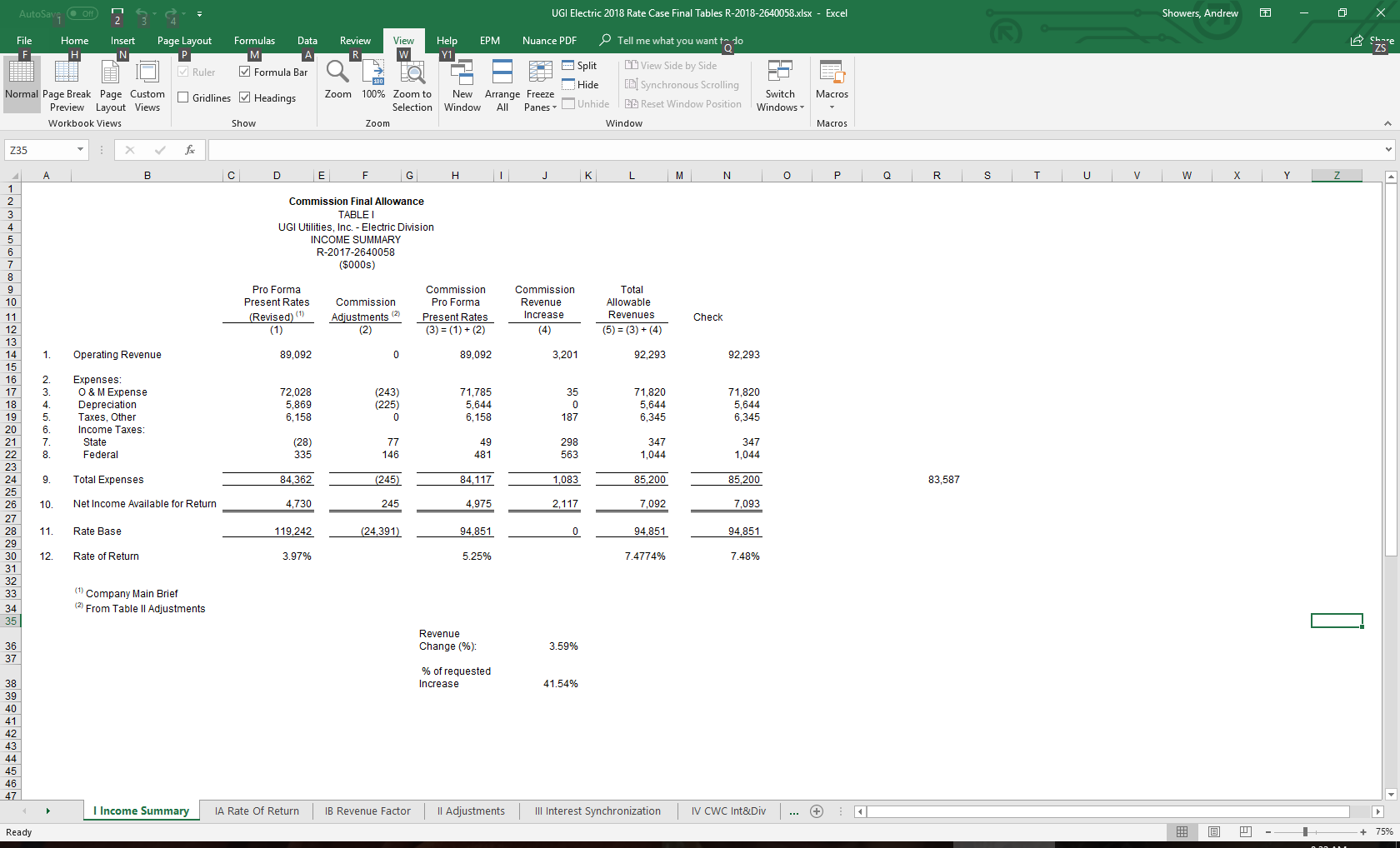
**Table II Adjustments**

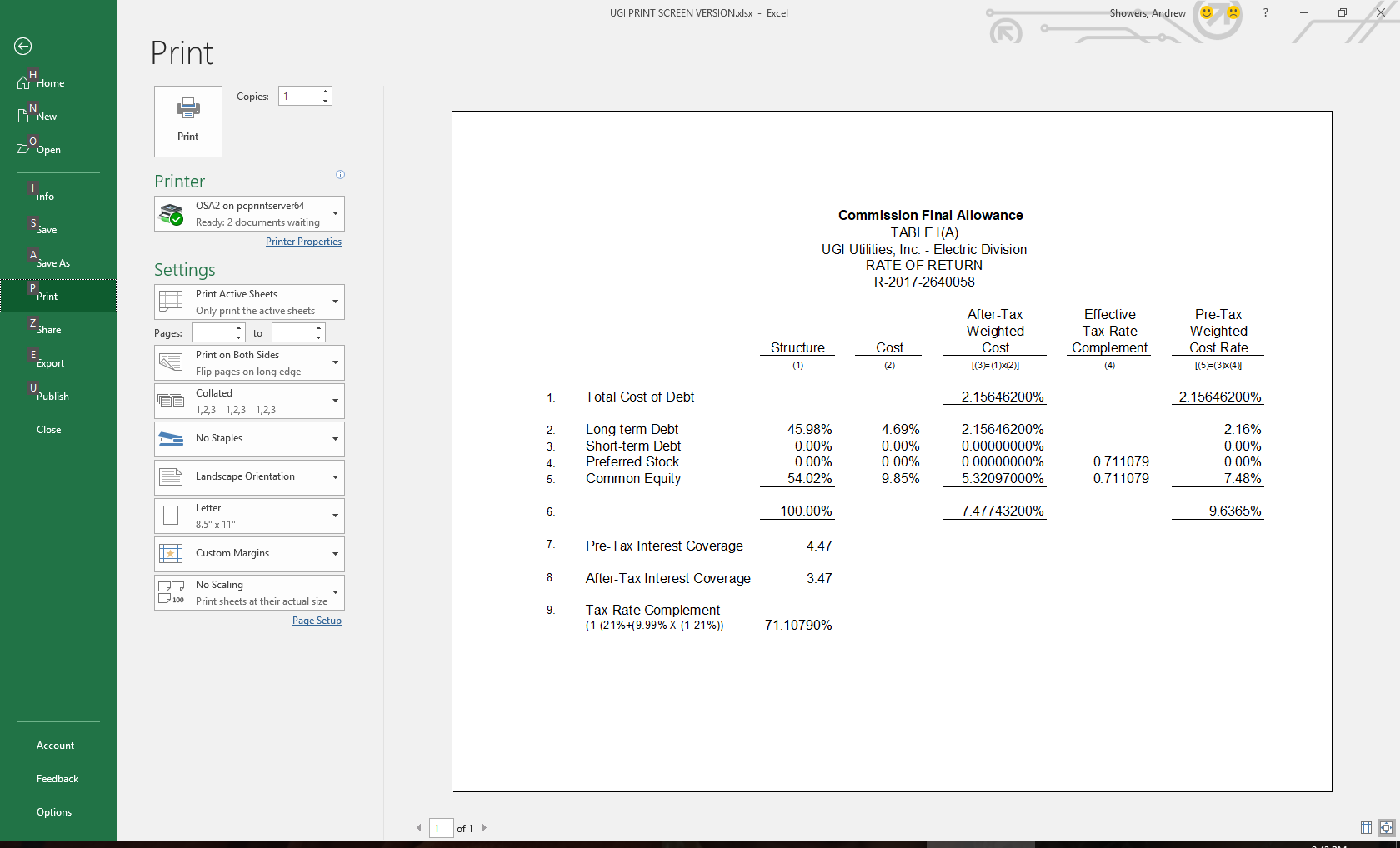
**Table III Interest Synchronization**

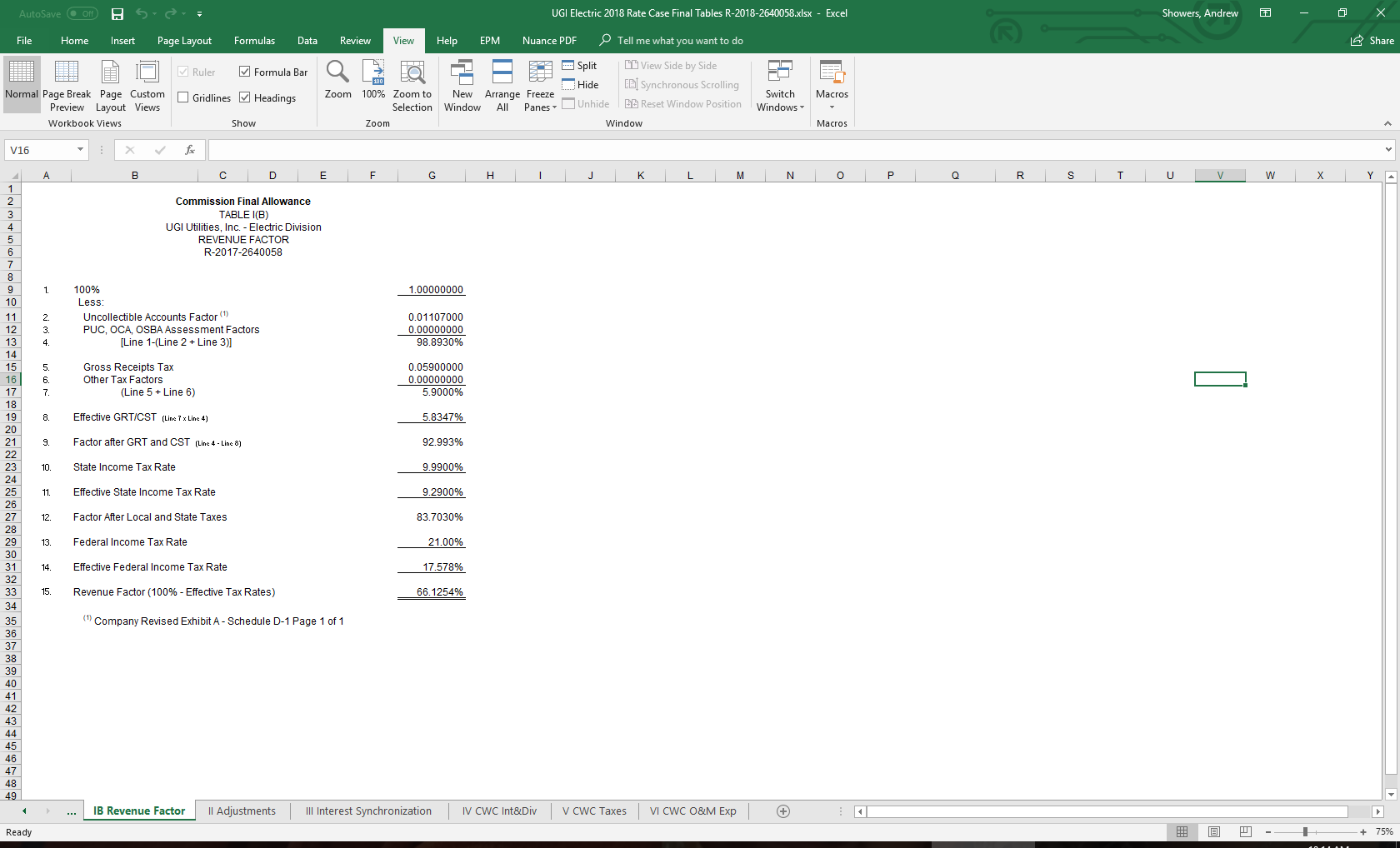
**Table IV Cash Working Capital: Interest and Dividends**

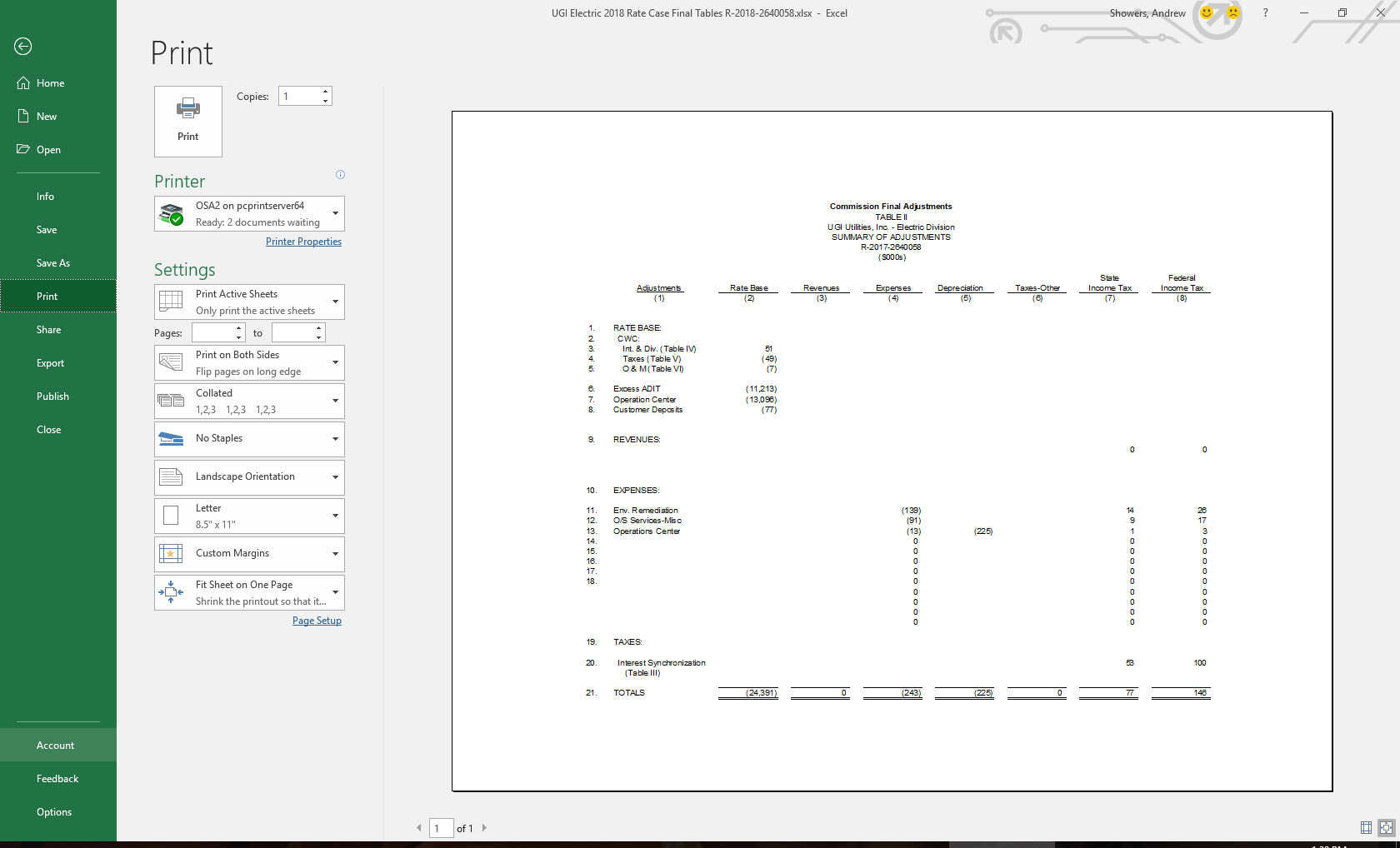
**Table V Cash Working Capital: Taxes**

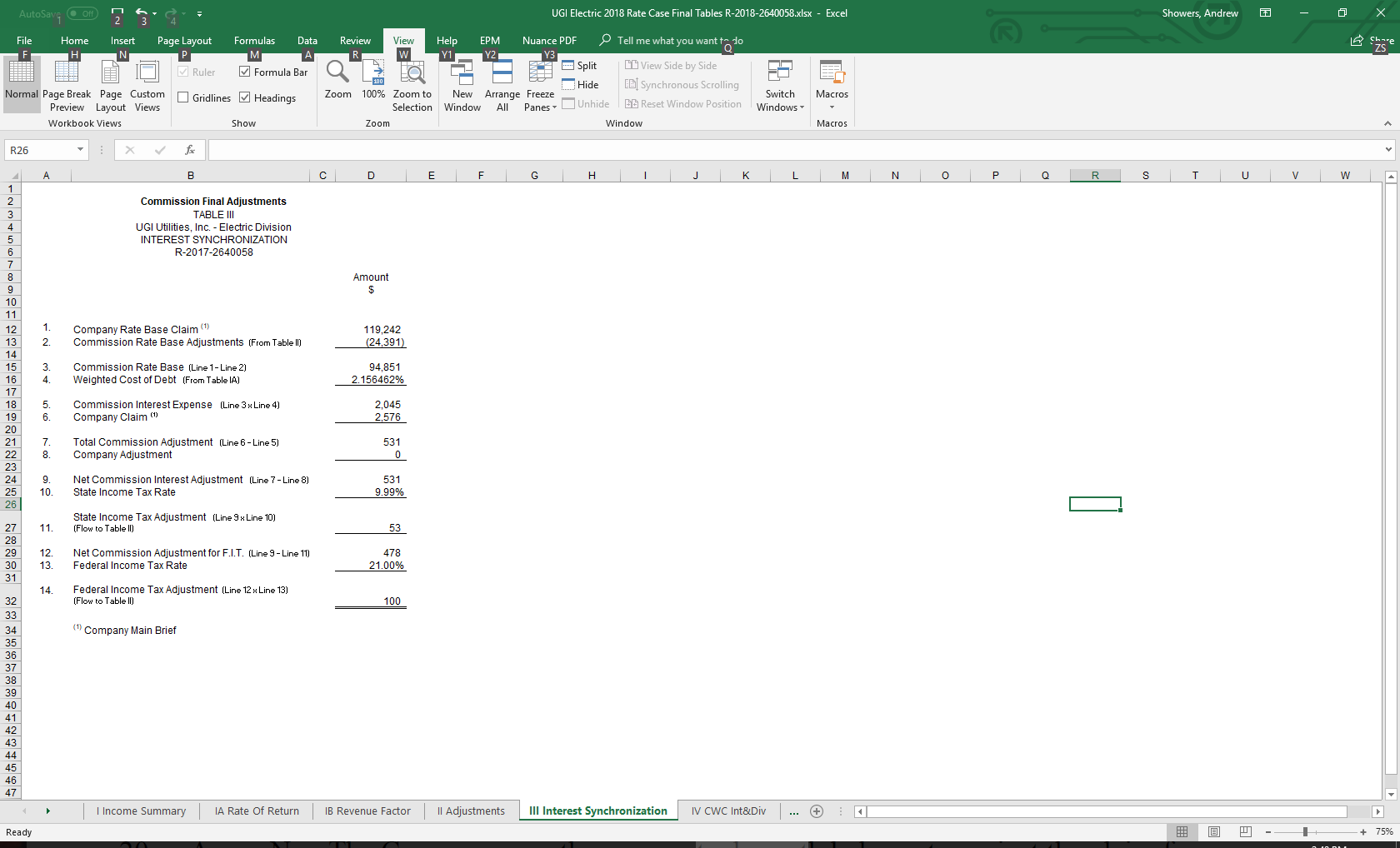
**Table VI Cash Working Capital: O&M Expense**

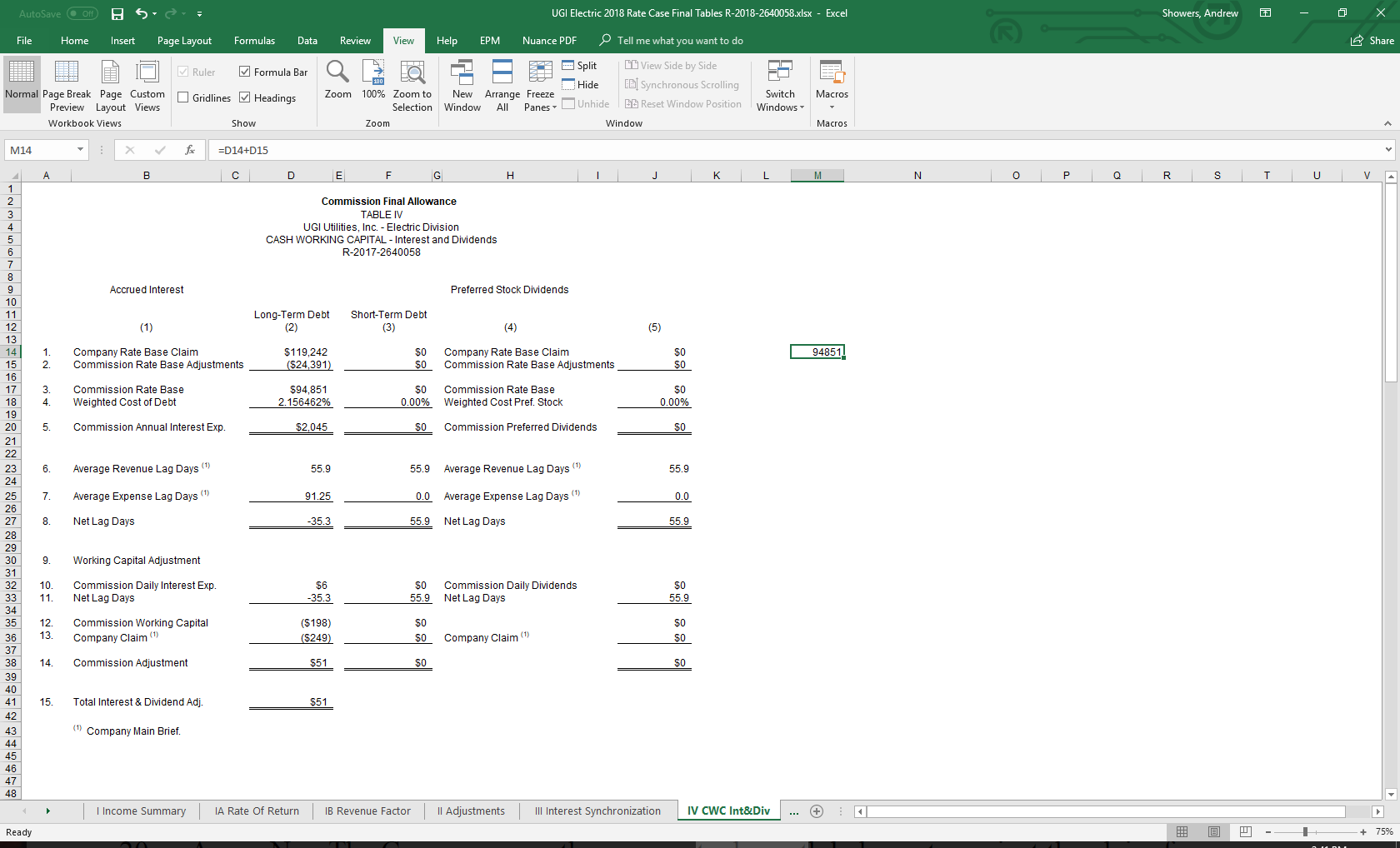


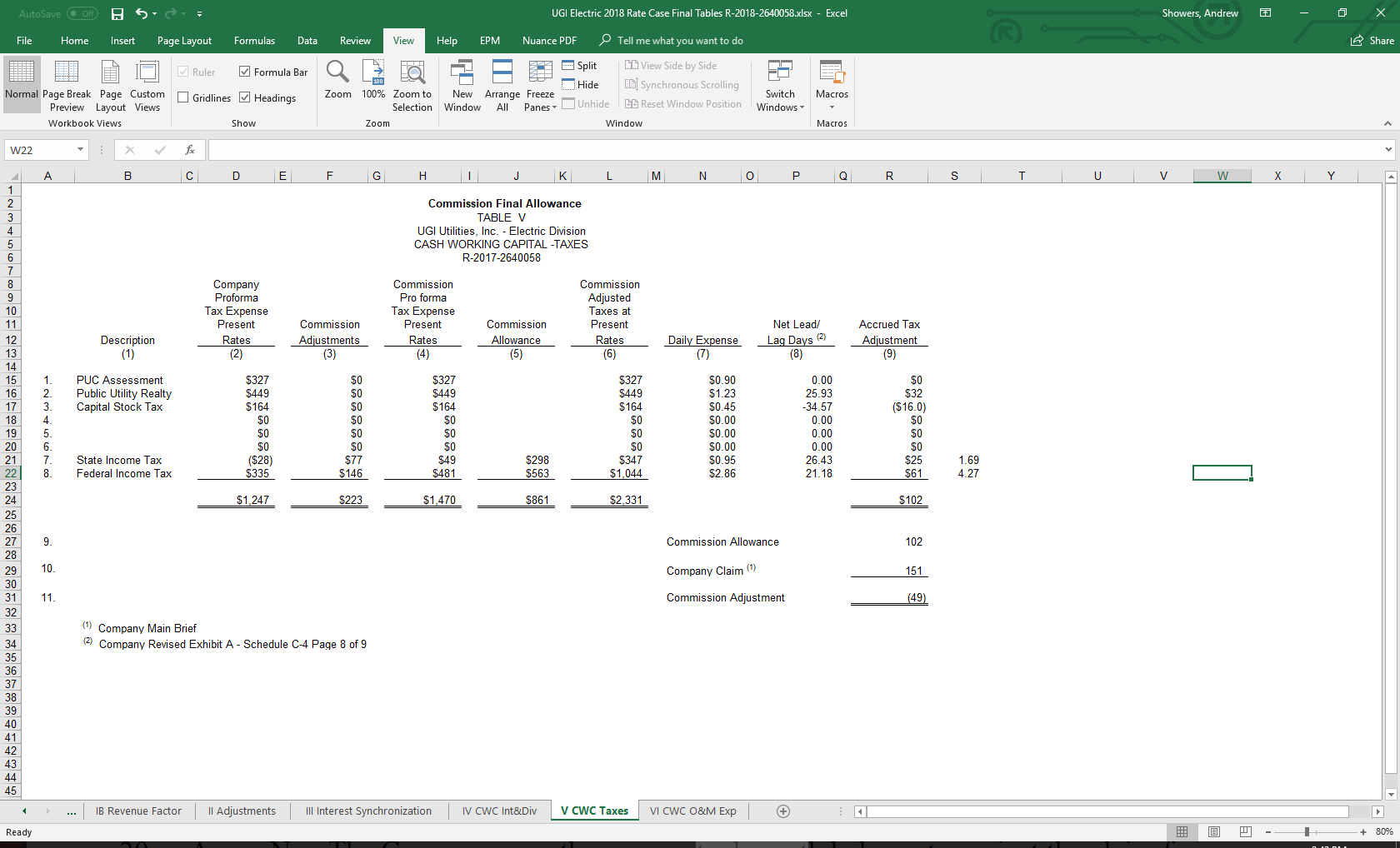


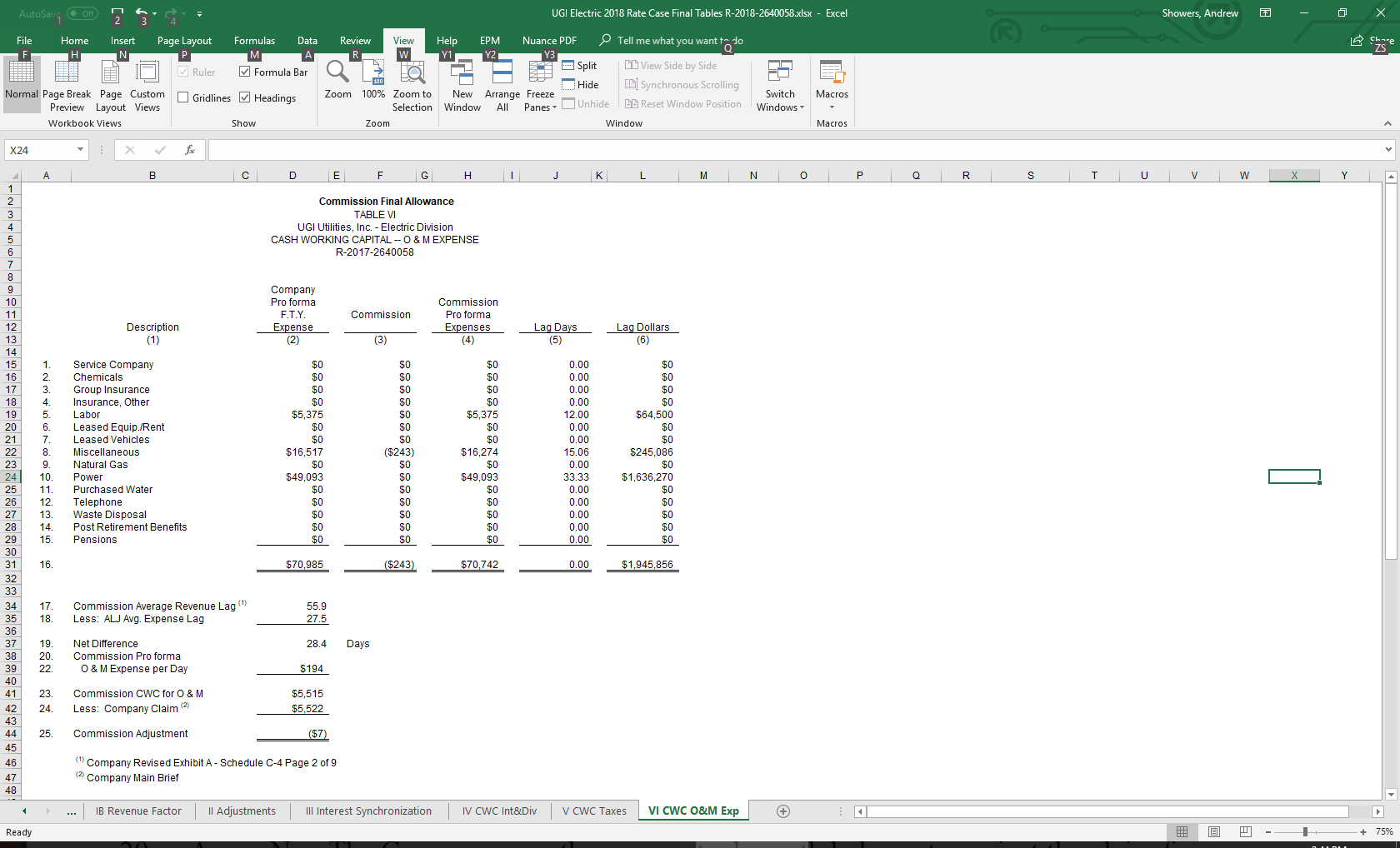












1. 1 Pa. C.S. § 1922(1), *PA Financial Responsibility Assigned Claims Plan v. English*, 541 Pa. 424, 430-431, 64 A.2d 84, 87 (1995). [↑](#footnote-ref-1)
2. For purposes of the Joint Stipulation, we shall refer to the settling parties as the Joint Petitioners. [↑](#footnote-ref-2)
3. The OSBA did not submit direct testimony on this issue but took the same position as I&E and the OCA in recommending an average rate base methodology. R.D. at 18. [↑](#footnote-ref-3)
4. The OCA calculated the average balances of plant in service, accumulated depreciation, and accumulated deferred income taxes using the balances from September 30, 2018, and September 30, 2019, and averaging both. The OCA argued that the effect of adjusting the rate base to reflect its proposed average balance methodology results in a reduction in rate base of $10.953 million. OCA St. 1 at 9. [↑](#footnote-ref-4)
5. Additionally, the ALJs correctly explained that the sections of the Illinois Administrative Code relied upon by the opposing Parties do permit the use of a year-end rate base where certain evidentiary requirements are met, which the Illinois Commission did not find applicable to the particular facts before it. *North Gas Company* at \*35. [↑](#footnote-ref-5)
6. The ALJs noted that based on average market stock prices and adjusting the OCA’s calculations for the “Altered Proxy Group” provides a dividend yield of 3.78%, an indicated cost of equity of 7.54%, and an implied growth rate of 3.79%. The ALJs also noted that based on the spot prices on March 31, 2018, the “Altered Proxy Group” has a dividend yield of 4.12%, an indicated cost of equity of 7.98%, and an implied growth rate of 3.86%. R.D. at 72. [↑](#footnote-ref-6)
7. I&E’s position regarding UGI’s QER is discussed in greater detail, *infra*. [↑](#footnote-ref-7)
8. *See* I&E St. 1 at 33-34; I&E St. 1-SR at 36. [↑](#footnote-ref-8)
9. More specifically, the OSBA proposed modifications related to (a) the separate allocation of Rate GS-1 and Rate GS-4 classes; (b) the classification of pole costs; (c) the classification of transformer costs; (d) the allocation of line transformer costs to secondary customers; and (e) the reallocation of meters for the lighting class. UGI considered all of these modifications minor and accepted them on the basis that they did not change the underlying methodology of the ACOSS. UGI M.B. at 139. [↑](#footnote-ref-9)
10. UGI also noted that it did not classify any of its electric distribution costs as energy related because none of its costs are caused by average or annual amounts of energy delivered by UGI. UGI M.B. at 138, n.26. [↑](#footnote-ref-10)
11. UGI explained that Rate GS5 is served under residential rates, which are identical to those proposed for Rate R in this proceeding. UGI M.B. at 151, n.35 [↑](#footnote-ref-11)
12. UGI noted that since the Lighting class is charged a flat fee because it is unmetered, the above table does not include the Lighting class. *Id*. at 151, n.31. [↑](#footnote-ref-12)
13. In its Main Briefs, UGI argued that I&E’s recommended $10.00 charge for Rate GS-5, which applies to general service customers taking service under the residential schedule, should be rejected for the same reasons as its recommendation regarding the Rate R customer charge. UGI M.B. at 154, n.39. [↑](#footnote-ref-13)
14. At the outset, we note that our disposition and analysis herein shall apply equally to UGI’s proposal to increase the customer charge for its GS-5 customer class. [↑](#footnote-ref-14)