**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17120**

Public Meeting held April 16, 2020

Commissioners Present:

Gladys M. Brown Dutrieuille, Chairman

David W. Sweet, Vice Chairman

Andrew G. Place, Dissenting in part, Statement

John F. Coleman, Jr.

Ralph V. Yanora

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| Pennsylvania Public Utility CommissionOffice of Consumer AdvocateAthens BoroughSouth Waverly BoroughLarry E. Colev.Valley Energy, Inc. | ::::::::: | R-2019-3008209C-2019-3011850C-2019-3012397C-2019-3012396C-2019-3012219 |

**OPINION AND ORDER**

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**BY THE COMMISSION:**

Before the Pennsylvania Public Utility Commission (Commission) for consideration and disposition is the Recommended Decision (R.D.) of Administrative Law Judges (ALJs) Steven K. Haas and Benjamin J. Myers, issued on February 28, 2020 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 March 12, 2020 by the Commission’s Bureau of Investigation and Enforcement (I&E), and on March 13, 2020,[[1]](#footnote-1) by the following Parties: Valley Energy, Inc. (Valley or Company), the Office of Consumer Advocate (OCA), and the Office of Small Business Advocate (OSBA). On March 23, 2020, Valley, I&E, and the OCA filed Replies to Exceptions.

As discussed below, Valley proposed a base rate change that would have increased its annual revenues by $745,079, or 14.7%, based on a fully projected future test year (FPFTY) ending December 31, 2020. In this Opinion and Order, we shall approve an annual revenue increase of $469,097, or 9.27%. Additionally, the Company proposed to increase its monthly residential customer charge from $10.50 to $12.79. Although we shall approve the Company’s proposed rate design, this Opinion and Order directs Valley to scale back its rates to correspond proportionally with the percent increase originally requested.

# **Background**

Valley is a public utility and an investor-owned natural gas distribution company (NGDC) as those terms are defined in the Pennsylvania Public Utility Code (Code), 66 Pa. C.S. §§ 102 and 2202. C&T Enterprises, Inc. (C&T), of which Valley is a wholly-owned subsidiary, is a holding and management services company that also owns Wellsboro Electric Company (Wellsboro) and Citizens’ Electric Company of Lewisburg (Citizens’). C&T formed Valley to purchase the assets of Valley Cities Gas Service, (Valley Cities) and Waverly Gas Service from NUI Corporation. The two public utilities operate as an integrated system, receiving all natural gas supplies through a single city gate[[2]](#footnote-2) located in Pennsylvania. Valley became the owner of the system in November 2002. The Company’s service territory is predominantly concentrated in Sayre and Athens Pennsylvania, and the surrounding areas of Bradford County. As of December 31, 2018, Valley served 6,942 customers, of which 6,058 were residential, 812 were commercial and industrial, and 72 were transportation customers.

Valley seeks approval of an increase in its annual jurisdictional natural gas distribution revenues of $745,079. The Company’s requested increase is based on a FPFTY ending December 31, 2020, and is designed to provide the Company with an opportunity to earn a 7.72% overall rate of return, including a 10.60% return on common equity, on a claimed rate base of $17.179 million.

Valley asserts that it conducted an analysis of whether the Company's base rates are sufficient to compensate the Company for the costs that it incurs to provide natural gas delivery and transportation service to its customers. Valley explains that while the Company earned a rate of return (distribution only) of 9.24% in 2018, it projected a rate of return for 2020 of only 4.64%, absent rate relief. According to Valley, this represents a return that will be insufficient to support the Company’s long-term health.

# **History of Proceeding**

On July 1, 2019, Valley filed Supplement No. 49 to Tariff Gas – Pa. PUC No. 2 (Supplement No. 49), to become effective August 30, 2019. In Supplement No. 49, Valley proposed changes to its base retail natural gas distribution rates designed to produce an increase in revenues of $1,034,186, based upon data for the FPFTY ending December 31, 2020. On July 29, 2019, Valley filed replacement schedules and tariff pages that updated its annual natural gas distribution revenue increase to $834,546. On August 2, 2019, Valley filed its Direct Testimony and Exhibits. Thereafter, in its Rebuttal Testimony, Valley revised its proposed revenue increase to approximately $745,000, reflecting rate of return, expense, and rate base adjustments to the as-filed request.

Notices of Appearances were filed by I&E on July 19, 2019, and by the OSBA on July 22, 2019. Formal Complaints against the proposed rate increase were filed by the OCA, on July 30, 2019; Larry E. Cole, on August 14, 2019; South Waverly Borough on August 19, 2019; and Athens Borough, on August 19, 2019.

By Order entered on August 29, 2019, the Commission instituted an investigation to determine the lawfulness, justness, and reasonableness of the proposed rate increase and the tariff was suspended until March 30, 2020.

On September 10, 2019, Valley filed a tariff supplement voluntarily extending the suspension period until April 29, 2020. On October 2, 2019, Valley filed an updated tariff supplement voluntarily extending the suspension period until May 1, 2020.

On October 15, 2019, I&E, the OCA, and the OSBA submitted direct testimony and associated exhibits. On November 14, 2019, Valley, the OCA, and the OSBA submitted rebuttal testimony and associated exhibits. On November 15, Valley filed an Errata to its rebuttal testimony. On December 4, 2019, Valley, I&E, the OCA, and the OSBA submitted surrebuttal testimony. On December 13, 2019, the OCA submitted revised surrebuttal testimony.

A telephonic public input hearing was held on November 4, 2019. Two witnesses testified during the public input hearing. Valorie Huckabee, Borough Manager, testified on behalf of South Waverly Borough; and Mark Burgess, Borough Manager, testified on behalf of Athens Borough. Both witnesses argued against Valley’s proposed rate increase.

Evidentiary hearings were held on December 16 and 17, 2019, during which rejoinder testimony was presented by Company witnesses and certain witnesses were made available for cross-examination. The evidentiary hearings were held jointly with rate cases filed by Wellsboro and Citizens’ at Docket Nos. R-2019-3008208 and R‑2019‑3008212, respectively.[[3]](#footnote-3) All prepared Statements and Exhibits were entered into the record by verification or by witness authentication.

Valley, I&E, the OCA and the OSBA filed Main Briefs on January 8, 2020, and Reply Briefs were filed by Valley, I&E, and the OCA on January 22, 2020. The OSBA filed its Reply Briefs on January 23, 2020, and the record was closed upon the filing of the Parties’ Reply Briefs.

In their Recommended Decision issued on February 28, 2020, the ALJs recommended that the Company be permitted to file tariffs or tariff supplements containing rates designed to produce a $497,080 or approximately 9.82% increase over its present annual operating revenues. R.D. at 1, 93.

As previously noted, I&E timely filed Exceptions on March 12, 2020 and Valley, the OCA, and the OSBA timely filed Exceptions on March 13, 2020. Additionally, Valley, I&E, and the OCA timely filed Replies to Exceptions on March 23, 2020.

# **Legal Standards**

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

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

The Commission is required to investigate all general rate increase filings. *Popowsky*, 683 A.2d at 961.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Additionally, Section 315(a) of the Code, 66 Pa. C.S. § 315(a), cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose. Inasmuch as the Legislature is not presumed to intend an absurd result in interpretation of its enactments,[[5]](#footnote-5) 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)

# **Rate Base**

As discussed above, Valley has requested that the Commission approve an increase in annual jurisdictional operating revenues of $745,079. The Company bases this increase on a FPFTY ending December 31, 2020, which is designed to provide Valley with the opportunity to earn a 7.72% overall rate of return on rate base, including a 10.60% return on common equity, on a claimed rate base of $17,179,542. Valley M.B. at Appendix A, Table I and II. The Company also provided data for the historic test year (HTY) ending December 31, 2018 and the future test year (FTY) ending December 31, 2019. Valley St. 1 at 2-4.

Valley argued that its final claimed rate base of $17,179,542 reflects all adjustments adopted by the Company in this proceeding. The claimed rate base consists of:

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

The Company explained that I&E proposed changes to CWIP, but did not dispute any other rate base components, while the OCA proposed adjustments to Plant in Service, CWIP, Materials and Supplies, Customer Deposits, Depreciation Expense, and EDIT. Valley M.B. at 15. This is discussed in more detail below.

## **Utility Plant in Service and FPFTY**

Act 11 of 2012, which is codified in Section 315 of the Code, 66 Pa. C.S. § 315 (Act 11), took effect on April 14, 2012. Act 11 amended the burden of proof requirements in rate proceedings by authorizing a utility to employ an FPFTY to meet its burden. 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. 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).

### **1. End of Year vs. Average Rate Base Methodology**

A threshold issue is whether Valley 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, the OCA recommended using an average rate base methodology. Neither I&E nor the OSBA specifically addressed this issue.

**a. Position of Parties**

Valley’s claim for original cost utility plant in service of $34,714,831 was based on projected plant in service at the end of the FPFTY, *i.e.*, December 31, 2020. Valley contended that the plain language and policy of Act 11 fully supports the use of end of test year balances. Valley stressed that Act 11 does not contain a separate provision for the FPFTY, but instead adds the FPFTY to the existing statute, thus authorizing the use of an FTY. Valley noted that when a company only utilizes an FTY, it is standard ratemaking practice to use end of test year balances for determining plant in service. Valley reasoned that Act 11 provides no indication that the FPFTY plant balances should be calculated differently. Valley further submitted that the Pennsylvania General Assembly: (1) expressly indicated that the FPFTY may include plant projected to be in service *during* the FPFTY; and (2) specifically noted that Section 1315 of the Code, which sets forth the “used and useful” standard, provides no bar to including in rate base all plant added during the FPFTY. As such, Valley asserted that the General Assembly clearly allowed for the FPFTY to be treated the same as the FTY in calculating plant in service. Valley M.B. at 16, 19.

The Company states that its rate base claim based on plant projected to be in service at the end of the FPFTY comports with other Commission precedent providing that rate base items should be calculated as of the end of the given test year. More specifically, Valley cited to the Commission’s recent decision in *Pa. PUC, et al. v. UGI Utilities Inc. – Electric Division*, Docket Nos. R‑2017-2640058, *et al*. (Order entered October 25, 2018) (*UGI*), which was upheld by the Commonwealth Court in *McCloskey v. Pa. PUC*, 1549 C.D. 2018 (Pa. Cmwlth. January 25, 2020) (*McCloskey*). Valley M.B. at 16, 17. Valley argued that in *UGI,* the Commission stated the following in rejecting the arguments of the OCA based on Section 1315 of the Code, which requires electric utility projects to be “used and useful” before being included in the rate base:,

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.

*Id.* at 18 (citing *UGI* at 23).

The Company also asserted that the Commission stated that by using an FPFTY, “a utility is essentially permitted to require ratepayers to pre-pay a return on its projected investment in future facilities.” Valley M.B. at 18 (citing *UGI* at 24). Therefore, Valley took the position that the OCA’s proposed average rate base methodology, *infra,* would dramatically weaken the benefits provided by the General Assembly in adopting Act 11, because that would effectively deny half of the rate recovery by disallowing half of the additions budgeted between the end of the FTY and the end of the FPFTY. Valley M.B. at 20-21.

Although the OCA acknowledged that the Commission decided against the use of an average rate base in *UGI*, the OCA, nonetheless, submitted that Valley has not met its burden to demonstrate that the use of the end-of-year methodology for rate base results in just and reasonable rates. Namely, the OCA reasoned that while Section 315 of the Code permits capital investments that are not used and useful on the first day of new rates to be included in a utility’s rate base during the FPFTY, Act 11 does not remove the requirement under Section 1301 of the Code, 66 Pa. C.S. § 1301, that rates be just and reasonable. The OCA asserted that prior to Act 11, utilities were permitted to use an HTY and an FTY. The OCA argued that an HTY includes all of the utility’s revenues, expenses, and other rate base eligible investments from an historic period defined as the prior twelve months. The OCA continued, that an FTY allows utilities to project out their anticipated revenues, expenses, and other rate base eligible investments to approximately the time that new rates become effective, at which point they will be historic. In contrast, the OCA stated that the FPFTY allows for a utility to project out its revenues, expenses, and other rate base eligible investments a full twelve months past the date that new rates become effective. 66 Pa. C.S. § 315(e). Therefore, the OCA submitted that, unlike the FTY, projections made under the FPFTY remain projections until one year after the new rates take effect. OCA M.B. at 11-15.

Based on the above, the OCA claimed that the end-of-year method will allow Valley to over-earn on its investment in the FPFTY. For this reason, the OCA remained of the opinion that the average rate base method should be used because it recognizes that capital investments will be made throughout the first year that new rates are in effect. Accordingly, the OCA submitted that the Commission should utilize the average rate base method for determining Valley’s rate base. The OCA explained that its proposed change from the Company’s filed end-of-test-year rate base to the OCA’s proposed use of an average rate base would decrease the Company’s utility plant in service by $839,474 from $34,714,831 to $33,875,357. OCA M.B. at 16.

**b. ALJs’ Recommendation**

The ALJs agreed with Valley that the use of the FPFTY is appropriate and supported by law. The ALJs found that the Company correctly cited to *UGI,* as upheld by the Commonwealth Court in *McCloskey,* for the premise that a FPFTY can be used even though some of the utility plant in service might not be operational until the latter part of the FPFTY. According to the ALJs, the Parties in this proceeding, and all subsequent rate proceedings, are bound by the Commission’s decision in *UGI.* The ALJs also disagreed with the OCA’s argument that Section 1301 of the Code should override the Company’s rate claims because those claims are allegedly unjust and unreasonable. The ALJs found that the OCA made no specific factual arguments in support of its contention that the Company’s end-of-year methodology results in unjust or unreasonable rates or permits the Company to over-earn on its investment. Finally, the ALJs noted that no other parties to this proceeding objected to the Company’s use of the end-of-year methodology or its use of the FPFTY. For these reasons, the ALJs found in favor of Valley on this issue. R.D. at 10‑11.

**c. Exceptions and Replies**

The OCA, in its Exception No. 1, maintains its position that in order to comply with the standard that rates be just and reasonable, the rates must be set based on the average rate base projected to be used and useful in the FPFTY. The OCA posits that in finding that subsequent rate proceedings are bound by the Commission’s decision in *UGI,* the ALJs misstated the Commonwealth Court’s conclusion in *McCloskey*. In this regard, the OCA argues that the Commonwealth Court did not conclude that an average rate base could never be used, but only that this was a matter within the Commission’s discretion and that the Commission’s finding in *UGI* was not erroneous. OCA Exc. at 2‑3 (citing *McCloskey* at 24-29). Therefore, the OCA submits that the Commission should consider the record and arguments in this proceeding, on their own merits, independent of the findings in *UGI* and *McCloskey.* The OCA claims that when an independent review of the record is conducted, it clearly indicates that the Company’s earnings will be overstated if the end-of-year method is used, and will cause ratepayers to overpay the revenue requirement, resulting in unjust and unreasonable rates that directly conflict with Section 1301 of the Code. In contrast, the OCA insists that the average rate base proposal properly reflects that plant is added throughout the year and not all at once on the first day of new rates. The OCA further submits that if its average rate base position is adopted, accumulated depreciation, depreciation expense, and CWIP should be adjusted accordingly. OCA Exc. at 3-5.

In its Replies to Exceptions, Valley characterizes as inapposite the OCA’s argument that the ALJs erred in deeming the Commission’s decision in *UGI,* as upheld in *McCloskey*,to be binding on the Parties. Valley explains that, while it agrees with the OCA that the Commission reserves discretion to overturn its Opinion and Orders, it also avers that the ALJs’ use of the word “binding” was intended to refer to the Commission’s obligation to render consistent opinions and to either follow, distinguish, or overrule its precedent. Applying this to the present matter, Valley submits that the OCA failed to distinguish the facts at issue in the instant case from those addressed in *UGI.*  Rather, Valley argues that the OCA has merely reiterated the arguments it made in *UGI,* which the Commission had rejected. Therefore, Valley contends that the Commission should deny the OCA’s Exception No. 1 and adopt the Company’s end-of-year rate base methodology. Valley R. Exc. at 3-4.

**d. Disposition**

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

We begin by noting that in developing rates, a utility uses a test year, which is a snapshot of time that reflects the typical conditions, revenues, expenses, and capital costs of the utility. *See McCloskey* \*2 (citing *Green v. Pa. PUC*, 473 A.2d 209, 213-15 (Pa. Cmwlth. 1984) (describing generally items within a test year); citing also *City of Pittsburgh v. Pa. PUC*, 112 A.2d 826, 832 (Pa. Super. 1955) (indicating that a condition to be considered in examining a test year is the weather during that year)). A utility may use a HTY, the year prior to the filing of the rate case, a FTY, the year ending shortly before the date the new rates would go into effect, or a FPFTY, which is “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) [(a period not to exceed seven months.)]” 66 Pa. C.S. § 315(e); *see also McCloskey* at \*2-3.

The Commission determines the utility’s rate base as measured by the aggregate value of all the utility’s property “used and useful” and “in service to the public” during the test year. 66 Pa. C.S. § 1315. To determine the amount of the utility’s rate base using a FPFTY, the Commonwealth Court has stated:

Under Section 315(e)’s plain language, a utility can include in its rate base, if permitted by the Commission, the costs of facilities that are not yet in service, but that are projected to be in service during the 12-month period beginning with the first month the new rates will be in effect.

*McCloskey* at \*11 (affirming *UGI*); citing 66 Pa. C.S. § 315(e)).

Applying this to the matter before us, we find that the ALJs correctly noted that the OCA’s argument has already been rejected in *UGI*, which has been recently upheld by the Commonwealth Court’s *McCloskey* decision. We agree with the ALJs that the OCA has failed to distinguish the facts at issue in this case from the facts addressed in *UGI* and the OCA presented no new evidence or arguments that would merit revisiting our decision in *UGI*.

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

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

## **Accumulated Depreciation and Plant Retirements**

**1. Position of Parties**

Valley’s rate base claim included a claim for accumulated depreciation of $16,499,533 for the FPFTY. Valley explained that accumulated depreciation is calculated by adding its annual depreciation expense at the end of each year and subtracting retirements from the previous year-end balance. Valley stated that the distinction between the OCA’s position and the Company's position on accumulated depreciation is a direct result of the two Parties’ different approaches to calculating the original cost plant in service. Valley reinforces its position that original cost plant in service should be calculated based on the FPFTY year-end balance. Valley M.B. at 20‑21.

The OCA argued that during historical periods, the activity for each year includes plant additions and retirements in the determination of the year-end balances for the FTY and the FPFTY. According to the OCA, the exclusion of retirements causes the year-end balances to be overstated. Therefore, the OCA recommended modifications to Valley’s proposed retirements and contributions of plant in service in the FTY and FPFTY. The OCA stated that there will also be a corresponding effect on accumulated depreciation. Consequently, the OCA proposed to adjust the Company’s year-end plant in service and accumulated depreciation to reflect the plant retirement amounts for 2019 and 2020 of $38,410 and $17,250, respectively. The OCA argued that after reflecting these reductions, the total downward adjustment to plant in service and accumulated depreciation is $55,659 and $56,678, respectively. Finally, the OCA argued that adjusting the year-end plant in service and accumulated depreciation to reflect the average FPFTY amounts in rate base results in downward adjustments of $783,815 and $544,153, respectively. OCA M.B. at 16-17.

As to the OCA’s proposed adjustments to the Company’s calculations of plant in service and accumulated depreciation to account for plant retirements, Valley retorted that these adjustments do not materially impact the Company’s rate base claim. Therefore, the Company asserted that its plant in service and accumulated depreciation calculations should be approved, without modification. Valley M.B. at 15-16; Valley R.B. at 3.

**2. ALJs’ Recommendation**

The ALJs found that the record is devoid of adequate evidence to support the OCA’s recommended downward adjustment to accumulated depreciation. The ALJs noted that they previously ruled in Valley’s favor as to the end-of-year rate base methodology. Consistent with this finding, the ALJs also found in the Company’s favor as to its claim for accumulated depreciation and recommended that this claim be approved. R.D. at 12-13.

**3. Exceptions and Replies**

As noted above, in its Exception No. 1, the OCA remains of the opinion that the Commission should adopt the average rate base methodology along with its corresponding proposed adjustment to the Company’s claim for accumulated depreciation. OCA Exc. at 2-5.

In its Exception No. 2, the OCA also takes issue with the ALJs’ discussion of its proposed adjustments for plant retirements. More specifically, the OCA argues that while the ALJs addressed, at length, the Parties’ positions on accumulated depreciation, the ALJs only briefly noted the OCA’s proposed adjustments for plant retirements under their discussion of the end-of-year versus average rate base methodology, *supra,* but did not otherwise address it. As such, the OCA submits that the ALJs misunderstood the OCA’s claim regarding the Company’s plant retirements. The OCA acknowledges that it adjusted year-end FPFTY plant in service and accumulated depreciation amounts for inclusion in rate base to reflect the use of the average rate base. However, the OCA explains that it did this only to conform this adjustment to its calculation of the average rate base. OCA Exc. at 5.

According to the OCA, this issue is not impacted by whether the average rate base or end-of-year rate base is used, but instead centers on the plant that is permitted to be included in rate base. Therefore, the OCA argues that while the ALJs did not address the issue raised by the OCA, the fact that the Company considers the impact to be minimal or insignificant cannot justify including overstated balances in rates. Accordingly, the OCA submits that the Company has failed to meet its burden of proof to demonstrate that its proposed calculations of plant in service and accumulated depreciation are accurate and requests that the Commission adopt the OCA’s proposed adjustments thereto. OCA Exc. at 5-7.

In its Replies to Exceptions, Valley submits that the ALJs correctly recommended the Company’s end-of-year methodology. Therefore, the Company submits that the OCA’s proposed adjustment to accumulated depreciation should be rejected, consistent with this recommendation. Valley R. Exc. at 3-4.

**4. Disposition**

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

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

Notwithstanding the above, we find merit in the OCA’s argument, set forth in its Exception No. 2, that the ALJs misunderstood the OCA’s claim regarding plant retirements, and improperly disposed of this claim in addressing the issue of the end‑of‑year versus average rate base methodology. The record supports the OCA’s assertion that its proposed adjustments for plant retirements are independent of its proposed adjustments that reflect its average rate base position. OCA St. 2, Schedule LKM-1. Therefore, the proper issue to consider is whether the Company’s rate base should be adjusted to take into account plant retirements in the FPFTY. We are of the opinion that the OCA has presented compelling evidence that such an adjustment should be made.

As noted, *supra*,Valley, in its Main Briefs and Reply Briefs, did not deny the OCA’s argument that the impact of plant retirements should be considered, but instead merely stated that the OCA’s proposed adjustments do not materially impact the Company's rate base claim. Therefore, Valley argued, without further support, that the Company’s calculations of its Plant in Service and Accumulated Depreciation should be adopted without modification. *See* Valley M.B. at 15-16; Valley R.B. at 3. We disagree. In our view, whether the Company considers the impact to be minimal or significant, the Company cannot justify including overstated balances in rates. Therefore, we shall grant the OCA’s Exception No. 2 and shall adopt the OCA’s proposed adjustment to Plant in Service of $55,659 and the parallel reduction of $56,678 to Accumulated Depreciation to properly reflect plant retirements in the FPFTY. Because we are reducing the Company’s Plant in Service amount, and correspondingly reducing the Company’s Accumulated Depreciation amount to account for the retirement of Plant in Service, this will result in a net addition to the Company’s rate base of $1,019 (*i.e.*,-$55,659-[-$56,678]=$1,019).

In light of the above, the OCA’s Exceptions are granted, in part, and denied, in part, and the ALJs’ Recommended Decision is modified accordingly.

## **Materials and Supplies**

Valley agreed to a small Materials and Supplies adjustment proposed by the OCA increasing its claim by $11,096 from $161,817 to $172,913. Valley M.B. at 22. No other Parties raised any objection or offered a different proposal.

In their Recommended Decision, the ALJs found this small adjustment to be reasonable and recommended its approval. R.D. at 13. No Party filed Exceptions on this issue, and we find substantial evidence of record supports the ALJs’ recommendation. Accordingly, we shall adopt the ALJs’ recommendation that the Company’s Materials and Supplies claim be increased by $11,096 from $161,817 to $172,913.

## **Accrued Pension/OPEB Liability**

Valley proposed a reduction to rate base of $899,115 for Accrued Pension/OPEB liability. Valley explained that this reduction reflects the excess of amounts charged to expense over amounts paid. Valley M.B. at 22. No Party opposed this reduction.

In their Recommended Decision, the ALJs concluded this small adjustment was supported by substantial evidence and is reasonable and recommended its approval. R.D. at 13. No Party filed Exceptions on this issue, and we agree with the ALJs’ recommendation. As such, we shall adopt the ALJs’ recommendation without further comment.

## **Cash Working Capital and Construction Work in Progress**

**1. Position of Parties**

Valley originally included a claim for CWC of $402,100, which it later revised to $399,027 to reflect the removal of the non-cash items. Valley explained that it derived its CWC upon 12.5 percent or one-eighth of its operations and maintenance (O&M) expenses, excluding depreciation expense, uncollectible expense, and taxes. Valley noted its agreement with the positions of I&E and the OCA regarding CWC, *infra*,to the extent that the Company’s CWC should be recalculated if the Commission orders any changes to the Company's claimed O&M expenses. The Company submitted that if the Commission does adjust the Company’s O&M claims, then it should use the same “one-eighth method” utilized by the Company, with removal of non-cash items as proposed by I&E, and the OCA, to adjust CWC. Valley M.B. at 23; Valley M.B. at Appendix A, Table VI.

Valley included a CWIP balance as of the end of the HTY of $114,497 in its rate base claim. However, Valley highlighted that, because its CWIP figures were based on historic figures rather than specific identified projects to be under construction at the conclusion of the FPFTY, it agreed to remove CWIP from its rate base. However, Valley emphasized that such acceptance is done only on the condition that the Commission reject the OCA’s proposal to calculate rate base and accumulated depreciation based on the average FPFTY plant in service. Valley M.B. at 12; Valley R.B. at 5-6.

I&E did not oppose the Company’s use of the one-eighth method to calculate CWC. However, I&E submitted that because all cash-based expenses are included in the Company’s overall CWC claim, any adjustments to the Company’s O&M expense claims impact the CWC allowance. I&E recommended that the Company’s O&M expense claims be reduced by $103,405, which reduces the Company’s CWC allowance by $12,925. I&E M.B. at 9-10.

I&E submitted that Valley’s entire claim for CWIP should be rejected. I&E reasoned that, although CWIP allows a utility to recover costs for plant additions that will be completed and in service within six months of the end of the test year, the Company elected to use an FPFTY ending December 31, 2020, which includes projections of plant in service and depreciation that will be recovered in rates during that twelve‑month period. Accordingly, I&E stated there is no reason to include a CWIP claim, given that the plant should be included in the Company’s FPFTY plant claim. I&E noted that Valley accepted this adjustment because it is using an end-of-year rate base for the FPFTY, and because it did not include specific projects in CWIP. I&E M.B. at 8-9.

The OCA recommended adjusting Valley’s CWC based on the final level of O&M expense. OCA M.B. at 49.

The OCA agreed with I&E that the Company’s entire claim for CWIP should be removed from its rate base claim. However, the OCA rejected Valley’s proposed condition for eliminating CWIP from its claim. In the OCA’s view, it is not appropriate to include CWIP in rate base regardless of whether the end-of-year or the average rate base methodology is used because, in either case, the plant item will not be completed and placed in service during the FPFTY. The OCA further reasoned that a utility’s CWIP balance as of the HTY is likely anticipated to be part of the plant placed in service during the FTY and the FPFTY. As such, the OCA took the position that the inclusion of CWIP in rate base would result in a double count. Further, the OCA pointed out that the Commission has historically disallowed the inclusion of CWIP in rate base. OCA M.B. at 17-19.

**2. ALJs’ Recommendation**

The ALJs found that the Company’s agreement to remove its CWIP is reasonable and should be approved. The ALJs concluded that the Parties’ proposal to adjust CWC consistent with any adjustment to the Company’s O&M is also reasonable and recommended its approval. R.D. at 15.

**3. Disposition**

As noted above, the OCA, in its Exception No. 1, argued that, if its average rate base position is adopted, CWIP should be adjusted accordingly. *See* OCA Exc. at 3‑5. Because we previously denied the OCA’s Exception No.1 and have adopted the end‑of-year rate base methodology, we find the OCA’s Exception to be moot with regard to CWIP. As noted above, the Company has agreed to remove its claim for CWIP from its rate base. Like the ALJs, we find that Valley’s agreement to remove its CWIP is reasonable and we shall adopt the ALJs’ recommendation to approve this removal. Additionally, we concur with the ALJs that the Parties’ proposal to adjust CWC consistent with any adjustment to the Company’s O&M is reasonable. As will be discussed in more detail in Section VI of this Opinion and Order, *infra,* regarding the Company’s expense claims, the CWC component of Valley’s rate base will be reduced by $20,646, which reflects our adjustment to O&M expenses of $165,169. In making this adjustment, we have applied the same “one-eighth” method utilized by Valley.

## **Other Reductions from Rate Base**

Valley asserted that all Parties are in agreement with regard to reductions to customer deposits, ADIT, and EDIT. Valley elaborated, as follows. First, Valley noted that the OCA proposed an upward adjustment of $98,293 to customer deposits, which the Company accepted. Second, Valley noted that no Party challenged the Company's calculation of ADIT or the proposal to amortize the EDIT balance over ten years. However, Valley stated that the OCA claimed the calculation of the EDIT balance should be modified to reflect the fact that EDIT will not accrue until new rates go into effect because the Commission has not required Valley to implement a credit flowing tax savings back to customers. Valley accepted the OCA's adjustment, which increases the EDIT balance by $27,443 and reduces rate base by the same amount.[[6]](#footnote-6) Third, the Company proposed to unbundle certain natural gas inventory costs in the amount of $650,909 from delivery rates and recover those costs for this asset through its Gas Cost Rate (GCR). No Party opposed this proposal. M.B. at 23-25.

In their Recommended Decision, the ALJs found the above reductions from rate base to be reasonable and recommended their approval. The ALJs noted that all Parties are in agreement on these reductions. R.D. at 16. Similarly, as no Party filed Exceptions to the ALJs’ recommendation, we agree that there is substantial evidence of record to support the ALJs’ recommendation. We therefore shall adopt it without further comment.

## **Summary and Final Rate Base Amount**

As noted above, we have adopted Valley’s use of an FPFTY using end-of-year balances. In summary, the following adjustments have been made to the Company’s rate base:

1. A Materials and Supplies adjustment increasing the Company’s claim by $11,096 from $161,817 to $172,913;

2. A reduction to rate base for Accrued Pension/OPEB liability. This reduction reflects the excess of amounts charged to expense over amounts paid. The deduction amount is $899,115;

3. A reduction of $114,497 to reflect the disallowance of the Company’s entire CWIP claim;

4. A reduction to Plant in Service of $55,659 and a corresponding reduction of $56,678 to Accumulated Depreciation to properly reflect plant retirements in the FPFTY. The resulting adjustments result in a net increase to the rate base of $1,019;

5. A $98,293 increase to Customer Deposits, which decreases rate base by a similar amount;

6. An EDIT balance of $91,477 and a corresponding reduction of $27,443 to the rate base to reflect this balance; and

7. A reduction to rate base of $650,909 due to the unbundling of certain natural gas inventory costs which the Company intends to recover through its GCR.

Additionally, CWC will be further reduced by $20,646, which reflects our adjustment to O&M expenses of $165,169, outlined in Section VI of this Opinion and Order, *infra*.

In their Recommended Decision, the ALJs recommended a final rate base for the Company of $17,159,033. R.D. at 17. However, our adjustments to CWC, utility plant in service, and accumulated depreciation result in a final rate base for Valley of $17,159,915. The ALJs’ Recommended Decision is modified accordingly.

# **Revenues and Revenue Requirement**

## **Revenue Requirement**

**1. Positions of the Parties**

Valley proposed a final revenue requirement of $5,804,499, which would result in an overall revenue increase of $745,079. Valley submitted that its claimed revenues at proposed rates are reasonable and should be adopted. Valley M.B. at 1, 11‑12, Appendix A at Table I.

I&E proposed a revenue requirement for Valley of $5,404,419, which would result in an overall revenue increase of $345,049. I&E M.B. at 4, Appendix A.

The OCA proposed a revenue requirement for Valley of $5,428,819, which would result in an overall revenue increase of $227,888. OCA M.B. at 1, Appendix A.

**2. ALJs’ Recommendation**

The ALJs recommended an overall revenue requirement of $5,556,450 for Valley based on the various adjustments they adopted in their Recommended Decision, resulting in an overall distribution revenue increase of $497,080. R.D. at 1,19.

**3. Disposition**

As noted above, we have modified the ALJs’ recommendation regarding certain inputs to Valley’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 Valley’s expenses, cost of common equity, and overall rate of return. Therefore, consistent with these modifications, we shall approve an overall revenue requirement of $5,528,467 for Valley, which will result in an overall distribution revenue increase of $469,097 on an annual basis.

## **FPFTY Sales and Revenue**

**1. Positions of the Parties**

Valley calculated its projected FPFTY sales and revenue using a statistical regression analysis for weather sensitive classes. Valley conducted this analysis for each major rate class using actual monthly sales for a period of time, using Heating Degree Day (HDD) data for these months. Valley’s regression analysis for tariff rate schedules Rate R-Residential, Rate C-Commercial, Rate L-Large Industrial Firm, Rate IS‑Interruptible Service, Rate SI-Small Industrial, Rate Transport DDQ,[[7]](#footnote-7) and Rate Transport Interruptible was conducted using its monthly number of customers and HDD data for 2016 through 2018. Additionally, Valley explained that with respect to its sales and revenue projection for tariff rate schedule Rate Transportation Firm, it applied the same calculation using only 2018 HDD data because changes in the customer configuration rendered data from prior periods inapplicable. Based on these regression analyses, Valley calculated an expected decline in anticipated system usage from 28,757,694 hundred cubic feet (ccf) in 2018 to 26,569,046 ccf in 2020. Valley explained that under present rates, this will reduce delivery revenues from $5,306,089 in 2018 to $5,059,370 in 2020. Valley M.B. at 25-26.

The OCA countered that Valley’s statistical regression analysis significantly understates the Company’s FPFTY sales and revenue projections. According to the OCA, the Company’s revenues should be adjusted upward by $141,561. In making this adjustment, the OCA utilized the most recent available annual usage data, along with localized weather information. The OCA reasoned that during the twelve‑month period ending August 2019, the winter weather was significantly colder than normal, which should be accounted for when projecting future revenues. OCA M.B. at 19-20; OCA R.B. at 9-11.

Valley rejoined that the OCA's proposed revenue calculation relies on limited sales data and fails to apply a monthly regression. Valley submitted that the OCA provided no explanation for why it declined to weather-normalize sales data for various customer classes. Further, Valley argued that the OCA failed to support its proposed adjustment to the Company’s sales and revenue projections or to identify any flaws in the Company's analysis. Valley R.B. at 6-8.

**2. ALJs’ Recommendation**

The ALJs recommended that Valley’s calculation for FPFTY sales and revenue at present rates be adopted. The ALJs found that Valley’s use of several years of data is more appropriate than using only the most recent year of data, as employed by the OCA. In the ALJs’ view, the OCA did not provide sufficient reasons to reject Valley’s methodology in favor of the OCA’s. The ALJs reasoned that Valley’s regression analysis more accurately corrects for any abnormal weather conditions that occur in any one year’s time period and represents a reasonable approach to forecasting future sales. R.D. at 18-19.

**3. Exceptions and Replies**

In its Exception No. 3, the OCA submits that the ALJs’ recommendation is contrary to the evidence presented. According to the OCA, the Company’s methodology does not align with Valley’s actual annual revenues. The OCA remains of the opinion that Valley’s analysis significantly understates FPFTY revenues and fails to account for the colder than normal 2019 winter. The OCA also objects to the ALJs’ finding that it did not provide sufficient justification for its proposed alternative methodology. The OCA reasserts that its own proposed methodology, and the associated proposed revenue adjustment, more accurately reflects anticipated revenues because it uses only the most recent sales data and localized weather data provided by the Company. OCA Exc. at 7-9.

In reply, Valley contends that the regression analysis employed by the Company is a standard industry practice used when developing rate case revenue projections for a weather-sensitive utility. Valley claims that the OCA’s sole basis for concluding that Valley has understated its FPFTY revenues is that its FTY revenues exceeded projections due to a particularly cold 2019 winter. However, Valley asserts that this is not a reasonable basis for departing from the Company’s generally accepted methods. Rather, Valley argues that it accounted for the colder than normal 2019 winter by incorporating weather-normalized data for all weather sensitive classes, thereby accounting for year-to-year weather fluctuations. Therefore, Valley submits that the Company’s analysis includes internal controls to prevent overreliance on a warmer than normal or colder than normal test year. Accordingly, Valley submits that the ALJs correctly found that the OCA failed to present valid reasons for rejecting the Company’s revenue projections and that the OCA’s Exception No. 3 should be denied. Valley R. Exc. at 4-5.

**4. Disposition**

Based on our review of the record, the ALJs’ decision, and the Parties’ positions, we agree with the ALJs that Valley’s calculation for its FPFTY sales and revenue at present rates should be adopted. The record indicates that Valley’s calculation method involves a standard statistical regression analysis that would be used for a sales forecast, wherein the Company regressed actual monthly sales data for each major rate class for a period of time using HDDs for those months. Additionally, the record indicates that the Company’s analysis used several years of data and incorporated weather normalization adjustments for all weather-sensitive customer classes. Valley M.B. at 25-26; Tr. at 83-84. Further, the record demonstrates that no Party identified any flaws in Valley’s analysis. Tr. at 83. In contrast, the record indicates that the OCA’s alternative method relies on only a single year of sales data, aggregates the usage over a full year instead of employing a monthly regression, and omits weather-normalization data for certain classes. *See* Valley R.B. at 7. For these reasons, we concur with the finding of the ALJs that Valley’s proposed method represents a more accurate measure for calculating FPFTY sales and revenue at present rates. Therefore, we shall deny the OCA’s Exception No. 3.

# **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).

## **Resolved Expense Issues**

The ALJs noted that Valley raised two expense adjustments in its rebuttal testimony that were accepted by the OCA and were not challenged by I&E. First, Valley explained that its annualized 2019 expense data based on actual expenses incurred as of September 30, 2019, does not reflect that Valley hired a Corrosion Technician on October 7, 2019. The labor and overhead costs associated with this employee hire were not included in the Company's 2019 budget or its FTY labor and overhead calculations. Adjusting the Company's FPFTY claim to reflect the unanticipated 2019 Corrosion Technician hire increases the FPFTY expense by $81,280. Second, Valley explained that its annualized 2019 expense data does not reflect that the Company had an employee take a prolonged medical leave from January 19, 2019 through May 12, 2019. As a result of this extended medical leave, labor costs to several labor accounts were reduced. The annual FTY expense to correct for the associated nonrecurring reduction in labor costs increases Valley’s FTY overhead expense by $14,720. The ALJs explained that the Parties agreed that these accepted expense adjustments would be added to the total FPFTY expense claim determined in this proceeding. R.D. at 24-25 (citing Valley St. 1‑R at 2; Valley St. 5-R at 4-5). We find substantial evidence of record supports these uncontested expense adjustments and affirm the ALJs’ recommended approval of same.

## **Inflation Adjustment**

**1. Positions of the Parties**

Valley explained that in developing its FPFTY expense projection, the Company considered historic expense increases and determined that generally increasing its FTY O&M expense estimates by three percent would reasonably account for anticipated FPFTY expense increases, primarily for wage, benefits, and salaries and for materials. Valley posited that the Company’s use of an inflation adjustment is a realistic approach to projecting expenses for the FPFTY. According to Valley, the Company's proposed inflation adjustment for FPFTY expenses is a conservative estimate developed to reflect both past experience and increases in the Company’s 2020 budget. Valley stated that it used the Producer Price Index (PPI) as a guideline in formulating its three percent inflation projection. Valley also submitted the Company's use of the three percent inflation rate is consistent with the Commission's purposes, as set forth in Act 11, in establishing the FPFTY as a ratemaking tool. According to Valley, by its fully projected future nature, the FPFTY requires utilities to propose estimates and to anticipate cost increases from the FTY to the FPFTY. Valley M.B. at 36-40.

The OCA countered that the Company’s use of a three percent inflation adjustment is speculative and does not rely on an objective quantitative approach for determination. In the OCA’s view, an across-the-board three percent inflation rate applied to all expenses does not comport with the legal requirement that expenses be known and measurable. According to the OCA, blanket inflation adjustments neither reflect the true cost of expenses nor do they directly relate to actual costs expected to be incurred by the Company in the period in which rates are set. Rather, the OCA took the position that costs should be based upon evidence or documentation that supports the Company’s adjustments. OCA M.B. at 21-22, 24.

The OCA also cited to several cases for the proposition that a blanket inflation adjustment is speculative in nature. The OCA claimed that a utility cannot meet its burden of proof under Section 315(a) of the Code by applying the inflation adjustment factor to its costs, because there is no way to assess the reasonableness of the FPFTY expenses relative to the HTY or the FTY expenses. In the OCA’s view, when utilities file a FPFTY, the utilities must demonstrate and explain reasons for FPFTY cost changes based upon specific causes such as unit price increases, planned activities, and abnormal activity in the HTY. OCA M.B. at 22-23.

Alternatively, the OCA submitted that if the Commission allows the use of an inflation adjustment, then it should be based on the Gross Domestic Product Price Index (GDP-PI), and not the PPI. According to the OCA, the GDP-PI is a better measure of inflation for ratemaking purposes. OCA M.B at 24.

**2. ALJs’ Recommendation**

The ALJs agreed with the OCA and rejected Valley’s position that the Commission should accept the Company’s total FPFTY expense projection claim derived from the annualization of the Company’s FTY YTD data as of September 30, 2019, plus a three percent inflation factor. The ALJs also accepted the OCA’s argument that Valley’s proposed inflation adjustment of three percent was based on judgment and not on a real quantitative approach. As such, the ALJs found this inflation factor to be a speculative figure that should not be used to set rates. The ALJs reasoned that although Act 11 allowed for utilities to use the FPFTY to project expenses for the FPFTY, it did not eliminate the “known and measurable” standard. According to the ALJs, the Company must support a claim through some known and measurable changes to demonstrate that an expense will increase in the FPFTY. Therefore, the ALJs concluded that claiming that an individual expense will increase by a blanket percentage is not supported by the record and does not meet the Company’s requisite burden of proof. R.D. at 23-24.

At the same time, the ALJs emphasized that accepting the position of the OCA does not mean that there are no cost increases from the FTY to the FPFTY. In this regard, the ALJs noted their recommendations, *infra*,that the Commission accept FPFTY projections consisting of cost increases from the FTY to the FPFTY that Valley can demonstrate and explain in the record. R.D. at 23.

**3. Exceptions and Replies**

In its Exception No. 1, Valley claims that the ALJs failed to appropriately recognize the substantial evidence in support of the Company’s three percent inflation factor. First, Valley takes issue with the ALJs’ application of the “known and measurable” standard. In this regard, Valley argues that there is nothing inherently inconsistent between the “known and measurable” standard and the application of an inflation adjustment. Valley states that it has applied an inflation adjustment only to its O&M expenses and emphasizes that it has not applied any inflation adjustment to its revenues or its rate base. Valley contends that its inflation factor is supported with Company-specific historic experience. Namely, Valley claims that: (1) its actual annual O&M expenses have consistently increased over three percent; (2) its 2020 budget indicates that the proposed three percent expense adjustment represents a conservative estimate of the FPFTY costs; and (3) its labor and healthcare expenses, which make up the majority of its O&M expense, will increase by at least three percent, and by as much as nine percent. Valley Exc. at 2-6.

Second, Valley claims that the ALJs’ recommendation is contrary to the purpose of Act 11 and the FPFTY. Valley elaborates, noting that the General Assembly enacted Act 11 to establish the FPFTY as a ratemaking tool to reduce regulatory lag due to the use of rate case inputs that are outdated by the time the new base rates become effective. Valley also notes Section 315(a) of the Code, 66 Pa. C.S. § 315(a), contemplates that there will be estimates included in the FTY and the FPFTY. Therefore, Valley submits that, if the Commission adopts the ALJs’ recommendation and denies the Company’s proposal to apply a three percent inflation factor to its FPFTY O&M expenses, it will erode the benefits of Act 11 and the FPFTY. Valley Exc. at 6-7.

Alternatively, Valley posits that if the Commission denies Valley’s proposal to apply a three percent inflation factor to all of its O&M expenses, it should, at a minimum, apply this inflation adjustment to the FPFTY for the O&M accounts predominantly associated with labor and overhead components. Valley states that these expenses are, as follows: (1) the Industrial/Commercial Meters and Regulators Operations Expense (Account 876); (2) the Customer Records and Collection Expense(Account 903); (3) and, the Admin and General Salaries Expense (Account 920). Valley reasons that to ignore the known and measurable increase for employee salary and benefits is inconsistent with the weight of the evidence of record and inconsistent with the forward-looking purpose of the FPFTY under Act 11. Valley Exc. at 7-8.

In its Replies to Exceptions, the OCA agrees with the ALJs that the Company has failed to substantiate its claim for a three percent inflation factor for any of the proposed expenses and has failed to meet its burden of proof to demonstrate that the inflation factor is appropriate for any of the claimed expenses. Therefore, the OCA submits that the Commission should deny both the OCA’s primary proposal, and its alternative proposal to apply the inflation factor to certain accounts. The OCA restates its assertion that Valley’s proposal is speculative and is not a known and measurable change. The OCA highlights that the Company identified in response to a discovery request, that its proposed three percent inflation adjustment is based on judgment rather than on a quantitative method. The OCA asserts that Valley has not limited its proposed inflation adjustment to expenses that it reasonably anticipates will increase. Rather, the OCA reasons that Valley’s proposal simply assumes that all expenses will increase by a three percent inflation factor without providing evidentiary support for those proposed increases. OCA Exc. at 1-5, 6.

The OCA also disagreed with Valley’s argument that the ALJs’ recommendation undercuts the purpose of the FPFTY authorized by Act 11. In the OCA’s view, the purpose of Act 11 was not simply to increase rates, but to provide an opportunity to mitigate regulatory lag for known and supported changes in the FPFTY. Thus, the OCA agrees with the ALJs’ finding that if a utility claims that an expense will increase in the FPFTY, then this claim must be supported by some known and measurable change. OCA R. Exc. at 5-6.

**4. Disposition**

On consideration of the record evidence and arguments before us, along with the Exceptions and Reply Exceptions of the Parties, we shall adopt the ALJs’ recommendation to not allow Valley to apply a blanket three percent inflation adjustment to all of its O&M accounts in its FTY to reach its FPFTY projections. We agree with the ALJs that the Company did not meet its burden in demonstrating that its proposed blanket three percent inflation adjustment to all expenses would meet the “known and measurable” standard for increasing each FTY expense claim in the FPFTY. To state it another way, the Company did not demonstrate that making this blanket adjustment to each expense claim directly relates to the actual costs expected to be incurred in each expense account in the FPFTY. *See* R.D. at 23-24. In our view, the ALJs’ recommendation to reject Valley’s position is reasonable and consistent with applicable law. However, we further echo the ALJs’ statement that in examining the Company’s expense claims, *infra*,we shall award Valley’s claims in such instances in which Valley has been able to show sufficient record evidence demonstrating FPFTY projections consisting of cost increases from the FTY to the FPFTY. Accordingly, we shall deny Valley’s Exception No. 1 and adopt the ALJs’ recommendation on this issue.

## **Blanket Expense Adjustments v. Individual Expense Adjustments**

**1. Positions of the Parties**

Although Valley argued that its entire FPFTY expense claim of $3,137,541 should be accepted, it proposed to accept an adjusted annualized FPFTY claim, based on its most recent YTD data as of September 30, 2019, as increased by a three percent inflation factor. As a result, Valley explained that it would accept a total expense claim of $3,107,445, or approximately $30,000 less than its total FPFTY expense claim. Valley noted that this does not include the expense amounts from the resolved and uncontested expense issues, *supra.*  Valley submitted that the Commission should accept this blanket expense adjustment in lieu of making adjustments to individual expense accounts for two reasons. First, Valley argued that making adjustments to individual expense accounts presents unique challenges for a smaller utility such as Valley, that moves expense amounts between general ledger accounts based on the operational needs of the Company. Second, Valley posited that making individual adjustments to its expense claims ignores the Company’s success in managing overall costs very close to its budgeted costs. Valley M.B. at 34-36.

I&E proposed individual adjustments to Valley’s expense claims. I&E asserted that it presented evidence that specific expense claims for the FPFTY are unjust and unreasonable. As such, I&E submitted that the Commission should reject the Company’s blanket approach. I&E M.B. at 11-22; I&E R.B. at 3-6.

The OCA also proposed individual adjustments to Valley’s expense claims. In the OCA’s view, the Company’s proposed blanket adjustment to all expenses is not known and measurable nor consistent with the law. OCA M.B. at 20-38; OCA R.B. at 11‑16.

**2. ALJs’ Recommendation**

Similar to their finding regarding the Company’s proposed inflation adjustment, *supra*, the ALJs rejected Valley’s proposal to conduct an “across the board” adjustment to expenses based on its annualized FTY expense as of September 30, 2019, plus a three percent inflation adjustment. The ALJs explained that, under Sections 315(a) and 1308(d) of the Code,[[8]](#footnote-8) Valley has the burden of proof to establish the justness and reasonableness of every element of its rate increase request. As a result, the ALJs ruled that each litigated O&M expense claim must be analyzed to determine the justness and reasonableness of the claim. R.D. at 25.

**3. Exceptions and Replies**

In its Exception No. 2, Valley opposes the ALJs’ recommendation and reiterates its position that making adjustments to individual expense accounts presents unique challenges for a smaller utility like Valley. More specifically, Valley claims that the Company's smaller size requires flexibility for labor assignments because the Company shifts resources and priorities during the year as operational needs arise. Valley also asserts that, while Section 315(a) of the Code, 66 Pa. C.S. § 315(a), mandates that a public utility must meet its burden of proof to show that a proposed rate involved is just and reasonable, it does not prescribe the methods used to demonstrate the justness and reasonableness of the proposed rate, or how individual expenses may be justified. Valley argues that contrary to the ALJs’ conclusion, the Company’s use of the most recent available data to develop its FPFTY projection is consistent with Section 315(a) because it reflects the actual FTY data for each expense account. Valley insists that the Company’s actual FTY expenses as of September 30, 2019, closely track its projected FTY expenses and demonstrate that the Company has very effectively managed its budget. Conversely, Valley submits that I&E and the OCA’s approach to reviewing Company expenses, which the ALJs recommended adopting, penalizes the Company for effectively managing its budget. According to Valley, reviewing the expenses individually results in a selective approach focused on accounts where expenses ran below budget in the FTY without recognizing the commensurate increases in other accounts, despite the fact that movement between accounts is required for a small Company like Valley to operate effectively. Valley Exc. at 8-9.

In its Replies to Exceptions, I&E proffers that, because O&M expenses are a common point of dispute in rate cases, the proper way to analyze Valley’s overall O&M expense is by analyzing the Company’s individual expense claims. According to I&E, adopting the Company’s approach would set a very dangerous precedent that would likely be cited by any other utility company where O&M expenses are scrutinized. I&E reasons that this would fatally handicap non‑company parties’ ability to evaluate individual expense accounts. Therefore, I&E submits that the ALJs correctly found that Valley has the burden of proof to establish the just and reasonableness of each claim, and that the ALJs correctly rejected Valley’s assertion of difficulty in substantiating individual expense claims. I&E R. Exc. at 1-4.

In its Replies to Exceptions, the OCA submits that the ALJs correctly found that Valley has an obligation under the law to demonstrate that each individual expense claim is supported. Therefore, the OCA takes the position that the Company’s Exception No. 2 should be rejected. OCA R. Exc. at 6-7.

**4. Disposition**

We shall reject Valley’s position on this issue. Valley avers that Section 315(a) requires only that the public utility meets its burden of proof to show that the rate involved is just and reasonable, but it does not prescribe the methods used to demonstrate the justness and reasonableness of a proposed rate, or how individual expenses may be justified. Valley argues that its use of the most recent available data to develop its FPFTY projection is consistent with Section 315(a) because it reflects the actual FTY data for each expense account. Valley Exc. at 8-9, Valley M.B. at 34-36. Accordingly, Valley argues the ALJs erred in evaluating the merits of the Parties’ positions on the Company’s individual O&M expense claims.  We disagree, and therefore we shall deny Valley’s Exception No. 2 on this issue.

Instead, we agree with the positions of I&E and the OCA, as recommended by the ALJs that, under Section 315(a) of the Code, the Company has the burden of proof to establish the justness and reasonableness of every element of its rate increase request filed under Section 1308(d) of the Code. *See* R.D. at 25 (citing 66 Pa. C.S. §§ 315(a), 1308(d)). Thus, we concur with the ALJs’ determination that each litigated O&M expense claim must be analyzed to determine the justness and reasonableness of the claim. R.D. at 25. Therefore, in the remainder of this section, we will address the merits of the Parties’ positions on each of the individual O&M expense claims that were at issue in this proceeding.

## **Individual Expense Adjustments**

### **Industrial/Commercial Meters and Regulators Operations Expense (Account No. 876)**

**a. Positions of the Parties**

Valley proposed a claim of $73,475 for Account No. 876. Valley argued that it generally incurs approximately thirty percent of its expense for Account No. 876 in the fourth quarter of each year. Therefore, the Company contended that annualizing the actual FTY costs incurred as of September 30, 2019, would understate the Company's expense. Valley M.B. at 43; Valley R.B. at 13.

The OCA agreed that it is evident that in the past two years, the Company’s fourth quarter expenses for Account No. 876 are equivalent to approximately thirty percent of its annual expenses. However, the OCA proposed a downward adjustment of $9,429 to the Company’s claim based on the Company’s annualized FTY costs as of September 30, 2019. According to the OCA, this adjustment amount more closely reflects the Company’s maintenance costs. The OCA reasoned that annualizing Account No. 876 by increasing the nine-month FTY expense by thirty percent only results in an increase from $48,034 to $62,444. In the OCA’s view, the Company did not demonstrate that it will meet or exceed its FTY projections. OCA M.B. at 25-26; OCA R.B. at 16-17.

**b. ALJs’ Recommendation**

The ALJs recommended that the Commission adopt the OCA’s position on this issue and the corresponding adjustment to the Company’s expense claim for Account No. 876. The ALJs explained that this would reduce the Company’s claim by $9,429, resulting in an allowed claim of $64,046. The ALJs rejected Valley’s argument that annualizing the FTY costs incurred as of September 30, 2019, would understate the Company’s expense. The ALJs explained that if the FTY costs incurred as of September 30, 2019, were to be annualized by thirty percent, the figure would increase from $48,034 to $62,444, which is less than Valley’s FPFTY claim and almost equal to the OCA’s proposed adjustment. The ALJs concluded that given Valley’s original claim of $73,475 for the FPFTY, Valley failed to provide sufficient evidence that it would meet or exceed the FTY projections. The ALJs reasoned that, because the OCA’s proposal accounts for the Company’s position that approximately thirty percent of the annual expenses are incurred in the fourth quarter, it is appropriate to annualize the FTY costs given the lack of evidentiary justification for the Company’s proposed claim. R.D. at 30.

**c. Exceptions and Replies**

In its Exception No. 3, Valley objects to the ALJs’ recommendation and argues that the ALJs have relied on a mathematical error. In this regard, Valley claims that to accurately reflect the accepted premise that thirty percent of its annual expense is incurred in the fourth quarter, the nine-month FTY data of $48,034 should represent seventy percent of the full year’s expenses, such that the annualized FTY expense would be $68,620. Further, Valley argues that the ALJs erred by not including an FPFTY inflation adjustment. Valley reasons that it has budgeted for increases to employee wages and benefits and that health care costs are increasing by more than nine percent. Therefore, Valley submits that because Account No. 876 consists primarily of labor and overhead expense, it is reasonable to apply a three percent inflation adjustment to this account. Accordingly, Valley argues that the Company’s original expense claim of $73,475 should be approved. Valley Exc. at 10-11.

In reply, the OCA restates its assertion that the Company did not provide sufficient evidence that it would meet or exceed the FTY projections. The OCA challenges Valley’s assertion that the ALJs’ recommendation contains a mathematical error. More specifically, the OCA contends that its proposed adjustment already accounts for the Company’s position that approximately thirty percent of its annual expenses for this account are incurred in the fourth quarter and that the ALJs correctly recognized this in the R.D. The OCA also disagrees with the Company’s assertion that the ALJs erred in not applying a three percent inflation factor to the FPFTY adjustment and reiterates its position that a three percent across-the-board inflation factor should not be applied. OCA R. Exc. at 7-9.

**d. Disposition**

Based upon our review of the record established in this proceeding, we shall decline to adopt the ALJs’ recommendation and shall grant Valley’s Exception on this issue. As noted above, we have rejected the Company’s proposal to apply a three percent inflation factor to all expenses. Nonetheless, we also explained that we will approve the Company’s individual expense claims in such instances in which it has demonstrated on the record that its FPFTY projections should be approved. Our review of the record demonstrates that such is the case with regard to the Company’s expense claim for Account No. 876. The record indicates that for this expense item, Valley’s historical costs will understate its future costs because aging infrastructure across the Company’s service territory requires maintenance. As Valley, the OCA, and the ALJs each noted, the record also demonstrates that the Company’s fourth quarter expenses for Account No. 876 equate to approximately thirty percent of its *annual* expense for this account. Valley St. 4-R at 6‑7; OCA M.B. at 26; R.D. at 30 (emphasis added).

However, as Valley points out in its Exception No. 3, the ALJs’ analysis used in adopting the OCA’s position contains a mathematical error. More specifically, we concur with Valley that the ALJs’ analysis increases the Company’s nine-month expense by thirty percent of the nine-month expense (*i.e.*, 30% x $48,034), and not thirty percent of the Company’s total *annual* expense for Account No. 876. Therefore, to properly reflect the record evidence that demonstrates thirty percent of the annual expense is incurred in the fourth quarter, we find that the nine-month data, or $48,038, should represent seventy percent of the full year’s expenses, such that the annualized FTY expense would be $68,625 (*i.e.*,[$48,038/70%]=$68,625). Valley M.B. at 30; Valley R. Exc. at 10-11. Consequently, in correcting this mathematical error and taking into account the Company’s increased maintenance costs related to Account No. 876, we find that the Company’s full expense claim should be approved.

In light of the above, we shall grant Valley’s Exception No. 3, reverse the ALJs’ recommendation on this issue, and award Valley its full expense claim of $73,475 for Account No. 876.

### **Meters and House Regulators Operating Expense (Account No. 878)/Meter Reading Expense (Account No. 902)**

**a. Positions of the Parties**

Valley's rate filing included a claim of $172,563 for Account No. 878 and a claim of $99,668 claim for Account No. 902. Valley submitted that in making its proposed downward adjustments, *infra,* the OCA fails to recognize the relationship between these two accounts. In this regard, Valley claimed that work shifted from Account No. 878 to Account No. 902. More specifically, Valley noted that, as of September 30, 2019, Account No. 902 was tracking $15,272 below FTY projections, which closely parallels the increased costs observed for Account No. 878, which was tracking $14,010 above FTY projections as of September 30, 2019. Valley submitted that, when read together, both accounts are tracking closely to the Company's projected FTY expenses. Valley M.B. at 44-45.

The OCA argued that the Company should use a three-year average of the Account No. 878 expenses for 2016 through 2018, which would take into account the increased costs that may occur. The OCA stated that using a three-year average would result in a total expense of $138,827, representing a reduction of $33,736. As to Account 902, the OCA proposed a downward adjustment of $12,847 to the Company’s claim, arguing that the Company's overhead costs incurred through the first six months of the FTY (*i.e.*,through June 30, 2019) are tracking below projected levels. OCA M.B at 26‑27, 29-30.

**b. ALJs’ Recommendation**

The ALJs recommended adopting the Company’s proposal and rejecting the OCA’s proposals to reduce the Company’s Account No. 878 expense claim by $33,736 to $138,827 and to reduce the Company’s Account No. 902 expense claim by $12,847 to $86,821. The ALJs found it persuasive that these accounts should be read together because the Company explained that work shifted between the two accounts such that Account No. 902, which is tracking below Valley’s FTY projections, parallels the increased costs observed for Account 878. R.D. at 32.

**c. Exceptions and Replies**

In its Exception No. 4, the OCA submits that the ALJs’ findings are in error because the Company has failed to justify the proposed increase in expenses. The OCA argues that the Company’s proposed expenses for Account No. 878 and Account No. 902 are twenty percent and seventeen percent higher than the HTY expense, respectively. The OCA remains of the opinion that in order to address year-to-year fluctuations in expenses for Account No. 878, the Company should use a three-year average of the expenses for this account from 2016 to 2018. Additionally, the OCA restates its position that the six-month FTY data for Account No. 902 indicates that the Company, through the first half of 2019, did not experience this level of forecasted expenses. OCA Exc. at 9-11.

In reply, Valley argues that the OCA’s proposed downward adjustment to the Company’s claims for both accounts results in a double disallowance. As such, Valley contends that the ALJs properly addressed both accounts together and treated them as interrelated because the Company explained on the record that work shifted between the two accounts. Valley also submits that the ALJs correctly rejected OCA's argument based on six-month FTY data. Valley emphasizes that when the updated nine-month FTY data (*i.e.*,through September 30, 2019), is used, it indicates that Account No. 878 is tracking $14,010 above FTY projections and Account No. 902 tracking $15,272 below FTY projections. In Valley’s view, the OCA has failed in its Exceptions to provide a reasonable basis for rejecting the ALJs’ recommendation. Valley R. Exc. at 11.

**d. Disposition**

We agree with the ALJs on this issue and shall deny the OCA’s Exception No. 4, consistent with the following discussion. The record indicates that Valley shifts employee hours between accounts to allocate resources to work on various projects. In this instance, Valley provided sufficient evidence to demonstrate that its projected labor costs for Account No. 878 were previously allocated to work related to meter reading under Account No. 902. Valley R.B. at 13-14; Valley St. 4‑R at 7. Therefore, it is appropriate to read these accounts together.

On the other hand, we find that the OCA’s proposed adjustments fail to recognize the direct connection between Account Nos. 878 and 902. For this reason, we also agree with Valley’s argument that, by proposing significant downward adjustments to both accounts, the OCA would essentially create a double disallowance. Further, we find that, because Valley has relied on more recent YTD data than the OCA, its proposal more accurately reflects its projected overhead costs. Accordingly, we shall adopt the ALJs’ recommendation, which approves the Company’s expense claims of $172,563 for Account No. 878 and $99,668 for Account No. 902.

### **Rate Case Expense-Normalization Period**

**a. Positions of the Parties**

Valley proposed a total rate case expense claim of $271,000 and proposed to normalize this amount over three years consistent with the anticipated frequency of base rate proceedings going forward, and with numerous prior Commission proceedings. This would result in a normalized claim of $90,333. Valley pointed out that while historic filing frequency is a factor considered in determining the normalization for rate case expense, it is not the only factor the Commission considers. Valley M.B. at 41-42.

Valley noted that in *UGI*,the Commission granted UGI a three-year rate case expense normalization period despite the fact that the company had not filed a base rate case for 22 years, because it found that UGI had shown its increased capital spending would require the company to seek relief in a base rate case. Valley M.B*.* at 42 (citing *UGI* at 60). Applying this reasoning to the instant case, Valley acknowledged that the filing intervals for its last three rate cases have been 33 months, 36 months, and 110 months. However, Valley claimed that its long stay-out period following its 2010 rate case is an outlier given that it connected a very large new contract customer following its 2010 rate case. According to Valley, additional contract revenues permitted the Company to offset rising operational costs that would have otherwise resulted in a request for a rate increase having been filed. Valley contended that it is unlikely that another similarly sized large customer will enter its service territory, necessitating that it file rate cases on a more frequent basis. Valley M.B. at 42-43.

I&E proposed that the Company’s rate case expense claim should be normalized over a period of sixty months, representing an adjustment of $36,133 to the Company’s claim. I&E reasoned that the Company’s proposed normalization period does not comport to the Company’s historic filing frequency. I&E contended that the factors Valley raised in support of this thirty-six-month period do not warrant deviation from the Commission precedent of examining the average number of months between a company’s rate case filings to determine the normalization period. I&E M.B. at 20-21.

The OCA also proposed that the Company’s rate case expense claim be normalized over sixty months. Like I&E, the OCA reasoned that the Commission has consistently held that rate case expenses are normal operating expenses and that normalization should be based on the historic frequency of the Company’s rate case filings. OCA M.B. at 36-37.

**b. ALJs’ Recommendation**

The ALJs pointed out that the Company’s total rate case expense claim of $271,000 is not disputed by the Parties, but rather the normalization period for the recovery of the rate case expense is the only issue at hand. The ALJs agreed with Valley on this issue and recommended this rate case expense claim be normalized over a period of thirty-six months, representing an expense of $90,333 per year. The ALJs reasoned that, although it has been the Commission’s practice to set a normalization period based upon historic filing frequency, there are exceptions. Namely, citing to *UGI, supra,* the ALJs noted that the normalization period for a rate case expense can be set based on future expectations. The ALJs found that the Company is likely to file its next base rate case within three years, as opposed to a longer time period. Conversely, the ALJs rejected I&E and the OCA’s proposal of a sixty-month normalization period. The ALJs concluded that the Company’s historic filing frequency is distorted by Valley forgoing a rate case filing for approximately nine years due to the large contract customer coming online. The ALJs further concluded that accepting either I&E or the OCA’s proposal would result in an under collection in the likely event that Valley files a rate case within the next three years. R.D. at 27-29.

**c. Exceptions and Replies**

In its Exception No. 1, I&E remains of the opinion that based on the Company’s historic filing frequency, the normalization period should be set at sixty months. According to I&E, a historic average should be used, because it is not known how long it will be until a future rate case filing will occur. I&E argues that the ALJs erred in citing to *UGI* to support their finding that a normalization period can be based on future expectations. I&E claims that the record in *UGI* had much more specific evidence to support deviation from using the historic filing frequency than the record in the instant proceeding. I&E Exc. at 4-5. In this regard, I&E contends that in *UGI,* the Commission found reference to $8 million in annual spending for capital projects following the FPFTY would cause a $3 million shortfall at the end of a three-year period. *Id.* at 5 (citing *UGI* at 60). In contrast, I&E claims that the record in the instant proceeding is devoid of any quantitative projections to demonstrate why the Company’s proposed use of a thirty-six-month normalization period is appropriate. I&E Exc. at 5.

Similar to I&E, the OCA, in its Exception No. 7 claims that the ALJs erred in recommending that the Company’s thirty-six-month rate case normalization period be adopted. The OCA’s Exceptions on this issue echo those of I&E, asserting that Valley has not supported its claim that a shortened normalization period is warranted. Therefore, the OCA submits that the Commission should reverse the ALJs’ recommendation and adopt a sixty-month normalization period, which is based on the Company’s historic rate case filing frequency. OCA Exc. at 14-16.

In its Replies to Exceptions, Valley submits that I&E and the OCA each failed in their Exceptions to account for record evidence supporting the Company’s proposed normalization period. Valley reinforces its position that the Company has demonstrated that the 110-month period following its 2010 rate case was not a normal occurrence and is an outlier in comparison to the prior 33-month and 36-month intervals between the rate cases that preceded its 2010 rate case. Therefore, Valley argues that both historic frequency and future expectations support the 36-month period used by the Company and recommended by the ALJs. Valley R. Exc. at 6‑7.

**d. Disposition**

We agree with the ALJs’ recommendation that Valley be permitted to normalize its rate case expense claim of $271,000 over a 36-month period. We find merit in the Company’s assertion that it is likely to file its next rate case within 3 years, as opposed to a longer time period, and the record in this case supports such a conclusion. R.D. at 27-29.

As asserted by Valley, we find that I&E and the OCA each failed in their Exceptions to account for record evidence supporting the Company’s proposed normalization period. Valley R. Exc. at 6-7; Valley St. 4-R at 5. Contrary to the claims of I&E and the OCA, substantial evidence exists to support deviation from the Commission’s common practice of setting a normalization period for rate case expense based only on historic filing frequency. We note that this practice of relying on historic filing frequency is not an absolute and each case should be decided on the basis of evidence of historic filing frequency and future expectations. Examination of the record in this case indicates that both historic frequency and future expectations support the 36‑month period used by the Company and adopted in the R.D. Valley M.B. at 42-43.

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

Accordingly, we shall adopt the ALJs’ recommendation and approve Valley’s total rate case expense claim of $271,000 to be normalized over 3 years, consistent with its historic and anticipated frequency of base rate proceedings, and with prior Commission proceedings. This would result in a normalized claim of $90,333. Valley St. 4-R at 5. Valley R. Exc. at 6-7; Valley M.B. at 41-43; R.D. at 27-29.

### **Customer Installations (Account No. 879)**

**a. Positions of the Parties**

Valley projected an FPFTY expense of $132,269 for Account No. 879 and, therefore, made an associated claim. Valley reasoned that the actual expenses for Account No. 879 are tracking ahead of projections for the FTY, based on FTY costs as of September 30, 2019. Valley R.B. at 14-15.

The OCA contended that the Company’s claim is $17,933, or sixteen percent, higher than the expense in the HTY. According to the OCA, although the overhead cost for customer installations can vary from year to year, the Company provided no explanation for an increase of this magnitude. As such, the OCA proposed that the Company use a three-year average of the Account No. 879 expenses for 2016 through 2018, which will take into account the increased maintenance cost that may occur, but that will also account for variations and abnormalities in year-to-year expenses to develop a normal level of on-going expense. Accordingly, the OCA proposed a downward adjustment of $14,873 to the Company’s claim, resulting in a reduction from $132,269 to $117,396. OCA M.B. at 27-28.

Valley explained that the vast majority of the HTY to FTY increase, or $13,352, is due to a three percent increase in wages effective January 1, 2019. Valley R.B. at 14.

**b. ALJs’ Recommendation**

The ALJs recommended the adoption of the Company’s proposal, finding that Valley sufficiently justified its projected FPFTY costs, given that the Company’s proposed increase is due mostly to the increases in wages effective January 1, 2019. The ALJs found it particularly persuasive that the actual expenses for Account No. 879 are tracking ahead of projections, based on the annualization of the FTY costs as of September 30, 2019. R.D. at 33.

**c. Exceptions and Replies**

In its Exception No. 5, the OCA objects to the ALJs’ use of the Company’s annualization of the nine-month actual data, or $136,265, to support the Company’s claim of $132,269, without addressing the factual issues raised by the OCA. The OCA maintains that a three-year average total expense of $117,396 should be used to develop a normal level of ongoing expense, representing a reduction of $14,873 to the Company’s claim. The OCA remains of the opinion that this methodology properly accounts for variations and abnormalities that occur in year-to-year expenses. OCA Exc. at 11-13.

In its Reply to the OCA’s Exception No. 5, Valley argues that the OCA’s claim is unsupported and should be rejected because its reliance on the 2016-2018 average does not accurately account for labor and overhead costs that are trending upward. Valley insists that the Company reasonably projected increases to this account, and that the 2019 YTD data supports the Company's expectations. Further, Valley reinforces its position that the vast majority of the HTY to FTY increase is due to a three percent increase in wages effective January 1, 2019. According to Valley, this wage expense will continue to increase. Valley R. Exc. at 10.

**d. Disposition**

In light of the record evidence, we agree with the ALJs’ recommendation, and therefore, shall allow Valley an expense claim of $132,269 for Account No. 879. The record indicates that the Company demonstrated that the vast majority of the HTY to FTY increase for Account No. 879, or $13,352, is a result of a three percent increase in wages that was effective January 1, 2019, and that the OCA acknowledged this wage increase in its direct testimony. *See* Valley St. 1, Exh\_(HSG-1), Schedule C1‑1 (R) at 2; OCA St. 1 at 7. Therefore, as Valley observed in its Replies to Exceptions, the OCA’s proposed use of the 2016-2018 average of Account No. 879 expenses does not accurately account for labor and overhead costs that are trending upward. *See* Valley R. Exc. at 10. Accordingly, we find that the OCA has not offered sufficient support for its proposed downward adjustment to the Company’s claim and Valley has presented substantial evidence in support of its Account No. 879 expense claim. For these reasons, we shall reject the OCA’s Exception No. 5.

### **Mains Operating Expense (Account No. 887)**

**a. Positions of the Parties**

Valley included a claim of $98,308 for Account No. 887. Although this is $41,499, or seventy-three percent higher than the expense in the HTY, the Company reasoned that this is due to additional purchases for an ongoing project to update signage, pipeline markers, and corrosion studies. Valley M.B. at 45; Valley R.B. at 15.

The OCA proposed a downward adjustment of $1,219, arguing that Valley’s witness Mr. Edward E. Rogers admitted in rebuttal that its expense claim included a one‑time expense for signage purchase. OCA M.B. at 29 (citing Valley Statement 4-R at 8).

**b. ALJs’ Recommendation**

The ALJs found that Valley justified the majority of its expense claim because the Company indicated that it has not completed an ongoing project and will likely continue to experience similar levels of expense in the FPFTY due to ongoing maintenance to address aging infrastructure. However, the ALJs also agreed with the OCA that this claim should be adjusted given the Company’s admission that it had a one‑time expense related to signage purchase. According to the ALJs, expenses that are not prudently incurred should be disallowed for ratemaking purposes. Therefore, the ALJs recommended that the Commission approve the OCA’s adjustment for Account No. 887 and reduce the Company’s claim by $1,219 from $98,308 to $97,089. R.D. at 34.

**c. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. Finding adequate record support to conclude the expense claimed, as adjusted is reasonable, we shall adopt the ALJ’s recommendation. Accordingly, we shall adopt the OCA’s proposal to reduce the Company’s claim for Account No. 887 by $1,219 from $98,308 to $97,089.

### **Customer Records and Collection Expense (Account No. 903)**

**a. Positions of the Parties**

Valley made a claim of $513,237 for Account No. 903, which represents a ten percent increase over the two years from the HTY to the FPFTY. Valley cited to increasing benefits and payroll expenses as the basis for this increase. Valley argued that Company-wide overhead expenses will increase during 2019, and particularly in 2020, due to the hiring of the Corrosion Technician in October 2019, because that position was not accounted for in the FTY budget. Valley reasoned that, although overhead YTD data within Account No. 903 is tracking lower than projected as of the first half of 2019, any adjustment should be made in conjunction with the increased FPFTY expense of the Corrosion Technician. Therefore, the Company submitted that the OCA’s proposed adjustment, *infra*, should be accepted only on the condition that the FPFTY expense adjustment for the Corrosion Technician is also accepted. Valley R.B. at 15-16.

The OCA proposed a downward adjustment of $32,977 to Valley’s claim for Account No. 903, representing a reduction from $513,237 to $480,260. In making this adjustment, the OCA proposed to allow the three percent overhead cost increases from the HTY to the FTY and to remove the three percent inflation adjustment from the FTY to the FPFTY. According to the OCA, the YTD overhead data as of June 30, 2019, supports its adjustment because overhead YTD data within Account No. 903 is tracking lower than projected as of the first half of 2019. The OCA took the position that the level of overhead expenses that the Company is claiming had not been experienced by the Company through the first half of 2019. OCA M.B. at 30-31.

**b. ALJs’ Recommendation**

The ALJs agreed with the OCA on this issue, recommending the denial of Valley’s expense claim for Account No. 903 in the amount of $513,237. The ALJs ruled that the Company failed to justify its projection that Company-wide overhead expenses will meet or exceed the FTY projections, given that YTD expenses as of September 30, 2019, are tracking lower than what the Company has projected. Regarding the addition of the Corrosion Technician that was not factored into the FTY budget, the ALJs reinforced that they accepted the Company’s expense adjustment of $81,280 for the Corrosion Technician. The ALJs explained that this adjustment would be reflected in the overall FPFTY claim in this proceeding. However, the ALJs also explained that while they recommend that the Commission adopt the OCA’s reasoning for reducing the Company’s claim, the OCA’s proposed final amount of $480,260 is higher than the Company’s YTD FTY annualized data. Therefore, the ALJs recommended a downward adjustment to the Company’s claim for Account No. 903 from $513,237 to $466,164, representing a reduction of $47,073. The ALJs explained that $466,164 is the nine‑month FTY data annualized without the inflation adjustment. R.D. at 35.

**c. Exceptions and Replies**

In its Exception No. 4, Valley submits that the ALJs erred in declining to apply a three percent inflation adjustment to labor-related costs to the FPFTY for this expense. Valley argues that because this account consists primarily of labor and overhead expense, it is reasonable to apply the Company’s three percent inflation adjustment to the expense approved for this account. Valley Exc. at 11.

In its Replies to Exceptions, the OCA restates that the ALJs correctly found that adding a three-percent inflation factor to the Company’s FPFTY adjustment is not appropriate. The OCA stresses that Valley made no attempt in its Exceptions to challenge the ALJs’ underlying finding that the Company failed to justify its projection that Company-wide overhead expenses for Account No. 903 will meet or exceed the FTY projections. OCA R. Exc. at 9-10.

**d. Disposition**

On consideration of the record evidence, we shall deny Valley’s Exception No. 4. We reinforce our finding, *supra,* that Valley should not be permitted to apply a three-percent inflation factor to all expenses. Additionally, we find that Valley has failed to justify its expense claim for Account No. 903. In this regard, our review of the record indicates that, while the Company cited to increases in overhead expenses comprised of payroll taxes and estimated increases in benefits in making its expense claim, this level of overhead expenses has not been experienced by the Company in the FTY. OCA M.B. at 31. Therefore, we shall adopt the ALJs’ recommended downward adjustment of $47,073 to the Company’s $513,237 claim for Account No. 903, resulting in an expense allowance of $466,164. As the ALJs noted, this reduction is more accurate than the OCA’s proposed adjustment, as it reduces the Company’s claim to the nine‑month FTY data annualized without the inflation adjustment. R.D. at 35.

### **Miscellaneous Customer Expense (Account No. 905)**

**a. Positions of the Parties**

Valley made a claim of $24,449 for Account No. 905, representing a seventeen percent reduction from the HTY to the FPFTY. Valley explained that this account was adjusted for a decrease in transportation, materials, and supplies. Valley submitted that the Commission should reject the OCA’s proposed adjustment, *infra,* related to the Company’s Information Technology (IT) backup system expense. According to Valley, the OCA provided no evidence that this expense will be non-recurring in future years. Further, Valley proffered that the OCA’s proposed adjustment fails to consider that Account No. 905 is running ahead of budget for 2019. Valley R.B. at 16.

The OCA proposed a downward adjustment of $8,980 to the Company’s claimed expense for Account No, 905. According to the OCA, the Company did not adjust for the inclusion of a one-time expense of $8,267 in 2018 for an IT backup system expense that should have been capitalized. Therefore, the OCA submitted that the Company’s claim should be lowered to account for this one-time expense and to eliminate the Company’s inflation adjustment. OCA M.B. at 32-33.

**b. ALJs’ Recommendation**

The ALJs agreed with the OCA’s reasoning on this issue and concluded that Valley did not provide sufficient evidence to show that the IT backup system expense is a recurring expense. Therefore, the ALJs recommended the disallowance of this expense. However, the ALJs recommended a downward adjustment of $8,515, as opposed to the $8,980 downward adjustment proposed by the OCA. The ALJs explained that their calculations provide for the removal of the IT backup expense and the elimination of the Company’s three percent inflation adjustment (*i.e.*, $8,267 x 1.03=$8,515). This would result in a final allowed claim for Account No. 905 of $15,934. R.D. at 36-37.

**c. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. Finding the ALJs’ recommendation is supported in the record and reasonable, we shall adopt it without further comment. Accordingly, we shall reduce the Company’s claim for Account No. 905 by $8,515 from $24,449 to $15,934.

### **Administrative and General Salaries (Account No. 920)**

**a. Positions of the Parties**

Valley made an expense claim of $536,697 for Account No. 920. Valley explained that this expense projection is an increase to the overhead portion of this expense, related to increasing benefits costs. According to Valley, even if the Company's claim is adjusted to reflect YTD FTY expenses, the OCA's proposal, *infra,* would still understate the allowance for Account No. 920. Valley argued that the YTD expense as of September 30, 2019, is tracking $56,277 below the Company's original projection, (inclusive of a three percent inflation adjustment). Additionally, Valley restated that Company-wide overhead expenses are projected to increase beyond the annualized numbers due to the hiring of the Corrosion Technician in October 2019, a position that was not in the FTY budget. Therefore, Valley contended that any adjustment to the Company's claim for Account No. 920 should be based on the annualized FTY YTD expense as of September 30, 2019, and accepted only on the condition that the FPFTY expense adjustment for the Corrosion Technician is also accepted, to account for general increases to overhead expense that were not accounted for in the FTY budget. Valley R.B. at 16‑17.

The OCA proposed a downward adjustment to the Company’s claim of $76,645, representing a reduction from $536,697 to $460,052. According to the OCA, the Company’s YTD overhead data supports this adjustment because the Company’s actual costs are not trending towards its projections. Therefore, the OCA proposed to allow only three percent overhead costs increases from the HTY to the FTY, while removing the three percent inflation adjustment from the FTY to the FPFTY. OCA M.B. at 33-34.

**b. ALJs’ Recommendation**

The ALJs recommended a reduction of $70,270 to the Company’s claim of $536,697, resulting in an Administrative and General Salaries expense of $466,427. The ALJs concluded that this figure more accurately reflects the projected expenses for the FPFTY. The ALJs explained that this figure represents the annualized FTY YTD expense for Administrative and General Salaries as of September 30, 2019. The ALJs found that the Company did not justify that the annualized FTY amount for benefit costs would increase in the FPFTY. Additionally, with regard to the addition of the Corrosion Technician that was not factored into the FTY budget, the ALJs reinforced that they accepted the Company’s expense adjustment of $81,280 for the Corrosion Technician. The ALJs explained that this adjustment would be reflected in the overall FPFTY claim in this proceeding. R.D. at 38.

**c. Exceptions and Replies**

In its Exception No. 5, Valley submits that the ALJs erred in declining to apply a three percent inflation adjustment to labor-related costs to the FPFTY for this expense. Valley reiterates that it has budgeted for increases to employee wages and that benefits and health care expenses will increase by at least nine percent. Therefore, Valley remains of the opinion that, because Account No. 920 consists primarily of labor and overhead expense, it is reasonable to apply the Company’s three percent inflation adjustment to the expense approved for this account. Valley Exc. at 12.

In its Replies to Exceptions, the OCA reinforces its assertion that the ALJs correctly found that adding a three-percent inflation factor to the Company’s FPFTY adjustment is not appropriate. The OCA stresses that Valley made no attempt in its Exceptions to challenge the ALJs’ underlying finding that the Company failed to justify its projection that the annualized FTY amount for benefit costs would increase in the FPFTY. OCA R. Exc. at 10.

**d. Disposition**

We shall deny Valley’s Exception No. 5. We have previously rejected Valley’s proposal that a three percent inflation factor be applied to all expenses. Further, we find that Valley has failed to adequately support its expense claim for Account No. 920. Namely, as the OCA and the ALJs noted, Valley did not justify that the annualized FTY amount for benefit costs would increase in the FPFTY. We also note that the ALJs’ recommended downward adjustment was based on FTY YTD data as of September 30, 2019, as opposed to the FTY YTD data as of June 30, 2019, that the OCA utilized in making its proposed adjustment. As the ALJs used more recent YTD projections, we shall adopt the ALJs’ recommendation and reduce the Company’s expense claim for Account No. 920 by $70,270, or from $536,697 to $466,427. In our view, this represents a more accurate adjustment to the Company’s claim based on the record before us.

### **Office Supplies and Expense (Account No. 921)**

**a. Positions of the Parties**

Valley’s filing included an expense claim of $74,701 for Account No. 921. According to Valley, this amount is needed because of increased training for new hires and replacements. Valley contended that the Company would be incurring ongoing training costs both to onboard new employees and “to address increasing regulatory obligations for certified Operators and employee training for continually evolving human resources issues.” Additionally, Valley submitted that actual FTY expenses for Account No. 921 as of September 30, 2019, are tracking below projections by $12,969. Valley M.B. at 45-46.

The OCA posited that Valley is only anticipating one new hire in the FPFTY, indicating that its training expense should not increase from prior years. Additionally, the OCA alleged that it is not likely that Valley will experience a significant increase in travel and training expenses based upon its travel and training expenses recognized through the first half of 2019. Therefore, the OCA argued that the FPFTY should reflect the HTY travel and training expenses and that the remainder of the Account No. 921 expenses should reflect the FTY levels to eliminate the use of the Company’s inflation factor that it used to determine FPFTY. Using this methodology, the OCA proposed a downward adjustment to the Company’s expense claim for Account No. 921 from $74,701 to $55,191, representing a reduction of $19,510. OCA M.B. at 34‑35.

**b. ALJs’ Recommendation**

The ALJs agreed with the OCA that Valley has provided no justification for its speculation that its travel and training expenses will significantly increase during the FPFTY. The ALJs highlighted the OCA’s assertion that Valley is only anticipating one new hire in the FPFTY. According to the ALJs, without justification that travel and training expenses will increase due to new hires, Valley’s original FPFTY claim for this expense has not been justified and supported in the record. At the same time, however, the ALJs found the OCA’s proposed adjustment should be modified to reflect more recent YTD projections as of September 30, 2019, and not the YTD projections as of June 30, 2019 that were utilized by the OCA. The ALJs stated that Valley’s YTD projections as of September 30, 2019, annualized and without an inflation adjustment, produces a figure of $59,934. According to the ALJs, this figure more accurately represents the projected costs for this expense for the FPFTY, as it reflects the travel and training expenses that the Company experienced through the first nine months of 2019. Accordingly, the ALJs recommended an allowance of $59,934 for the Company’s Office Supplies and Expense, representing a reduction of $14,767 to the Company’s claim. R.D. at 40.

**c. Exceptions and Replies**

In its Exception No. 6, the OCA submits that, although the ALJs correctly adopted the OCA’s reasoning for why the Company’s expense claim for Account No. 921 should be reduced, they erred in reducing the OCA’s proposed downward adjustment. The OCA alleges that the ALJs over-emphasized the Company’s most recent one-time expenditures and that their recommended adjustment fails to eliminate one-time increases experienced by the Company. The OCA remains of the opinion that there is no indication that the Company’s proposed training and travel expenses will continue beyond 2020. Therefore, the OCA submits that the Commission should modify the ALJs’ recommendation and adopt the OCA’s proposed downward adjustment for this expense. OCA Exc. at 13-14.

Valley did not except to the ALJs’ recommendation on this issue. In its replies to the OCA’s Exception No. 6, Valley contends that its training and travel expenses are ongoing and the Company will continue to incur them. More specifically, Valley argues that the Company will incur ongoing training costs both to onboard new employees and increase gas safety training. Therefore, Valley contends that the ALJs appropriately recognized that these ongoing expenses should not be ignored. Valley R. Exc. at 12.

**d. Disposition**

We shall adopt the ALJs recommendation on this issue. In our view, Valley has not provided sufficient evidence to justify its full expense claim for Account No. 921. As the OCA observed, given that Valley is only anticipating one new hire in the FPFTY, its training expense should not increase from prior years. OCA St. 1 at 16. On the other hand, we disagree with the arguments of the OCA set forth in its Exception No. 6 that we should adopt its proposed downward adjustment of $19,510 to Account No. 921. As the ALJs noted, the OCA’s proposed downward adjustment was based on YTD projections as of June 30, 2019, rather than more recent YTD projections as of September 30, 2019. R.D. at 40. Thus, we concur with the ALJs that the more recent data more accurately represents the Company’s projected cost for the FPFTY, as it reflects the travel and training expenses Valley experienced through the first nine months of 2019, instead of only the first six. Accordingly, we shall deny the OCA’s Exception No. 6 and adopt the ALJs’ recommendation, which reduces the Company’s expense claim for Account No. 921 by $14,767, or from $74,701 to $59,934.

### **Regulatory Commission Expense (Account No. 928)**

**a. Positions of the Parties**

Valley's rate filing included a $38,524 claim for Regulatory Commission Expense, which it revised to $36,813. However, the Company did not oppose the position of I&E, *infra.* Namely, Valley conceded that if the Commission denies the Company's primary proposal to accept its FPFTY expense claim based on the FTY annualized expense, the three percent inflation factor, and the additional expense adjustments related to the Corrosion Technician hire and the employee prolonged absence due to medical leave, the Company would accept this adjustment. Valley M.B. at 44.

I&E submitted that the Company’s entire claim should be disallowed. According to I&E, Valley claimed the Regulatory Commission Expense both as an expense and taxes other than income taxes. More specifically, I&E argued that Valley identified regulatory expenses for Account No. 928 as consisting of its Commission assessment and its Public Utility Reality Tax (PURTA) amount. However, I&E noted that Valley also claimed a PURTA amount of $10,000 and a Commission assessment expense of $24,296, as taxes other than income taxes. I&E submitted that the Company failed to provide an adequate explanation for why these expenses were double counted. I&E M.B. at 14-15.

**b. ALJs’ Recommendation**

The ALJs agreed with I&E and recommended that the Company’s entire expense claim for Account No. 928 be disallowed. The ALJs found persuasive I&E’s argument that Valley claimed PURTA and Commission assessment expenses as taxes other than income taxes. Therefore, the ALJs concluded that allowing Valley to also claim these expenses as Regulatory Commission Expenses would be improper, as it would allow the Company to double-count for the Commission assessment and the PURTA. The ALJs pointed out that Valley did not oppose I&E’s position. Further, the ALJs reinforced that with respect to the adjustments related to the Corrosion Technician hire and the prolonged employee absence, the total FPFTY expense claim recommended would be adjusted to reflect the inclusion of these expense adjustments. R.D. at 41.

**c. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. We likewise find the recommendation of the ALJs to be supported by the record and reasonable. As I&E and the ALJs both observed, it would not be proper to permit the Company to double-count this expense when it has already claimed it as part of taxes other than income taxes. Accordingly, we shall adopt the ALJs’ recommendation and shall disallow the Company’s entire claim for Account No. 928.

### **General Advertising Expense (or Miscellaneous General Expenses) (Account No. 930)**[[9]](#footnote-9)

**a. Positions of the Parties**

Valley included an expense claim for Account No. 930 of $73,373. Valley argued that it recently began participating in an annual Beyond the Boardroom leadership training program organized by the American Gas Association. Valley stated that in October 2019, one director attended the training, but another had to cancel due to scheduling conflicts. However, Valley submitted that, because it will continue to budget for two attendees every year, this will be a recurring expense. Valley also addressed the Company’s volunteer labor expenses that are included in this account. According to Valley, these volunteer programs “foster happy, healthy, and fulfilled employees, which helps to reduce turnover and to increase employee productivity.” Valley St. 4 at 10. Valley reasoned that increased productivity benefits ratepayers through better service. Valley posited that these expenses benefit Valley's customers by contributing to a productive and engaged workforce. Therefore, Valley asserted that the Commission should approve the Company’s claim in its entirety. Valley M.B. at 46-47.

I&E argued that the Company’s claim should be reduced by $14,415 to $58,958. The first component of I&E’s proposed downward adjustment reflects a $7,351 downward adjustment that I&E argues the Company made to Account No. 930 in its rebuttal testimony ($73,373 – $66,022). The remaining component of I&E’s proposed adjustment, or $7,064, consists of $6,603 for volunteer labor and $461 for volunteer expense. According to I&E, Valley did not provide adequate analysis, support, or documentation that volunteer labor provides direct benefits to ratepayers or that it is an operational cost necessary to provide safe and reliable natural gas service. In I&E’s view, ratepayers should not be required to finance the Company’s decision to pay its employees to provide volunteer labor because a portion of this volunteer labor may be for organizations that ratepayers would choose not to support. I&E M.B. at 15-16.

The OCA challenged the Company’s inclusion of off-site volunteering labor in its claim for Account No. 930. The OCA alleged that this labor does not benefit ratepayers. Therefore, the OCA proposed a downward adjustment of $3,889, which would remove the Company’s inclusion of such labor expense. OCA M.B. at 35.

**b. ALJs’ Recommendation**

The ALJs recommended that the Commission adopt the OCA’s proposed downward adjustment of $3,889 and approve a total claim of $69,484 for Account No. 930. The ALJs explained that the primary point of contention between the Parties on this issue centers on whether the expenses the Company undertook relating to volunteer labor were expenses necessary to provide gas service to its customers. The ALJs found that Valley did not provide sufficient evidence that off-site volunteer work expenses are necessary in the provision of gas service to its customers. Therefore, the ALJs concluded that a reduction to the Company’s claim to remove these expenses is needed. R.D. at 43.

**c. Exceptions and Replies**

In its Exception No 3, I&E objects to the ALJs’ recommendation and insists that the record does not support a claim of greater than $58,958 for Account No. 930, representing a reduction of $14,415 to the Company’s claim. I&E restates that its proposed reduction includes two components. I&E reiterates that the first component reflects the $7,351 downward adjustment Valley made to this expense in rebuttal testimony. I&E argues that it accepted this adjustment in its surrebuttal testimony and that Valley did not claim a further adjustment to its rebuttal testimony at any subsequent stage of the proceeding. Therefore, I&E submits this $7,351 downward adjustment is uncontested and should be approved. I&E Exc. at 8 (citing Valley Errata St. 1-R at 5; I&E St. 1-SR (Errata Version) at 20).

I&E argues that the second component of its proposed adjustment should also be adopted by the Commission. In this regard, I&E claims that the ALJs erred in recommending that the Commission adopt the OCA’s proposed downward adjustment of $3,889 to remove this expense, rather than I&E’s proposed reduction of $7,064. Namely, I&E claims that the ALJs erred by accepting the OCA’s adjustment, because it is Valley’s accounting of volunteer expenses for 2019. In contrast, I&E argues that its own proposed adjustment reflects the removal of volunteer labor expenses for 2020, *i.e.*,the FPFTY. I&E Exc. at 8-9.

In reply to I&E’s Exception No. 3, Valley notes that it did not except to the ALJs’ recommendation and submits that it should be adopted by the Commission, subject to the three percent inflation adjustment addressed in the Company’s Exceptions. Valley refutes I&E’s argument that the first component of its proposed downward adjustment, or $7,351, is uncontested. Namely, Valley argues that the presentation of individual expense data by its witness Mr. Howard S. Gorman in Valley’s rebuttal testimony did not modify the initial claim for the individual expense item. Rather, Valley contends that Mr. Gorman proposed an overall approach to O&M expenses of annualizing the most updated available YTD data as of September 30, 2019 and adding an inflation adjustment to convert FTY expenses to FPFTY projections. However, Valley argues that this was an across-the-board proposal in response to the fact that small companies must often shift resources as needs arise, not a limitation on the Company's individual claims following rejection of the across-the-board proposal. Valley R. Exc. at 8-9 (citing Valley St. 1-R at 4-6); Valley R. Exc. at 10.

Valley also challenges I&E’s argument that its proposed reduction of $7,064, related to the removal of volunteer labor expenses should be adopted. Valley claims that the ALJs correctly adopted the OCA's proposed downward adjustment of $3,889 because the ALJs’ expense allowance is based on annualized 2019 data, and not the 2020 data advocated by I&E. Therefore, Valley submits that the ALJs reasonably deducted the annualized YTD 2019 volunteer expense and applied its adjustments consistently. Valley R. Exc. at 9-10.

**d. Disposition**

At the outset, we note that we agree with each of I&E, the OCA, and the ALJs that the Company has not provided any adequate analysis, support, or documentation that volunteer labor provides direct benefits to ratepayers and is an operational cost necessary to provide safe and reliable natural gas service. Therefore, we agree with the ALJs’ recommendation that expenses related to volunteer labor must be removed from the Company’s expense claim for Account No. 930. However, upon review, we shall also grant I&E’s Exception No. 6. First, as I&E has pointed out, Valley, in its rebuttal testimony, made a downward adjustment of $7,351 (from $73,373 to $66,022) to its claim for Account No. 930, which I&E accepted in its surrebuttal testimony. Valley St 1-R at 5; I&E St. 1-SR (Errata) at 19-20. Because Valley did not make a further adjustment to this claim, we must accept this as the Company’s final claim for Account No. 930. Second, we find that the second component of I&E’s proposed adjustment to the Company’s claim more accurately reflects the removal of expenses related to volunteer labor, because it reflects the removal of these expenses for 2020, which is the FPFTY. Accordingly, we shall modify the ALJs’ recommendation and adopt I&E’s proposed downward adjustment of $14,415 to the Company’s expense claim for Account No. 930. This will result in a final allowed claim of $58,958.

### **C&T Allocation Expense**

**a. Positions of the Parties**

Valley sought allowance of $233,608 for allocated expenses for shared services from C&T. C&T highlighted that the Company's C&T Allocation Expense claim for the FPFTY represents an exception from the Company’s proposal to increase FTY expense by the three percent inflation adjustment, as Valley applied a one percent increase from FTY costs based on historic increases to its C&T allocation. Valley M.B. at 47. Valley provided YTD data that shows that the expense for C&T Allocation Expense is $128,441.23 as of September 30, 2019. *Id.* at 48 (citing Valley Rejoinder Exh. 7). Valley noted that annualizing the YTD FTY data and adding a one percent increase would result in a FPFTY claim of $172,967. However, Valley submitted that because the Company’s historic annual expense for C&T Allocation Expense exceeded the 2019 projections in 2016, 2017, and 2018, annualizing the YTD data would not produce a reasonable expense claim for the Company’s C&T Allocation. Valley M.B. at 48.

According to the Company, anticipated future trends support the approval of the Company’s expense claim. Valley stressed that C&T allocation is based on the revenue and meter counts for Valley and its affiliated operating companies. Valley emphasized that the first phase of its East Athens Main Extension Project (East Athens Project) was not scheduled for completion until November 2019. As such, Valley asserted that the YTD numbers as of September 30, 2019, for C&T Allocation Expense do not reflect additional customers in East Athens anticipated to begin service before the end of the FTY and throughout the FPFTY. Valley M.B. at 48.

I&E proposed a downward adjustment of $44,429, which would reduce the Company’s claim to $189,179. I&E argued that this proposed adjustment should be made because the projected increase from the HTY to the FTY exceeds the historical annual increases for this expense item. Therefore, I&E based its adjustment on the Company’s average annual percentage increase of the C&T allocation to Valley from 2016 to the HTY due to the Company's three-year history not supporting its twenty-six percent increase to the C&T allocation from the HTY to the FTY. I&E contended that the current FTY data confirms that this adjustment is reasonable. I&E M.B. at 18-19.

**b. ALJs’ Recommendation**

The ALJs agreed with Valley and recommended that the Company’s proposed expense claim of $233,608 be approved. The ALJs reasoned that Valley provided sufficient evidence to justify its claim, because it connected its claim to the East Athens Project. The ALJs agreed with the Company’s assertion that the YTD numbers as of September 30, 2019, are not reflective of additional customers anticipated to begin service in the FTY and through the FPFTY. The ALJs pointed out that the use of a FPFTY allows the Company to base expenses on future expectations. Because this recommendation involves the approval of estimated projected expenses that will be included in the Company’s base rates, the ALJs also recommended that the Company’s future actual expenditures related to the allowed C&T Allocation Expense be monitored to ensure the accuracy of projected expenses. R.D. at 44-45.

**c. Exceptions and Replies**

In its Exception No. 2, I&E argues that the ALJs erred as a matter of law by allowing Valley to present its claim regarding the East Athens Project for the first time in the briefing stage of this proceeding. According to I&E, Valley’s East Athens Main Extension Project rationale relies, in part, on a discovery response it provided to I&E, which I&E included in its direct testimony as I&E Exhibit No. 1, Schedule 1. However, I&E submits that no Party included any testimony as to the relationship of the East Athens Project to the Company’s C&T Allocation expense claim. Therefore, I&E submits that its due process rights were violated, as it was deprived of the ability to respond to or examine the Company’s claim in testimony, hearings, or in its Main Brief. I&E also remains of the opinion that substantial evidence does not exist to support a claim of more than $189,179 because Valley provided no quantifiable analysis to support its claim. I&E Exc. at 7-8, n.19.

Valley refutes I&E’s argument that it raised this issue for the first time in its Main Briefs, arguing that its position stated in Main Briefs, and the ALJs’ recommendation relating thereto, relied on existing evidence in the record. Valley argues that there is substantial evidence in the record to demonstrate that the annualized FTY expense will understate the Company's C&T Allocation Expense for the FPFTY. Valley also restates that the C&T Allocation Expense is determined by the Company's revenue and meter count. Valley R. Exc. at 7-8. Further, Valley argues that it stated in its direct testimony that it has projected customer growth in the FPFTY due to the East Athens Project. *Id.* at 8 (citing Valley St. 4 at 11).

**d. Disposition**

We agree with the ALJs’ recommendation that Valley’s proposed expense claim of $233,608 should be approved. Additionally, we agree with the ALJs’ recommendation that, given the Company’s use of an FPFTY, which permits the Company to estimate project expenses, Valley’s future actual expenditures related to the allowed C&T Allocation Expense should be monitored to ensure the accuracy of projected expenses. *See* R.D. at 44-45. We find no merit in I&E’s argument in its Exception No. 2 that Valley presented its claim regarding the East Athens Project for the first time in its Main Briefs. Rather, the record supports Valley’s assertion that the Company’s position in its Main Briefs, and the ALJs’ recommendation thereto, relied on evidence that was already in the record.

More specifically, in his direct testimony, Valley’s witness Mr. Rogers noted that on May 9, 2019, the Commission entered an Order at Docket No. P‑2018‑3006500 authorizing Valley to fund construction of gas mains to serve customers in Athens Township, Pennsylvania. Mr. Rogers explained that Valley is certified to provide service in all of Athens Township, but had not previously served customers on the east side of the Susquehanna River (*i.e.*,East Athens). Therefore, Valley developed an expansion project to extend gas mains across the river to East Athens. Mr. Rogers further noted that Valley applied for and received a Pipeline Investment Program (PIPE) grant from the Pennsylvania Department of Community and Economic Development (DCED) to help fund this project. Valley St. 4 at 10-11. In addition, in his rebuttal testimony, Mr. Rogers reiterated that the Company’s efforts in obtaining the DCED PIPE grant made it financially possible to provide the benefits of natural gas service to an unserved community. Valley St. 4-R at 3. Further, Valley provided an exhibit indicating its expectation to commence service to customers in East Athens before the end of 2019 and quantified the additional customers in its FTY and FPFTY customer accounts. Valley St. 1, Exh\_(HSG-1), Sch. B3(R).

We further agree with the ALJs that Valley successfully connected its East Athens Project to its C&T Allocation Expense claim. The record demonstrates that the C&T Allocation is based on the revenue and meter counts for Valley and its affiliated operating companies. However, because the first phase of the East Athens Project was not scheduled for completion until November 2019, the FTY YTD numbers as of September 30, 2019 for C&T Allocation Expense do not reflect the additional customers in East Athens anticipated to begin service before the end of the FTY and throughout the FPFTY. Valley M.B. at 48. Therefore, we find it reasonable to conclude that either a claim based on the Company's annualized FTY expense or the I&E claim based solely on the Company's historical expense level would understate the FPFTY expense. As such, we shall approve the Company’s full expense claim of $233,608 and shall deny I&E’s Exception No. 2.

### **Uncollectible Expense**

**a. Positions of the Parties**

Valley claimed an Uncollectible Expense of $55,430, which reflects the Company's total projected Uncollectible Expense for the FPFTY of $100,799 minus the commodity portion of Uncollectible Expense ($45,369) to be unbundled for recovery through the GCR. Valley explained that the Company’s calculation is based on the most recent Company information regarding uncollectible accounts. Valley argued that I&E’s proposed downward adjustment, *infra*, would understate the Company’s Uncollectible Expense by following the 0.84% write-off percentage Valley experienced in the HTY. In addition, Valley noted that I&E's recommended Uncollectible Accounts Expense would be lower than the Company’s actual experienced Uncollectible Accounts Expense in 2014 and 2015. Valley M.B. at 49.

I&E proposed an Uncollectible Expense allowance of $31,229, representing a downward adjustment to the Company’s claim of $24,201. I&E also recommended that the Commission use a write-off ratio of 0.62% to determine the additional uncollectible accounts expense that results from any final rate base increase to be determined in this proceeding. According to I&E, the Company’s use of only the most recent information to determine its Uncollectible Accounts Expense ignores the fact that this expense fluctuates from year to year. Therefore, I&E proposed that the Company use a three-year average of gross revenues and net write-offs. I&E explained that Valley’s three-year net write-off history is 0.49% for 2016, 0.52% for 2017, and 0.84% for the 2018 HTY, resulting in an average write-off ratio of 0.62%. I&E reasoned that, because the HTY indicates a much larger net write-off ratio than the previous two years, the Company would be overstating its claim by using only the most recent experience. I&E further argued that the Company did not properly support or explain its large increase of $43,852 in Uncollectible Accounts expense for the FTY. I&E M.B. at 17-18.

The OCA, likewise, argued that Valley’s uncollectible expenses are not trending in a way that supports the Company’s forecast. The OCA highlighted that the Company’s total projected uncollectible expense of $100,799 is $46,787, or eighty-seven percent, higher than the expense in the HTY. Therefore, the OCA proposed that the Company’s bad debt reserve be adjusted based upon the Company’s approved revenue requirement and projected sales at the conclusion of this case. OCA M.B. at 31-32.

**b. ALJs’ Recommendation**

The ALJs agreed with I&E and recommended that the Company’s Uncollectible Expense claim of $55,430 be reduced by $24,201, for a final allowed claim of $31,229. The ALJs agreed with I&E that Valley has overstated its claim by only using the 0.84% write-off percentage experienced in the HTY to determine its uncollectible expense given that this write-off percentage is greater than those experienced by the Company in the previous two years. The ALJs also agreed with I&E’s proposal to direct the Company to use a write-off ratio of 0.62% attributable to any final base rate increase. According to the ALJs, using the three-year average that I&E used to derive this percentage normalizes the write-off percentage and prevents over-recovery of this expense. R.D. at 46.

**c. Exceptions and Replies**

In its Exception No. 6, Valley finds fault with the ALJs’ recommendation. The Company claims that the write-off ratios it experienced in 2014, 2015, and 2018 are all higher than the 0.62% write-off ratio proposed by I&E and recommended by the ALJs. As such, Valley reasons that its 2016 and 2017 write-off ratios appear to be abnormally low in comparison to the years prior and the years after. Therefore, Valley remains of the opinion that it is reasonable and prudent for the Company to rely on the most recent year as more reflective of normal operating conditions. Valley Exc. at 12-13.

In its Replies to Exceptions, I&E supports the ALJs’ recommendation and reiterates its position that because Valley’s write-off history for the HTY shows a much larger net-write off ratio than the previous two years, the Company would be overstating its claim by relying solely on data from the HTY. I&E further argues that the Commission should disregard Valley’s argument regarding 2014 and 2015, because the Company did not introduce this argument until the briefing stage of this proceeding, thereby depriving I&E of its ability to scrutinize this contention in testimony. Further, I&E submits that Valley has provided no discussion or analysis to explain its contention, or how it relates to or supports its claim. I&E R. Exc. at 4-5.

**d. Disposition**

We agree with I&E and the ALJs on this issue and shall grant I&E’s $24,201 downward adjustment to Valley’s Uncollectible Expense. We find that Valley failed to carry its burden of proof that only the most recent year should be relied upon when examining the Company’s uncollectibles and the associated write-off percentage. Rather, we agree with I&E and the ALJs that using an average of the Company’s three-year net write-off history for the period of 2016 through 2018 represents a more accurate measure which will prevent the Company’s Uncollectible Expense from being overstated. The record indicates that Valley’s three-year net write-off history is 0.49% for 2016, 0.52% for 2017, and 0.84% for the HTY, representing an average write-off percentage of 0.62%. Examining this three-year period more closely, the history shows a larger change in net write-offs from 2017 to 2018 of 0.32% (*i.e.*,from 0.52% to 0.84%) and a smaller change between 2016 and 2017 of 0.03% (from 0.49% to 0.52%). *See* I&E St. 1 at 16.

Therefore, we disagree with Valley that the 2016 and 2017 write-off ratios were outliers. Rather, the HTY indicates a much larger net-write off ratio than the previous two years, which would cause the Company to overstate its claim by using only the most recent experience. Further, the record supports I&E’s argument that Valley did not raise the issue of its 2014 and 2015 write-off percentages until the briefing stage of this proceeding. *See* I&E R. Exc. at 5. As such, we give no weight to Valley’s argument. Accordingly, we shall deny Valley’s Exception No. 6 and adopt the ALJs’ recommendation to award Valley an Uncollectible Expense of $31,229,[[10]](#footnote-10) representing a downward adjustment of $24,201 to its original claim of $55,430. Further, we shall adopt the ALJs’ recommendation to direct Valley to use a write-off ratio of 0.62% attributable to the base rate increase of $469,097 that we are awarding the Company in this Opinion and Order.

### **Depreciation Expense**

**a. Positions of the Parties**

As a result of Valley’s use of the end of test year rate base, Valley has also based its depreciation expense on the projected balance of plant in service as of the end of the FPFTY. OCA M.B. at 38. Valley Exhibit\_(HSG-1) Schedule C3 indicates a depreciation expense for the Company of $971,413. Valley Exh\_(HSG-1) Sch. C3 at 2.

The OCA proposed an adjustment to the Company’s depreciation expense that aligns with its proposed average rate base methodology for calculating the FPFTY. After first adjusting the Company’s, as filed depreciation expense from $971,413 to $970,394 to reflect retirements, the OCA proposed that this expense be reduced by an additional $33,805 to reflect the use of an average test year rate base, resulting in a depreciation expense of $936,589. OCA M.B. at 38; OCA St. 1 at Sch. LKM-1 and LKM-2.

**b. ALJs’ Recommendation**

Consistent with their recommendation that Valley be permitted to utilize end-of-year methodology in its FPFTY, the ALJs recommended that the Commission adopt Valley’s claim for depreciation expense and reject the OCA’s proposed downward adjustment. The ALJs noted that this is consistent with the Commission’s decision in *UGI.* R.D. at 47-48 (citing *UGI* at 74-76).

**c. Exceptions and Replies**

As noted under our discussion of the Company’s rate base claims, *supra,* the OCA, in its Exception No.1, excepts to the ALJs’ recommendation that Valley be permitted to utilize an end of test year rate base. Therefore, the OCA maintains that its proposed downward adjustment of $33,805 to the Company’s depreciation expense should be adopted to reflect the use of an average test year rate base. OCA Exc. at 2-5.

In reply, Valley argues that the ALJs properly adopted the end of FPFTY methodology and that the Exceptions of the OCA should be denied, consistent with this recommendation. Valley R. Exc. at 3‑4.

**d. Disposition**

For the reasons set forth in our disposition of the issue pertaining to the end-of-year versus average rate base methodology, *supra*, we find that the ALJs properly permitted Valley to use the end-of-year methodology in its FPFTY. However, as set forth in our disposition of the issue pertaining to plant retirements, we have also found merit in the OCA’s argument that such retirements should be reflected in Valley’s rate base for the FPFTY. Accordingly, we shall deny the Exceptions of the OCA as they relate to its argument that a downward adjustment of $33,805 should be made to the Company’s depreciation expense to reflect the use of an average test year rate base.

At the same time, we shall grant the OCA’s Exceptions to the extent that we shall reduce Valley’s depreciation expense claim to reflect plant retirements. As noted above, prior to adjusting the Company’s depreciation expense to reflect its position on the average rate base, the OCA first made a reduction to the Company’s as-filed depreciation expense from $971,413 to $970,394 to reflect retirements. We shall adopt this adjustment. This results in a downward adjustment of $1,019 to the Company’s depreciation expense.

Accordingly, we shall grant the OCA’s Exceptions on this issue, in part, and deny them, in part, and modify the ALJs’ recommendation regarding the Company’s depreciation expense.

### **Cash Working Capital**

**a. Positions of the Parties**

As noted under our discussion of the Company’s rate base claims, *supra,* Valley’s CWC claim is based on one-eighth, or 12.5% of its O&M expenses. Therefore, adjustments to working capital will be made in accordance with total O&M operating adjustments adopted in this proceeding. R.D. at 47.

**b. ALJs’ Recommendation**

The ALJs recommended a total downward adjustment to O&M expenses of $164,072 based on the individual expense adjustments they recommended, as discussed above. The ALJs explained that this recommendation results in a downward adjustment to CWC of $20,509 ($164,072 x 12.5% = $20,509). R.D. at 47.

**c. Disposition**

Based on the above discussion of the adjustments to Valley’s individual expense claims, we have approved a total downward adjustment to the Company’s O&M expenses of $165,169. As noted in our discussion of the CWC under Section IV of this Opinion and Order, *supra*,we have employed the same “one-eighth” method as utilized by the Company in making the corresponding adjustment to Valley’s CWC claim. Therefore, our finding that the Company’s total O&M expense should be reduced by $165,169 results in a corresponding downward adjustment to CWC of $20,646 ($165,169 x 12.5% = $20,646).

# **Fair Rate of Return**

## **Capital Structure**

**1. Positions of the Parties**

Valley proposed a capital structure of 47.45% long-term debt and 52.55% common equity, consistent with the average capital structure ratios in the Company’s Gas Utility Proxy Group. No Parties disputed the Company’s proposal. Valley M.B. at 51; I&E M.B. at 25; OCA M.B. at 44.

**2. ALJs’ Recommendation**

The ALJs recommended the adoption of Valley’s proposed capital structure. R.D. at 51.

**3. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. We find that the ALJs’ recommendation is supported by ample record evidence and is just and reasonable. Accordingly, we shall adopt a capital structure for Valley of 47.45% long-term debt and 52.55% common equity, as recommended by the ALJs.

## **Cost of Long-Term Debt**

**1. Positions of the Parties**

Valley and I&E agreed that the Company’s cost of long-term debt should be set at a rate of 4.54%. The OCA did not oppose this cost of long-term debt. Valley M.B. at 51; I&E M.B. at 25-26; OCA M.B. at 44.

**2. ALJs’ Recommendation**

The ALJs recommended the adoption of Valley’s proposed long-term debt cost rate. R.D. at 51.

**3. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. Finding the ALJs’ recommendation to be supported by record evidence and reasonable, we adopt it without further comment. Accordingly, we shall adopt a long-term debt cost rate for Valley of 4.54%.

## **Cost of Common Equity**

In the instant proceeding, Valley, I&E and the OCA each 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, and the reflection or rejection of a size risk adjustment 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[[11]](#footnote-11) used by the Parties in this proceeding:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Party** | **DCF** | **CAPM** | **RP** | **CE** | **ROE** |
| **Valley** | 9.02% | 9.22% | 9.26% | 10.26% | 10.60% |
| **I&E** | 8.46% | 8.04% |  |  | 8.46% |
| **OCA** |  7.67-10.02% |  9.54-9.61% |  9.54-9.61% |   | 8.34% |

**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 M.B. at 26-27; OCA M.B. at 49-50.

**a. Positions of the Parties**

Initially, Valley selected a seven-company proxy group based on selection criteria, which is outlined below. Valley explained, in its rebuttal testimony, that it updated this proxy group to exclude one company after re-running the selection criteria based on updated data. Valley M.B. at 51. Valley determined its gas utility proxy group of six gas companies based on the following criteria:

1. The company must be included in the Natural Gas Utility Group of *Value Line’s Standard Edition* (March 1, 2019);
2. The company must have sixty percent or greater of fiscal year 2017 total operating income derived from, and sixty percent or greater of fiscal year 2017 total assets attributable to, regulated gas distribution operations;
3. At the time of preparation of the testimony of Valley’s witness Mr. D’Ascendis, the company must not have publicly announced that they were involved in any major merger or acquisition activity (*i.e*.,one publicly-traded utility merging with or acquiring another);
4. The company must not have cut or omitted their common dividends during the five years ended 2017 or through the time of preparation of Mr. D’Ascendis’ testimony;
5. The company must have *Value Line* and Bloomberg Professional Services (Bloomberg) adjusted betas;
6. The company must have positive *Value Line* five-year dividends per share (DPS) growth rate projections; and
7. The company must have *Value* Line, Reuters, Zacks, or Yahoo! Finance consensus five-year earnings per share (“EPS”) growth rate projections.

Valley St. 2 at 12.

The OCA adopted the Company’s original proxy group for use in this proceeding. OCA M.B. at 50.

I&E’s proxy group consisted of five companies. To select a proxy group that resembles the natural gas utility industry, I&E applied the following criteria:

1. Fifty percent or more of the company's revenue were generated from the regulated natural gas industry;
2. The company's stock was publicly traded;
3. Investment information for the company was available from more than one source, including Value Line;
4. The company must not be involved in an announced merger or the target of an announced acquisition;
5. The company must have five consecutive years of historic earnings data; and
6. The company must be operating in a state that has a deregulated gas utility market.

I&E M.B. at 27.

The following table is a summary of the companies each party utilized in their respective proxy groups:

|  |  |  |
| --- | --- | --- |
| **Valley** | **OCA** | **I&E** |
| Atmos Energy Corporation | Atmos Energy Corporation | Atmos Energy Corporation |
| Northwest Natural Holding Co. | Northwest Natural Holding Co. | Northwest Natural Holding Co. |
| ONE Gas, Inc |  ONE Gas, Inc | ONE Gas, Inc |
| Spire, Inc | Spire, Inc | Spire, Inc. |
| South Jersey Industries, Inc | South Jersey Industries, Inc | NiSource Inc |
| Southwest Gas Holdings, Inc | Southwest Gas Holdings, Inc. |  |
|  | New Jersey Resources |  |

Valley St. 2 at 12-13; Valley St. 2-R at 4; I&E M.B. at 33; OCA M.B. at 50.

I&E submitted that Valley’s proxy group is flawed, because it includes South Jersey Industries, Inc., which does not meet I&E’s first criterion that fifty percent or more of the company’s revenues must be generated from the regulated gas utility. Additionally, I&E argued that if Valley used 2018 data, then the Company’s inclusion of South Jersey Industries, Inc. would not meet Valley’s own second criterion, *supra.* I&E acknowledged that the Company re-ran its selection criteria in its rebuttal testimony. However, I&E pointed out that South Jersey Industries, Inc. remains in the Company’s proxy group. Thus, I&E claimed that its own proxy group criteria are based upon more current information than the Company’s. I&E M.B. at 33-34.

In response, Valley argued that its updated proxy group is based on data available as of September 30, 2019, which is the most recent data available. Therefore, Valley claimed that its proxy group should be adopted. Valley R.B. at 22.

**b. ALJs’ Recommendation**

The ALJs found in favor of I&E and recommended that its proxy group be utilized. The ALJs found persuasive I&E’s argument that, if 2018 data were used for the Company’s second criterion, South Jersey Industries, Inc. would not have qualified for Valley’s proxy group. Because this company remains part of Valley’s proxy group, the ALJs concluded that data cannot be considered fresh if it is based upon older criteria. R.D. at 59.

**2. Methods for Determining the Cost of Common Equity**

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

The DCF method applied to a proxy group of similar utilities, has historically been the primary determinant utilized by the Commission in determining the cost of common equity. *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.

**(1) Positions of the Parties**

Valley utilized a single-stage constant growth DCF model. Valley explained the theory behind the DCF model, *supra,* and stated that the cost of capital, or the investors' capitalization rate is the anticipated common equity return rate and consists of the dividend yield on market price plus a growth rate. Valley M.B. at 57.

To derive a dividend yield, Valley calculated the dividends for each company in its proxy group as of September 30, 2019 and divided by the average closing market price for the sixty trading days ending September 30, 2019. Valley applied a conservative adjustment to reflect prospective increases to the dividend yield. Valley explained that, because the companies in its proxy group increase their quarterly dividends at various times during the year, a reasonable assumption is to reflect one-half of the annual dividend growth rate in the dividend yield component. Valley reasoned that this is a conservative approach done so as not to overstate the dividend yield, given that the dividend should be representative of the next twelve-month period. Therefore, Valley ultimately used an adjusted dividend yield in its DCF calculation. Valley M.B. at 57-58.

Valley calculated its growth rate using the same published earnings per share (EPS) growth rates relied upon by investors in the marketplace. Valley reasoned that investors with more limited resources than institutional investors are likely to rely on widely available financial information services because they realize that analysts have significant insight into the dynamics of the industries and individual companies they analyze. Therefore, Valley determined a growth rate for each proxy group company by averaging the five-year projected growth rates published by Value Line, Zacks, and Yahoo! Finance. Valley M.B. at 58.

The companies in Valley’s proxy group had a DCF range from 7.62% to 11.54%, for a mean of 9.15% and a median of 8.90%. Valley utilized the average of the mean and median of these DCF results to arrive at its proposed DCF cost of common equity of 9.02%. Valley M.B. at 56; Valley St. 2-R, Exhibit \_DWD-1R, Sch. DWD‑1R at 2‑3.

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 utilization of the DCF methodology outlined in the testimony of I&E witness Christopher Henkel, I&E calculated that it produces a cost of common equity of 8.46%. I&E M.B. at 29.

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 2.71%. I&E St. 2 at 23-24.

In calculating its expected growth rate, I&E examined the earnings growth forecasts and used five-year projected growth rate estimates for its proxy group of companies using data from Value Line, Yahoo! Finance, Zacks, and Morningstar. For the purpose of determining its growth estimate, I&E classified Northwest Natural Holding Co.’s Value Line growth estimate of 27.00% as an outlier. Accordingly, I&E removed this outlier from its proxy group’s average forecasted growth rate calculation. Based on this, I&E determined a new adjusted average of 5.75%, which, it argued, was appropriate to use for the growth rate component of the DCF calculation. I&E M.B. at 29-30; I&E St. 2 at 24-26. Thus, I&E added the average dividend yield calculation of 2.71% to the average growth rate calculation of 5.75% to arrive at its 8.46% ROE recommendation based on a constant growth DCF model. I&E St. 2 at 27.

The OCA relied primarily on the DCF model and noted that this model is straight-forward and provides reliable results when the growth rate used in the model is consistent with the model’s assumptions. The OCA conducted three types of DCF analyses for each company in its proxy group: (1) a constant growth DCF; (2) the FERC-2-Step DCF; and, (3) the Two-Stage DCF. The OCA highlighted that Valley is not a publicly traded company with a dividend yield and, therefore, lacks the necessary data to run a unique DCF analysis. Therefore, the OCA explained that, because the DCF cannot be applied directly to Valley, it conducted multiple DCF analyses for each company within its gas proxy group. More specifically, the OCA calculated three constant growth DCFs for each of the seven companies in its proxy group, because it used three separate growth rates and one DCF calculation for each source: (1) Yahoo! Finance; (2) Value Line; and (3) Zack’s. According to the OCA, calculating a DCF for each company in the proxy group provided for more accurate results because the OCA was able to utilize each company’s actual dividend yield and growth rate in its calculation. The OCA used this same format to calculate three sets of FERC 2-Step DCFs and three sets of Two-Stage DCFs for each company in its proxy group. OCA M.B. at 51-52; OCA R.B. at 27.

In calculating its constant growth DCF, the OCA utilized the same general DCF formula as I&E, *supra.* In calculating its FERC 2-Step DCF, the OCA explained that the DCF can be modified to take into account the fact that an individual company cannot grow faster than the economy as a whole in perpetuity. In this regard, the OCA used a weighted average of the analysts’ growth forecasts and the long-term Gross Domestic Product growth rate forecast to establish the “g” in the general DCF equation. Therefore, the OCA employed a two-step, weighted average of the analysts’ growth forecasts, which is the same approach that is utilized by FERC. Finally, in calculating its Two-Stage DCF, the OCA divided the constant growth version of the DCF model into two parts: a high growth initial period followed by the long-term sustainable growth period. OCA M.B. at 51, 52-53; OCA St. 3 at 13.

The OCA calculated a constant growth DCF cost of equity range of between 7.67% and 10.02%, a FERC 2-Step DCF cost of equity range between 7.68% and 9.24%, and a Two-Stage DCF cost of equity range between 7.73% and 8.18%. The OCA explained that ultimately, its recommended 8.34% ROE is based upon the median of its constant growth DCF calculation and its FERC 2-Step DCF calculation. OCA M.B. at 53-54.

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

The traditional CAPM is applied by adding a risk-free rate of return to a market risk premium, which is adjusted proportionately to reflect the systemic risk of the individual security relative to the total market as measured by the beta coefficient. Valley M.B. at 60. The traditional CAPM is portrayed in the formula K = Rf + β(Rm – Rf), where K is the cost of equity, Rf is the risk free rate of return, Rm is the expected rate of return on the overall stock market, (Rm-Rf) represents the market risk premium, and β is the beta measure of the systematic risk of the asset. I&E M.B. at 30. As outlined below, each of the parties that presented a position on the cost of common equity utilized the CAPM with various inputs, including some variation of the model.

**(1) Positions of the Parties**

Valley used the traditional CAPM and averaged these results with an Empirical CAPM (ECAPM) analysis. Valley explained that the ECAPM analysis generally mirrors the CAPM analysis but incorporates a more gently sloping Security Market Line to reflect the results of analysis showing that the steeper slope of the predicted Security Market Line, as used in the traditional CAPM analysis, is not borne out by the analysis of the empirical Security Market Line. Valley used a beta of 0.61 derived from an average of the mean and median of the average betas in its proxy group of 0.62 and 0.59, respectively. Valley used the yield on 30-year U.S. Treasury bonds in setting its risk-free CAPM rate of 2.64%. According to the Company, the yield on long‑term U.S. Treasury bonds is almost risk-free and its term is consistent with the long-term cost of capital to public utilities measured by the yields on Moody’s A-rate public utility bonds; the long-term investment horizon inherent in utilities’ common stocks; and the long-term life of the jurisdictional rate base to which the allowed fair rate of return (*i.e*., the cost of capital) will be applied. Valley M.B. at 60‑61; Valley St. 2-R, Exhibit \_DWD-1R, Sch. DWD-1R at 41.

Valley calculated its CAPM risk premium using an average of three historical data-based market risk premiums, two Value Line data-based market risk premiums, and one Bloomberg data-based market risk premium. Valley derived a 10.5% market risk premium as a result. Valley explained that applying the above-referenced risk-free rate and market risk premium to the traditional CAPM and the ECAPM for the its proxy group results in a CAPM equity cost rate of 8.72% and an ECAPM equity cost rate of 9.71%. Valley then averaged these outputs to arrive at a CAPM/ECAPM cost of capital of 9.22%. Valley M.B. at 61.

I&E stated that it gave no specific weight to its CAPM results, *infra*, because it claimed that there are weaknesses associated with the CAPM. In this regard, I&E emphasized that unlike the DCF, which measures the cost of equity directly by measuring the discounted present value of future cash flows, the CAPM measures the cost of equity indirectly and can be manipulated by the time period used. Therefore, I&E submitted that the DCF method should be the primary method that is used to determine the cost of common equity; and that CAPM results should be used as a secondary method against which the DCF results may be compared to check for reasonableness. I&E M.B. at 31; I&E St. 2 at 17-18.

In calculating the CAPM cost of common equity, I&E chose the risk-free rate of return (Rf) of 2.40% from the projected yield on 10-year Treasury bonds as the most stable risk-free measure. I&E explained that its decision to use 10-year Treasury bonds balanced out issues related to the use of long term bonds and short term T-Bills. I&E used the average of the betas from the Value Line Investment Survey of 0.62. To arrive at a representative expected return on the overall stock market, I&E stated that its witness Mr. Henkel reviewed Value Line’s 1700 stocks and the S&P 500. I&E explained that the result of the overall stock market returns based on Mr. Henkel’s CAPM analysis is 11.49%, which yields a cost of equity result of 8.04%. According to I&E, its 8.04% CAPM analysis confirms the reasonableness of its proposed 8.46% DCF cost of capital. I&E M.B. at 30, 31; I&E St. 2 at 28-30.

As previously noted, the OCA relied primarily on its DCF calculation in calculating its proposed cost of common equity. The OCA argued that the Commission has generally preferred the DCF over the CAPM in setting a utility’s cost of common equity. Similar to I&E, the OCA contended that the CAPM has shortfalls. The OCA specifically asserted that the rate on short duration T-bills, which it claims represents the closest measure available for a true risk free rate, is highly influenced by Federal Reserve monetary policy, and thus does not reflect a market-determined risk free rate. Nonetheless, the OCA, like I&E, submitted that the CAPM can be used as a secondary measure to assess the reasonableness of the DCF results. OCA M.B. at 51, 54-55.

The OCA conducted its CAPM analysis, combined with its Risk Premium analysis, *infra*, by using the same time frame used in its DCF analysis. The OCA calculated bond betas for its proxy group companies based on the New York Stock Exchange (NYSE) Index using weekly holding period returns for the period of September 1, 2014 through August 31, 2019. The OCA then adjusted the calculated betas using Value Lines’ adjusted formula. The OCA submitted that its CAPM/Risk Premium median of 9.54% and average of 9.61%, confirms the validity of its proposed DCF results because they provide upper limits not to be exceeded. OCA M.B. at 56-58.

**c. Additional Methods**

**(1) Positions of the Parties**

Valley opined that in setting a utility’s ROE, it is important to utilize multiple models, because limiting the focus to any one model may result in understating the utility’s cost of equity. Thus, in Valley’s view, the use of multiple models adds reliability to the estimation of the common equity cost rate. According to Valley, the prudence of using multiple cost of common equity models is supported by both financial literature and regulatory precedent. Therefore, Valley proposed the use of two additional methods, outlined below. Valley M.B. at 65-68.

In addition to using the DCF and CAPM models, Valley conducted a risk premium (RP) analysis. Valley argued that an RP analysis seeks to quantify the additional ROE demanded by investors to account for the greater equity investment risk as compared to debt capital. Valley stated that under an RP analysis, the cost of common equity equals the expected cost rate for long-term capital, plus a risk premium over that cost rate, to compensate common shareholders for the added risk of being unsecured and last-in-line for any claim on the corporation's assets and earnings upon liquidation. Valley explained that its RP analysis averaged the results of two analyses. The first analysis was the Predictive Risk Premium Model (PRPM), which directly estimates the risk premium for equity capital investment based on an evaluation of the actual variance between historical equity risk premiums. The second analysis was the total market RP approach, which relies on known metrics to develop prospective RP model cost rates. Valley determined a PRMP cost rate of 9.08% for its proxy group, and a total market RP cost rate of 9.43%, for a combined RP cost of capital of 9.26%. Valley M.B. at 58-60; Valley St. 2-R, Exh\_DWD-1R, Sch. DWD-1R at 2‑3.

Valley also conducted a Comparable Earnings (CE) analysis in which it calculated equity cost rates based on the application of the above-referenced DCF, RP, and CAPM models to a proxy group of domestic, non-price regulated companies. Valley reasoned that this CE method provides a valuable indicator of anticipated investor returns for public utilities. Valley opined that, because the purpose of rate regulation is to be a substitute for marketplace competition, non-price regulated firms operating in the competitive marketplace make an excellent proxy, if they are comparable in total risk to the gas proxy groupbeing used to estimate the cost of common equity. Therefore, Valley alleged that this information is relevant to the Commission’s consideration of an appropriate ROE for the Company. Valley explained that applying its DCF, RPM, and CAPM analyses to its non-price regulated proxy group resulted in a CE cost of common equity of 10.26%. Valley M.B. at 61-64.

The OCA also utilized an RP method and explained that the basic RP model consists of a bond yield plus a risk premium. The OCA submitted that, while the RP model, like the CAPM, has limitations when compared to the use of the DCF model, the RP model, nonetheless, provides an additional secondary method reasonableness measure in comparison to the DCF results. As previously noted, the OCA combined its CAPM and RP analyses and determined a CAPM/RP median of 9.54% and average of 9.61%, which, it asserted, confirms the validity of the OCA’s DCF results, because they provide upper limits not to be exceeded. OCA M.B. at 55-58.

The OCA opposed Valley’s use of the CE method. The OCA submitted that, contrary to Valley’s assertions, the Company’s proxy group of non-price regulated companies is not similar in risk to its proxy group of natural gas utilities. Rather, the OCA alleged that the common equity cost estimates for Valley’s non-price regulated proxy group is systematically higher than its utility common equity cost estimates by 66 to 208 basis points. As such, the OCA submitted that non-price regulated proxy group results should be given no weight in determining the Company’s allowed ROE. OCA M.B. at 61.

I&E opposed both the use of the RP method and the CE method. I&E claimed that the RP method is a simplified version of the CAPM. Therefore, I&E took the position that, in addition to posing the same pitfalls as it outlined for the CAPM, *supra*,the RP method does not recognize company-specific risk through beta. With regard to the CE method, I&E argued that determining which non-regulated companies are comparable in risk to natural gas utilities is subjective, and that it is debatable whether historic accounting values are representative of the future. I&E claimed that, because the Commission has long recognized this problem, the historic usage of the CE method in this regulatory forum has been minimal. I&E M.B. at 36.

**d. ALJs’ Recommendation**

The ALJs adopted the positions of I&E and the OCA, concluding 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, noting that based on Commission precedent, including in *UGI*,the Commission favors this approach. Therefore, the ALJs recommended against the use of the RP and CE methods proffered by Valley. R.D. at 56 (citing *UGI* at 104-5); R.D. at 78-79.

The ALJs explained that, in assessing the Parties’ proposed DCF costs of common equity, they would utilize the respective proposals the Parties made, using the constant growth DCF model, because each of the Parties had done so. The ALJs compared the mean, median, and average of the mean and median for each Party’s proposal, noting that: (1) Valley’s constant growth DCF calculations resulted in a mean of 9.15%, a median of 8.90%, and an average of the mean and median of 9.02%; (2) I&E’s constant growth DCF calculations resulted in a mean of 8.47%, a median of 8.77%, and an average of the mean and median of 8.62%; and (3) the OCA’s constant growth DCF calculations resulted in a mean of 8.70% and a median of 8.51%, and an average of the mean and median of 8.61%. The ALJs concluded that based on their finding, *supra,* that I&E has presented a favorable proxy group, I&E’s proposed DCF of 8.46% should be utilized in setting Valley’s DCF cost of common equity. The ALJs pointed out that, I&E’s average and Valley’s mean are nearly 70 basis points apart, which was attributable to the difference in proxy groups. R.D. at 63, 64, 65.

The ALJs also stated that they would not determine the reasonableness of the Parties’ CAPM results. Rather, the ALJs explained that they would use the results to determine the reasonableness of the Parties’ DCF calculation. R.D. at 66. The ALJs noted that, in its rebuttal testimony, Valley challenged the various sources I&E relied upon in its CAPM analysis and proposed adjustments. The ALJs endorsed I&E’s response in its surrebuttal testimony, that even if I&E accepted Valley’s adjustments, the CAPM result would only adjust from 8.04% to 8.59%. R.D. at 16, n.67 (citing Valley St. 2-R at 26-27; I&E St. 2-SR at 16). Therefore, the ALJs found that I&E’s CAPM results validate its DCF results. R.D. at 16, n.67.[[12]](#footnote-12)

Based on the above findings, and as will be discussed in more detail under our section regarding Valley’s proposed size adjustment, *infra,* the ALJs recommended a DCF cost of common equity of 9.68%, which is one standard deviation above I&E’s DCF recommendation of 8.46%. The ALJs opined that this DCF rate will reflect Valley’s status as a company that is significantly smaller than the companies in its proxy group. R.D. at 79.

**e. Exceptions and Replies**

In its Exception No. 7, Valley finds fault with the ALJs’ recommendation that the Company’s ROE should be based solely on the results of the DCF method, with the CAPM used as a reasonableness check on the DCF results. Valley submits that, although the ALJs cited to the Commission’s decision in *UGI* in support of this finding, the Commission also stated in *UGI* that, while the DCF method is the preferred method, other methods will be considered where reliance on the DCF would lead to unreasonable results. Valley Exc. at 13-14 (citing *UGI* at 104-5). Therefore, Valley remains of the opinion that in setting an ROE, multiple methods should be analyzed. According to Valley, the record in this proceeding demonstrates that primary reliance on the DCF method in the current market environment will understate the appropriate ROE for the Company. Valley avers that the Commission should consider this evidence and incorporate the multiple models presented by its witness Mr. D’Ascendis in determining the appropriate ROE for the Company. Valley Exc. at 13.

Valley elaborates that its witness Mr. D’Ascendis analyzed the market-to-book (M/B) ratios of the combined I&E and the OCA gas utility proxy groups and observed that the M/B value for the combined proxy group has significantly exceeded the ten-year average of 1.75, with especially high M/B ratios since 2018. In contrast, Valley claims that the DCF model assumes an M/B ratio of 1.0, which indicates that the model will understate the required ROE if the actual M/B value of the proxy group is greater than 1.0. Valley submits that to further demonstrate the inaccuracy of the DCF model when the M/B ratio exceeds 1.0, Mr. D’Ascendis applied the I&E and the OCA DCF models to the book value capital structure of the respective proxy group, which increases the respective ROEs by over 100-basis points (*i.e.*,1.00%). Further, Valley argues that in support of his analysis, Mr. D’Ascendis also reviewed financial literature concluding that the application of the standard DCF model to utility stocks understates the investor’s expected return when the M/B ratio of a given stock exceeds unity (*i.e.*, 1.0). Valley Exc. at 14-15 (citing Valley M.B. at 67-68).

Valley proffers that, while the ALJs partially addressed the shortcomings of the I&E and the OCA ROE recommendations by establishing a ROE at the high end of a standard deviation range, they erred by justifying this recommendation as reflecting a size adjustment. In addition, Valley claims that, although the ALJs utilized the CAPM as a check on the DCF, they erred in declining to consider the Company’s full CAPM analysis. Valley stresses that each of the other methods the Company used to determine its cost of equity yielded ROEs that are greater than the Company’s proposed DCF cost of common equity. In Valley’s view, this further underscores the shortcomings of relying on the DCF method in an environment where market values far exceed book values. Therefore, Valley claims that, to ensure that the Company has an opportunity to earn a reasonable rate of return, the Commission should modify the R.D. and consider the multiple ROE models proposed by the Company. Valley Exc. at 16-17.

In its Reply to Valley’s Exception No. 7, I&E rebuts that Valley failed in its exceptions to demonstrate that the results of the DCF are understated. In this regard, I&E points to the ALJs’ finding on page 68 of the R.D. that Valley’s standalone CAPM ROE and DCF ROE were within 20-basis points, making Valley’s DCF analysis appear reasonable. In addition, I&E contends that Valley’s sole support for the argument it sets forth in its Exceptions is based on the Company’s M/B ratio analysis. According to I&E, Valley’s M/B ratio analysis is flawed, because it has not established that investors expect utility returns to be set on a different basis than book value. Further, I&E echoes the finding of the ALJ that the Commission has consistently validated the use of the CAPM method as a check on the DCF analysis, including in *UGI*. Therefore, I&E submits that the ALJs correctly considered and applied the CAPM analysis, and ignored the M/B analysis, as a comparison to DCF results. I&E R. Exc. at 5-7.

In its Replies to Exceptions, the OCA submits that the Commission has stated on numerous occasions its preference to rely upon the DCF methodology over other methods such as the CAPM or RP methods in determining a utility’s allowed rate of return. Like I&E, the OCA also restates that the Commission has traditionally utilized the DCF method, with use of the CAPM method as a check. According to the OCA, Valley has offered no evidence for why the Commission should deviate from this common practice in the instant proceeding. In addition, the OCA submits that the Company’s claim that “the ALJs partially addressed the shortcomings of the I&E and OCA ROE recommendations by establishing a ROE at the high end of a standard deviation” is inaccurate given that the ALJs clearly accepted the DCF and CAPM recommendations. Rather, the OCA argues that the ALJs’ use of the high-end of a standard deviation was the ALJs’ attempt to acknowledge the risk of a smaller utility. OCA R. Exc. at 10-13.

**f. Disposition**

Upon our consideration of the record evidence, we agree with the finding of the ALJs that the Company’s cost of equity in this proceeding should primarily be based upon the use of the DCF methodology and that the results of the CAPM analysis should be used as a comparison to the DCF results. R.D. at 78-79. At the outset, we note the validity of Valley’s argument, in its Exceptions, that in *UGI*,we stated that when evidence based on other cost of equity methods indicates that the reliance on only the DCF results may understate the utility’s cost of equity capital, we would give credence to those other methods, to an extent, in evaluating the appropriate range of reasonableness in setting an ROE. *See* Valley Exc. at 13; *UGI at* 104-5. However, in *UGI,* we also found that UGI failed to demonstrate on the record that the DCF method understated its ROE or that the other methods it proffered served as an aid in arriving at the appropriate cost of common equity. *See UGI* at 105-6. We likewise find in the instant case that Valley has failed to present a valid reason for why the other methods it has proffered should be given equal weight to the DCF method.

First, we are not persuaded by Valley’s argument that the difference between the market value of a utility’s stock and its book value causes the DCF method to undervalue the rate of return when the M/B ratio of a given stock exceeds unity. *See* Valley M.B. at 67-68; Valley St. 2-R at 11-12. Rather, as I&E highlighted, the Company’s argument assumes that investors are unaware of the difference between the book value and the market value. The record indicates that the forecasted growth rates used in the DCF method are set by analysts based on current conditions, as well as future expectations for the stock. The stock market is impacted by regulatory policies and by economic and financial conditions. Therefore, while an M/B ratio greater than 1.0 implies that investors expect future cash flows to be more valuable than the historical accounting value of the company, an M/B ratio of less than 1.0 could result either when the stock market is in depression or when the company is underperforming. *See* I&E St. 2-SR at 9-10. Therefore, in establishing an ROE for regulatory purposes, we find that it is not appropriate to evaluate the results of the DCF using an M/B ratio.

Second, as to the RP method, the record indicates that the Company’s PRPM analysis, which it used as an input in developing its RP cost of equity, is a specialized form of the RP method, which is not commonly used. I&E St. 2 at 31‑32. Further, as noted above, the RP method is an indirect measure of the cost of equity, because it does not recognize company-specific risk through beta. In addition, the RP method relies on the use of historic data that may not accurately represent the current or future economic conditions. For these reasons, we find that Valley has failed to demonstrate that any weight should be given to its use of the RP method in setting an appropriate cost of equity.

Third, we reject the Company’s use of the CE method. As both I&E and the OCA pointed out, the CE method utilizes data for non-regulated firms. Thus, by its very nature, determining which companies are comparable under the CE method is entirely subjective. In addition, the record evidence indicates that the proxy group of domestic, non-price regulated companies that Valley utilized in conducting its CE method included such companies as Campbell’s Soup, Hershey Co., and General Mills. *See* Valley St. 2, Exh\_DWD-1, Sch. DWD-7 at 6. Each of these companies operate in industries that are very different from a utility company and have significantly more competition, which would require a higher return for the associated additional risk. Indeed, as the OCA noted, Valley’s common equity cost estimates for its non-price regulated proxy group are systematically higher than the Company’s utility common equity cost estimates by between 66 and 208 basis points, indicating that the two proxy groups are not similar in risk. *See* OCA M.B. at 61.

Additionally, as both I&E and the OCA noted, we have expressly endorsed the use of the DCF method as the primary method for setting a utility’s cost of equity capital in several other rate proceedings that have come before the Commission. For example, in addition to our recent decision in *UGI,* we affirmed the use of the DCF as our preferred methodology in *Pa. PUC v. PPL Electric Utilities Corporation*, Docket Nos. R‑2012-2290597, *et al.* (Order entered December 28, 2012), and again, more recently, in *Pa. PUC, et. al v. City of Dubois-Bureau of Water*, Docket No. R‑2016‑2554150, *et. al.* (Order entered March 28, 2017). Because Valley has not presented substantial evidence on the record that would cause us to deviate from the use of the DCF method as the primary ROE setting method in the instant case, we shall reject the Company’s arguments. Accordingly, Valley’s Exception No. 7 is denied and we adopt the ALJs’ recommendation that the Company’s cost of equity in this proceeding should primarily be based upon the use of the DCF methodology and that the results of the CAPM analysis should be used as a comparison to the DCF results.

**3. Size Adjustment**

**a. Positions of the Parties**

Valley claimed that it is a smaller public utility compared to the companies in its proxy group, and to most of the other NGDCs that are regulated by the Commission. Therefore, Valley proposed a 100-basis point size adjustment to its ROE to account for the additional risks associated with smaller public utilities such as Valley. Valley submitted that its proposed size adjustment is necessary to meet the standard under *Bluefield, supra*,that the Company is able to earn an ROE that is commensurate with other business undertakings that are attended by corresponding risks and uncertainties. Additionally, Valley posited that there is an inverse relationship between company size and risk, such that failure to reflect the increased risk faced by smaller utilities would understate the ROE demanded by investors, given that investors demand greater returns to account for size risk. According to Valley, this inverse relationship has been recognized as a valid basis for a basis-point adjustment in financial literature wherein studies have shown that, *inter alia,* smaller-sized firms are associated with greater risk and, therefore, have greater cost of capital; and that the capital market demands higher returns on stocks of small firms than on otherwise similar stocks of large firms. Valley cited to technical literature, including the Duff & Phelps 2019 Valuation Handbook Guide to Cost of Capital - Market Results through 2018 (*Duff and Phelps Handbook*). Valley M.B. at 69, 85-87.

Valley also claimed that an empirical market capitalization analysis conducted by its witness Mr. D’Ascendis offers further evidence of the inverse relationship between a firm’s size and its risk. In this regard, Valley explained that Mr. D’Ascendis’ study observed that, as of March 29, 2019, Valley had a market capitalization of $19.24 million compared to an average company market capitalization of $4.6 billion for Valley’s proxy group, amounting to a size difference of 239x. Valley elaborated that, in order to quantify the appropriate size adjustment, Mr. D’Ascendis relied on size premiums for portfolios of NYSE, American Stock Exchange (AMEX), and NASDAQ listed companies ranked by deciles for the 1926 to 2018 period, as set forth in the *Duff and Phelps Handbook*. Valley stated that the $4.6 billion market capitalization of Valley’s proxy group ranked in the 4th decile, while Valley's $26.8 million market capitalization ranked in the 10th decile, resulting in a size premium spread of 4.37%. Valley noted that, after reviewing the proxy groups compiled by I&E and the OCA, Mr. D’Ascendis refined this market capitalization analysis to include the average market capitalizations of I&E and the OCA’s proxy groups and found similar results. Valley also explained that Mr. D’Ascendis pointed to Valley's rate base as an indicator of size, observing that even the combined $45 million rate base of Citizens’, Valley, and Wellsboro are multiple times smaller than the $4.6 billion rate base of the average natural gas utility granted an ROE of approximately 9.70%. Valley asserted that Mr. D’Ascendis’ analysis demonstrated that a 437-basis point adjustment could be justified for Valley. However, Valley stated that Mr. D’Ascendis had recommended a more modest size adjustment of just 100-basis points. Valley M.B. at 87-88, n.9.

I&E opposed the size adjustment proposed by the Company. I&E challenged Valley’s arguments that the testimony of its witness Mr. D’Ascendis is demonstrative of the Company’s need for a size adjustment. Importantly, I&E claimed that Mr. D’Ascendis’ use of technical literature to support his argument for a size adjustment is inapposite, because none of the technical literature he utilized is specific to the utility industry. I&E highlighted that in *UGI*,the Commission rejected UGI’s request for a size adjustment based, in part, on the company’s use of technical literature that was not specific to the utility industry. I&E M.B. at 45, 46 (citing *UGI* at 100). I&E also cited to technical literature specific to the utility industry, arguing that in the article “Utility Stocks and the Size Effect: An Empirical Analysis,” Dr. Annie Wong concluded that a size adjustment for risk is not applicable to utility companies. I&E M.B. at 47-48 (citing Wong. Annie, “Utility Stocks and the Size Effect: An Empirical Analysis” *Journal of the Midwest Finance Association* (1993) at 95-101 (*Wong Study*)).

Similarly, I&E contended that the empirical study Mr. D’Ascendis conducted is also inapposite. More specifically, I&E asserted that the difficulty in predicting the risk effect of a company’s size is demonstrated in the year-to-year variance of returns for large- and small-capitalization stocks listed on the NYSE, AMEX, and NASDAQ, illustrating that there may be no expectation of higher return for smaller stocks. I&E M.B. at 46; I&E St. 2-SR at 22-23. In addition, I&E argued that in his rebuttal testimony, Mr. D’Ascendis noted that his study has limited explanatory power. I&E M.B. at 48 (citing Valley St. 2-R at 36). In I&E’s view, such a weak explanatory power of size with respect to risk does not justify an increase to the Company's ROE. Therefore, I&E submitted that Valley’s proposed size adjustment should be denied. I&E M.B. at 48.

The OCA, likewise, took the position that the Company should not be awarded a size adjustment. The OCA pointed to the testimony of its witness Dr. Habr, who argued that the Company’s reliance on size premiums in the *Duff and Phelps Handbook* does not support a size adjustment. Dr. Habr noted that the *Duff and Phelps Handbook* also provided ordinary least squares (OLS) betas associated with the size deciles utilized by Valley’s witness Mr. D’Ascendis. According to the OCA, size premiums are associated with OLS betas that are greater than 1.0. In contrast, the OCA asserted that each of the utility holding companies in the proxy groups in this proceeding were calculated using OLS and have OLS beta values less than 1.0. Therefore, the OCA claimed that if any adjustment is made for size, it should be negative rather than positive. OCA M.B. at 62-63 (citing OCA St. 3 at 29-30). The OCA also opined that a utility’s customers should not be required to pay higher costs associated with inefficient utility operations. In the OCA’s view, if a utility company chooses to operate at such a small scale that its cost of common equity is truly increased, there is no reason for the utility’s captive customers to pay any increased costs resulting from the utility’s inefficient size. OCA M.B. at 63.

Valley challenged the arguments of both I&E and the OCA. As to the arguments of I&E, Valley asserted, *inter alia*,that I&E placed exclusive weight on the *Wong Study* for the premise that there is no need to adjust the firm size in utility rate regulation. According to Valley, Dr. Wong focused only on the risk captured in beta coefficients, thereby understating the total impact of size risk. As to the OCA’s arguments, Valley submitted that the OCA offered no explanation to support its contention that OLS betas are more relevant than market capitalization in assessing size risk. In addition, Valley averred that in characterizing the Company as “inefficient,” the OCA made no effort to quantify the customer benefits of being served by a smaller public utility such as Valley. Valley M.B. at 88-91.

**b. ALJs’ Recommendation**

The ALJs found that there is a general relationship between size and risk. However, the ALJs also noted the offsetting arguments of Valley and I&E, particularly: (1) Valley’s argument that the *Wong Study* focused only on the risk captured in beta, indicating that the impact of size risk may be understated; and (2) I&E’s argument that the empirical study performed by Valley’s witness Mr. D’Ascendis shows weak correlation and does not seem to be significant enough to prove that size is a risk for utilities. Therefore, the ALJs explained that they were not able to conclude whether size is, or is not, a risk. Nonetheless, the ALJs also opined that it is reasonable to conclude that smaller companies face size risk and noted that Valley is a smaller company. The ALJs pointed to the testimony of Mr. D’Ascendis that failure to reflect the increased risk faced by smaller public utilities would understate the ROE demanded by investors. Therefore, the ALJs agreed with Valley that the Company is significantly smaller than the companies in its proxy group, such that it is reasonable to conclude that it would face proportionally greater financial and business risk than much larger utilities. R.D. at 73‑74.

Although the ALJs declined to quantify a specific size adjustment amount, the ALJs recommended that Valley’s ROE be based upon the higher end of the DCF range to ensure a market-based result, while acknowledging the risk of a smaller utility. Therefore, the ALJs recommended that Valley be granted an ROE of 9.93% using 9.68% which is one standard deviation above I&E’s DCF recommendation of 8.46%, reflecting Valley’s status as a smaller company, and adding 25 basis points for managerial effectiveness, discussed, *infra.*  The ALJs summarized the results of I&E’s DCF range, as follows:

|  |
| --- |
| **I&E** |
| STD | 1.22 | Range |
| DCF Results | Upper | Lower |
| I&E Average | 8.46 | 9.68 | 7.24 |
| Mean (1) | 8.47 | 9.69 | 7.25 |
| Median (2) | 8.77 | 9.99 | 7.55 |
| Avg. (1+2) | 8.62 | 9.84 | 7.40 |

R.D. at 74-75.

**c. Exceptions**

All three of the Parties that presented a position on Valley’s allowed ROE excepted to the ALJs’ recommendation on this issue. Valley submitted that the ALJs’ recommendation does not adequately account for the Company’s small size, while both I&E and the OCA claimed that the ALJs erred by awarding the Company *any* size adjustment. These Exceptions, and the replies thereto, are outlined below.

In its Exception No. 8, Valley claims that the ALJs correctly concluded that an ROE based on the average, mean, and, median DCF results on the record would produce an unreasonable result for the Company. However, Valley posits that the ALJs erred in attributing its use of the standard deviation method solely to the Company's size. Namely, Valley asserts that the methodology developed by the ALJs results in an ROE that is commensurate with the ROEs established for much larger NDGCs and, therefore, is not truly reflective of the Company's size risk. As a result, Valley requests that the Commission apply a size adjustment to the result of the standard deviation method approved by the ALJs, such that the Company’s ROE properly reflects the Company's risk, but that does not exceed Valley’s proposed ROE of 10.60%. Further, Valley restates its argument that its requested 100-basis point size adjustment is conservative in nature, compared to the empirical analysis performed by its witness Mr. D’Ascendis, which concluded that the Company should be awarded a size adjustment of as many as 437 basis points. Valley Exc. at 17-19.

In its Reply to Valley’s Exception No. 8, I&E retorts that the ALJs’ size adjustment already effectively awards a 122-basis point size adjustment to Valley (*i.e.*, I&E’s recommended ROE of 8.46% plus 122-basis points is equal to the 9.68% ROE recommended by the ALJs, excluding the additional adjustment for managerial effectiveness, *infra*). I&E argues that Valley has failed to demonstrate the ALJs erred by not further adjusting for Valley’s size. Namely, I&E claims that Valley’s Exception No. 8 essentially asks the Commission to completely abandon any methodological analysis, and to simply conclude that the ALJs’ recommended ROE is similar to Distribution System Improvement Charge (DSIC) ROEs awarded to larger NGDCs, such that a further adjustment is needed for a smaller NGDC like Valley. In I&E’s view, such an adjustment is not supported by the record. I&E R. Exc. at 8-9.

In its Reply to Valley’s Exception No. 8, the OCA contends that the ALJs correctly denied Valley’s requested 100-basis point size adjustment. Additionally, the OCA also restates many of the arguments that it made in its own Exception No. 8, discussed, *infra*, that the Company should not receive *any* size adjustment to its ROE. OCA R. Exc. at 13-17.

In its Exception No. 4, I&E takes issue with the ALJs’ finding that substantial evidence exists to merit a size adjustment, and with their recommendation that Valley be awarded an ROE at the highest point of a standard deviation range for the DCF analysis. I&E notes that the ALJs did not find any evidence of size risk specific to utilities, but instead found only that in general, size appears to be a risk factor for companies. Therefore, I&E claims that Valley has failed to meet its burden of proof to justify *any* size adjustment. I&E restates that in *UGI*,the Commission rejected a size adjustment and the use of technical literature that was not specific to the regulated utility industry to support such an adjustment. I&E Exc. at 8-9.

I&E also takes the position that monopoly utilities are not subject to the same market-based risks facing competitive companies included in a general size adjustment analysis. I&E points out that most utilities have a captive customer base, and that, if Valley faces difficulties or unforeseen risks, it has the ability to request higher rates to offset increased expenses. Further, I&E argues that because Valley’s rate filing is made on a FPFTY basis, certain forecasted expenses are already included in its request such that no additional size adjustment is needed. Therefore, I&E submits that the ALJs’ recommendation on this issue should be reversed. I&E Exc. at 9.

In its Exception No. 8, the OCA submits that, although the ALJs were correct in not awarding the Company’s requested 100 basis point size adjustment, the ALJs erred in utilizing the upper range DCF results to award the Company *any* size adjustment. In the OCA’s view, the ALJs’ recommendation based on a DCF result of 9.68% is unreasonable given the DCF range presented by the Parties in this proceeding. In addition, the OCA, like I&E, points out that the ALJs were not able to conclude whether size is a risk for utilities. Therefore, the OCA objects to the ALJs’ finding that because size seems to be a risk for companies, in general, Valley, as a smaller company, faces size risk. According to the OCA, the ALJs’ recommendation is contrary to solid ratemaking principles, given that utilities are natural monopolies and should be treated as such. Further, the OCA restates its argument, *supra*,that the economic literature presented by Valley in attempt to bolster its position actually, more accurately, supports a downward adjustment. Finally, the OCA maintains its position that including a size adjustment in the calculation of the Company’s ROE would be unduly burdensome for ratepayers. OCA Exc. at 17-20.

In its Replies to the Exceptions of I&E and the OCA, Valley submits that both Parties’ arguments are misguided and should be rejected. Valley argues that a smaller and less diverse customer base exposes smaller utilities like Valley to higher risks of substantial negative financial impacts from losing a single large customer or having a significant revenue loss from increased energy efficiency. Additionally, Valley argues that its witness Mr. D’Ascendis conducted an unrebutted study demonstrating correlation between utility size and risk, which shows an R-Squared of 0.09, indicating that 9% of utility risk is attributable to size. Valley contends that this R-Squared is higher in comparison to the R-Squared of the I&E and the OCA proxy group companies' beta coefficients, which means that differences in size explain more about utility risk than beta coefficients, and constitutes evidence of an inverse relationship between utility size and risk, in direct contravention of I&E's Exception. Additionally, Valley submits that, although the OCA argued that the ALJs’ finding conflicts with solid ratemaking principles, the OCA neither provided a citation to support its proposition, nor did it specify which ratemaking principles it believed the ALJs’ recommendation would violate. Valley R. Exc. at 13-18.

**d. Disposition**

Based upon the evidence of record, we agree with the recommendation of the ALJs that the Company be awarded a DCF cost of common equity of 9.68%, which is one standard deviation above I&E’s DCF recommendation of 8.46%. In so doing, we recognize that Valley’s size is a factor in assessing its ability to attract capital. Accordingly, we shall reject Valley’s Exception No. 8, I&E’s Exception No. 4, and the OCA’s Exception No. 8, consistent with the following discussion.

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

At the same time, however, we echo the ALJs that the Parties have presented offsetting arguments such that there is not substantial evidence to determine whether size is specifically a risk for utilities. As I&E and the OCA both noted, the technical literature presented by Valley is not specific to the utility industry and also may not definitively support a size adjustment. Additionally, as I&E observed, the empirical study undertaken by Valley’s witness Mr. D’Ascendis illustrates the difficulty in predicting the risk effect of a company’s size. More specifically, while Mr. D’Ascendis used market information from the NYSE, the AMEX, and the NASDAQ, we find that I&E offered evidence indicating that for certain periods, large-capitalization stocks have outperformed small-capitalization stocks such that there is not sufficient correlation to prove that size is a specific risk for utilities. I&E St. 2-SR at 32-33. Therefore, we are not persuaded by Valley’s argument that the ALJs erred by not awarding the Company a greater size adjustment. For this reason, we decline to award an explicit 100-basis point size adjustment, as advocated by Valley.

Consistent with the foregoing discussion, like the ALJs, we shall not specify an exact size adjustment. Instead, we shall adopt the ALJs’ recommendation that the Company be awarded a DCF cost of common equity of 9.68%, which is one standard deviation above I&E’s DCF recommendation of 8.46%. In our view, this cost of equity is reasonable and strikes an appropriate balance by recognizing the general inverse relationship between a company’s size and its risk, while acknowledging that there is not substantial evidence in the record to prove that an explicit size basis point adjustment is warranted in this case.

**4. Management Effectiveness Adjustment**

**a. Positions of the Parties**

Valley included a 25-basis point management effectiveness adjustment to its ROE claim. Valley M.B. at 81-85.

Both I&E and the OCA opposed any allowance for management effectiveness. I&E M.B. at 48-49; OCA M.B. at 63-64; OCA R.B. at 61-62.

Valley 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 Valley, it has demonstrated strong performance in the area of management effectiveness. In support of its claim, Valley noted that it has undertaken several initiatives to improve its operations to increase reliability, increase attention to customer needs and customer satisfaction, and increase the overall effectiveness of the Company's service. Valley stated that these initiatives included, *inter alia:* (1) replacing all cast iron mains, bare steel mains, and services without assessing a DSIC to its customers; (2) responding quickly to emergencies in a time frame of sixty minutes or fewer; (3) making technological improvements in customer service by offering “Smarthub” use to customers to allow them to pay bills and track their usage electronically; and (4) obtaining grant funding from the Department of Community and Economic Development’s Pipeline Investment Program in order to extend the East Athens Main at a reduced cost to customers. Valley also asserted that it has received favorable feedback from its customers. Further, Valley highlighted that in the past three years, it has experienced zero formal complaints and has only experienced two informal complaints. Valley asserted that in both such instances, the Commission found that it did not violate any Commission rules or regulations. Valley submitted that these performance metrics demonstrate that the Company has gone above and beyond what it is required to do under the Code and warrants recognition through an affirmative adjustment to its cost of common equity. Valley M.B. at 81-85.

I&E argued that the Company’s proposal is inappropriate and is not supported by the record in this proceeding. 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, 66 Pa. C.S. §1501, to provide safe and reliable service. I&E M.B. at 48-49.

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 refuted Valley’s assertion that it has gone beyond what it is required to do and opined that Valley’s purported evidence in support of a management effectiveness adjustment merely indicates that the Company’s management is doing the job it is expected to do to efficiently maintain its operations and provide satisfactory customer service. OCA M.B. at 63-64; OCA R.B. at 61-62.

**b. ALJs’ Recommendation**

The ALJs recommended that Valley be given a 25-basis point addition to its cost of common equity due to management effectiveness. The ALJs stated that under Section 523(a) of the Code,[[13]](#footnote-13) the Commission is merely required to consider a utility’s efficiency, effectiveness, and adequacy of service, but that no particular, remarkable, or extraordinary level of operations or service is required to award an adjustment. The ALJs concluded that Valley presented substantial evidence to demonstrate that the Company is operated in a very efficient and effective manner and that it provides very good customer service. According to the ALJs, there is no evidence that suggests or proves otherwise. The ALJs highlighted that, in the instant proceeding, other than I&E, the OCA, and the OSBA, only three other Parties filed complaints to Valley’s rate increase request, all of which challenged the requested rate increase amount. The ALJs stressed that no Party raised service quality issues. Further, the ALJs pointed out that no Party has disputed or otherwise challenged Valley’s claims about its initiatives or accomplishments. R.D. at 78.

**c. Exceptions and Replies**

In its Exception No. 5, I&E submits that, although Section 523 of the Code contains no specific mandate for awarding additional basis points for management effectiveness, the ALJs erred by finding that substantial evidence exists to award Valley a 25 basis point increase to its ROE. I&E Exc. at 10. I&E remains of the opinion that the Company has not provided any evidence why, specifically, a 25-basis point upward adjustment for management effectiveness is warranted. Additionally, I&E submits that, to the extent any additional basis points are awarded, the Commission should award no more than 5-basis points, consistent with its decision in *UGI.*  More specifically, I&E notes that in *UGI*,we reduced the ALJs’ award from 20-basis points to 5-basis points, noting that such an adjustment is reasonable, appropriate, and conservative and better serves the public interest. *Id.* (citing *UGI* at 115).

The OCA, in its Exception No. 9, also finds fault with the ALJs’ recommendation. In the OCA’s view, 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 Valley failed to demonstrate that such circumstances exist in the present case. Further, the OCA asseverates that, even with no upward adjustment for management effectiveness, the ALJs’ recommendation of a base ROE of 9.68% is already well-above what the record supports. OCA Exc. at 21-22.

In its Replies, Valley submits that the Commission should deny I&E and the OCA’s Exceptions on this issue. According to Valley, the ALJs correctly weighed many instances in which the Company has demonstrated exemplary and innovative service and properly awarded an upward adjustment to ROE, accordingly. Valley also refutes I&E’s alternative suggestion that the Commission should reduce the awarded performance adjustment to 5-basis points, consistent with its findings in *UGI*. The Company claims that, while the Commission awarded a smaller upward adjustment for management performance in *UGI*,Valley has demonstrated a significantly greater degree of innovation, such that its full 25-basis point upward adjustment should be awarded. Valley R. Exc. at 18-20.

**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 Valley regarding its management performance and the initiatives it has undertaken to improve its operations to increase reliability, increase attention to customer needs and customer satisfaction, and increase the overall effectiveness of the Company's service. We are particularly cognizant of Valley’s initiatives in, *inter alia*: (1) replacing all cast iron mains, bare steel mains, and services without assessing a DSIC to its customers; (2) responding quickly to emergencies in a time frame of sixty minutes or fewer; (3) making technological improvements in customer service by offering “Smarthub” use to customers to allow them to pay bills and track their usage electronically; and (4) obtaining the DCED PIPE grant in order to extend the East Athens main at a reduced cost to customers, thereby demonstrating the Company’s practical commitment to extending natural gas service. Valley M.B. at 81-85.

We are of the opinion that the above initiatives of the Company warrant consideration as a factor in our final cost of equity allowance such that we will grant a management effectiveness adjustment. However, similar to our recent decision in *UGI,* we shall not grant the full 25-basis point adjustment requested by Valley and recommended by the ALJs. Rather, we shall apply a 5-basis point (*i.e.*, 0.05%) adjustment to Valley’s rate of return on equity. *See UGI* at 113-15. In our view, this adjustment is supported by the record as reasonable, appropriate, and conservative based on Section 523 of the Code and better serves the public interest*.* Accordingly, we shall grant the Exceptions of I&E and the OCA, in part, and deny them, in part, and modify the recommendation of the ALJs on this issue.

**5. 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: (1) DCF; (2) CAPM; (3) RP; and (4) CE. Valley relied on each of these methodologies to determine a 9.35% cost of equity plus an additional 1.25% to reflect requested upward adjustments to ROE for size risk and management effectiveness. As a result, Valley presented a recommended rate of return on equity of 10.60%. Valley St. 2-R, Exh\_(DWD-1R), Sch. 1R at 2; Valley M.B. at 56.

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 Valley erred in giving equal weight to the four different methodologies it had employed 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, with the CAPM results used only as a check on the results of the DCF method. I&E M.B. at 30-31, 34-45; OCA M.B. at 46, 58-66.

As a result of its DCF analysis, I&E recommended a cost of common equity of 8.46%. I&E M.B. at 26.

The OCA recommended an 8.34% return on common equity primarily based on the DCF model, including a full range of indicators of dividend yields and growth rates, and based upon the median of its constant growth DCF calculation and its FERC 2-Step DCF calculation. OCA M.B. at 47-50, 53-54.

**b. ALJs’ Recommendation**

As noted, *supra,* the ALJs recommended that consistent with Commission precedent, the Commission should utilize the DCF method to set Valley’s rate of return on common equity and that it should utilize the CAPM as a comparison. Under the DCF method, the ALJs recommended a DCF cost of common equity of 9.68%, which is one standard deviation above I&E’s DCF recommendation of 8.46% and reflects Valley’s status as a company that is significantly smaller in size when compared to the natural gas companies in its proxy group. Therefore, using the DCF result of 9.68% and the additional 0.25% management effectiveness adjustment that they recommended should be granted, the ALJs recommended a rate of return on common equity of 9.93% for Valley. According to the ALJs, this represents a reasonable return for the Company. R.D. at 79.

**c. Exceptions and Replies**

As discussed in more detail above, Valley, in its Exception Nos. 7 and 8, takes issue with the ALJs’ finding that the DCF method should be the primary method used to determine the cost of common equity, and with the ALJs’ decision not to apply the Company’s requested 100-basis point adjustment for size risk. Valley Exc. at 13‑19. In its Exception No. 8, Valley also submits that the methodology developed by the ALJs results in a ROE that is commensurate with the ROEs established for much larger NGDCs, and, as a result, is not truly reflective of the Company's size risk. Therefore, Valley remains of the opinion that to accurately account for its size risk, the Commission should approve the Company's proposed size adjustment, subject to the maximum proposed ROE of 10.60%. *Id.* at 17.

In its Exception Nos. 4 and 5, I&E finds fault with the ALJs’ acceptance of a size adjustment by basing the ROE on the higher end of the DCF range; and to the ALJs’ recommendation that the Company be awarded a 25-basis point upward adjustment for management effectiveness. As discussed, in detail, above, both of these recommendations by the ALJ resulted in an ROE for the Company that is greater than the 8.46% ROE advocated by I&E. I&E Exc. at 8-10.

The OCA, likewise, in its Exception Nos. 8 and 9, takes issue with the ALJs’ recommendations that Valley be awarded upward adjustments to its ROE to account for size risk and managerial effectiveness. OCA Exc. at 16-22. In addition to what has been presented above, in its Exception No. 8, the OCA restates that, based on record evidence, the common equity for similar risk utility operations persuasively supports an ROE for the Company of no more than 8.34%. *Id.* at 16. The OCA argues that, in adopting the higher end of the DCF range, the ALJs violated the OCA’s CAPM limits. In this regard, the OCA quotes the testimony of its witness Dr. Habr, who stated as follows:

The CAPM/Risk Premium model yields maximum common equity estimates when it is applied assuming the bond betas equal zero as done in this case. Thus, the combined CAPM/Risk Premium median 9.54% and 9.61% average provide an upper limit for common equity cost rates. All of the measures of central tendency (medians and averages) for my DCF analysis fall well below these values.

*Id.* (citing OCA St. 3 at 28; OCA M.B. at 57).

The OCA also notes that on page 68 of their Recommended Decision, the ALJs, in summarizing the Company’s position on the CAPM method, observed that because Valley’s standalone CAPM ROE and DCF ROE were within 20 basis points, the Company’s DCF analysis appeared to be reasonable. The OCA claims that, in making this observation, the ALJs erroneously adopted the Company’s CAPM analysis, which the OCA’s witness Dr. Habr found to be unreasonable. More specifically, the OCA argues that the Company relied on a 30-year treasury yield that violates the purpose of a test year in utility regulation. According to the OCA, the purpose of a test year is to match the costs incurred that year with the services provided in that year. Therefore, the OCA claimed that test year costs are not based on costs that may exist during some period in the future. Accordingly, the OCA submits that the recommendation of the ALJs, which based the Company’s ROE upon the higher end of the DCF range, should not be adopted. OCA Exc. at 20.

Valley,[[14]](#footnote-14) in its Reply to the OCA’s Exception No. 8, also challenges the OCA’s claim that the ALJs’ application of the standard deviation method to account for size risk violates the OCA’s CAPM/RP limits. In this regard, Valley submits that the OCA’s argument would undermine the very purpose of an adjustment for size, which is to award an ROE higher than the result of a standard DCF analysis to recognize that small utilities face greater risk than similarly-situated larger utilities. Therefore, Valley claims that such limits proffered by the OCA cannot serve as the ceiling for a size adjustment. Valley further claims, that even if the Commission were to accept the OCA’s premise that the size adjustment should fall within the range of reasonableness supported by the unadjusted ROE, the OCA’s CAPM/RP model is flawed because, among other things, it fails to utilize a risk-free rate based on a forecasted period. Valley R. Exc. at 17-18.

**d. Disposition**

We have previously determined above that, consistent with Commission precedent, we shall use the DCF method as the primary method in establishing Valley’s cost of common equity and shall use the results of the CAPM method as a comparison to our DCF results. Therefore, we have adopted the ALJs’ recommendation to use a DCF cost of common equity rate of 9.68%, which they set at one standard deviation above I&E’s recommended DCF cost rate of 8.46% to account for the fact that Valley is a smaller utility. Additionally, we have determined that Valley should receive a 5-basis point upward adjustment to its cost of common equity because it has demonstrated management effectiveness. This is in lieu of the 25-basis point adjustment recommended by the ALJs.

Finally, we shall reject the Exceptions of the OCA that the ALJs’ recommendation that the Company’s DCF cost rate be set at one standard deviation above I&E’s recommended DCF cost rate violates the OCA’s CAPM/RP limits. First, while we have determined that the CAPM should be used as a secondary method to check for the reasonableness of the DCF results, we have rejected the use of the RP method in any regard in this proceeding. Second, as Valley points out, the OCA’s argument would undermine the purpose of adding a size adjustment, which is to award an ROE that is greater than the result of the stand-alone ROE analysis given that smaller utilities face greater risk than larger utilities. It would also ignore the record evidence regarding the initiatives undertaken by the Company, which warrant that its ROE be increased to recognize its management effectiveness. Therefore, although we will not award the 10.60% ROE that the Company has requested, we have found that the record supports a higher ROE than what has been recommended by either the OCA or I&E. Accordingly, we shall set a cost of equity rate of 9.73% for Valley, inclusive of the management effectiveness adjustment. All Exceptions to the contrary are denied.

**D. Overall Rate of Return**

**1. Positions of the Parties**

Valley claimed that it should be permitted to earn a 7.72 % overall rate of return, including a 10.60% return on common equity. Valley M.B. at 91.

I&E recommended that Valley should be afforded the opportunity to earn an overall rate of return of 6.60%. 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 8.46% rate of return on common equity. I&E M.B. at 50.

The OCA proffered that the Commission should allow Valley the opportunity to earn an 8.34% return on common equity and a 6.75% overall return on its rate base. OCA M.B. at 66.

**2. Recommended Decision**

The ALJs recommended an overall authorized rate of return for Valley of 7.37%. This is based upon their determination that Valley should be permitted to earn a 9.93% rate of return 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 the recommended rate of return as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **Capitalization Ratio** | **Cost Rate** | **Rate of Return** |
| Long-Term Debt |  47.45% |  4.54% |  2.15% |
| Common Equity |  52.55% |  9.93% |  5.22% |
| *Total* |  *100.00%* |  |  *7.37%* |

R.D. at 79.

**3. Exceptions and Replies**

Each Party’s Exceptions and Replies to Exceptions on this issue are based on their respective Exceptions and Replies to Exceptions regarding the ALJs’ recommended adjustments for size risk, management effectiveness, and 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 Valley. This, in turn, modifies the ALJs’ recommended overall rate of return. The following table summarizes our final determinations regarding Valley’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 Valley of 7.27%.[[15]](#footnote-15)

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **Capitalization Ratio** | **Cost Rate** | **Rate of Return** |
| **Debt** | 47.45% | 4.54% | 2.15% |
| **Equity** | 52.55% | 9.73% | 5.11% |
| **Total** | 100.00% |   | 7.27% |

# **Taxes**

**A. Positions of the Parties**

I&E stated that its various recommendations have a flow-through impact on the Company’s taxes for the FPFTY. I&E M.B. at 50.

In its Main Briefs, the OCA explained that it resolved issues with Valley related to the treatment of EDIT. OCA M.B. at 8.

**B. ALJs’ Recommendation**

In their Recommended Decision, the ALJs explained that, because no Party raised an issue in this proceeding regarding taxes, they had no recommendations to make regarding this topic. R.D. at 80.

**C. Disposition**

As discussed above, there are no outstanding issues regarding this topic. Therefore, similar to the position of I&E, we simply note that the various positions we have adopted in other sections of this Opinion and Order have a flow-through impact on Valley’s taxes for the FPFTY. This can be seen in the rate tables set forth in Appendix A of this Opinion and Order.

# **Rate Structure**

## **Allocated Class Cost of Service (ACOSS)**

Our Regulations at 52 Pa. Code § 53.53, only require an ACOSS to be filed if the requested rate increase is in excess of $1 million. Therefore, because Valley only sought a rate increase of approximately $745,000, it was not required to file an ACOSS. R.D. at 80.

## **Revenue Allocation**

**1. Positions of the Parties**

Valley proposed an across-the board increase to all tariff rate schedules, reflecting the unbundling of certain GCR-related costs. Valley submitted that, because no other Party to this proceeding opposes Valley’s proposed revenue allocation, it should be approved by the Commission. Valley M.B. at 92.

I&E explained that its witness Mr. Ethan Cline accepted the Company’s proposed revenue allocation. I&E argued, *inter alia,* that an across-the-board increase is the simplest to implement, and probably the fairest given the Company’s stable sales base. I&E also pointed out that Valley is of the opinion that this approach would be the most acceptable to its ratepayers. I&E M.B. at 51.

The OCA noted that Valley excluded from the proposed rate increase three Firm Fixed and Firm Volumetric customers whose rates are set by contract. The OCA explained that its witness Mr. Jerome D. Mierzwa found both Valley’s across-the-board increase for tariff customers, and its proposal for contract customers to be reasonable. OCA M.B. at 67.

The OSBA submitted that Valley's proposal to assign uniform increases to rate classes was appropriate, noting that, absent class cost-of-service information, there is no cost basis to assign non-uniform increases to individual classes. OSBA M.B. at 6.

**2. ALJs’ Recommendation**

The ALJs found Valley’s proposed revenue allocation to be supported in the record and reasonable and recommended its adoption. The ALJs agreed that a uniform rate increase is the simplest to implement and one that is most acceptable to ratepayers. The ALJs also reasoned that absent class cost-of-service information, there is no cost basis to assign non-uniform increases to individual classes. R.D. at 81-82.

**3. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. Finding the ALJs’ recommendation to be based on substantial evidence and reasonable, we shall adopt it without further comment. Accordingly, we shall adopt an across-the-board revenue allocation for Valley in this proceeding.

## **Rate Design**

**1. Positions of the Parties**

Valley proposed a rate design reflecting its proposed across-the-board revenue allocation. As part of this rate design, the Company proposed increasing its monthly residential customer charge from $10.50 to $12.79 and its volumetric distribution charge from $0.25628/ccf to $0.31142/ccf. Valley M.B. at 92; Valley St. 1, Exhibit\_(HSG-1) Schedule B5(R). Valley explained that although it was not required under 52 Pa. Code § 53.53 to conduct a cost of service study, it did provide a customer charge analysis to support its proposed increases. Valley M.B. at 92 (citing Valley St. 1, Exhibit\_(HSG-1) Schedule C1-8(R). According to Valley, no Party opposed its proposed rate design. Valley M.B. at 92.

The OCA stated that its witness Mr. Mierzwa testified that a customer charge should only include those direct costs associated with serving customers and determined that only those costs have been included in the Company’s analysis. OCA M.B. at 67-68 (citing OCA St. 4 at 28). The OCA argued that a proposed increase to the residential customer charge equal to the system average increase authorized by the Commission in this proceeding is reasonable and cost justified. The OCA submitted that rather than adopt the Company’s proposed 21.8% increase to its customer charge, the customer charge should be increased by a percentage that reflects the Commission’s final rate determination and that the volumetric distribution charge should be adjusted accordingly. OCA M.B. at 68.

The OSBA restated its position that, absent class cost-of-service information, there is no cost basis to assign non-uniform increases to individual rate elements. Therefore, the OSBA submitted that Valley’s proposal to assign uniform increases to individual distribution rate elements is appropriate. OSBA M.B. at 6.

**2. ALJs’ Recommendation**

The ALJs explained that, while they recognized the arguments of the OCA, they also found the Company’s proposal to be reasonable. The ALJs pointed out that Valley’s proposal is not only supported by a customer charge analysis, but also by all of the Parties generally. The ALJs concluded that Valley’s rate design reflects the across-the-board revenue allocation, which the ALJs recommended, *supra*. Therefore, the ALJs recommended that the Commission adopt the Company’s proposed rate design. R.D. at 83.

**3. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. Finding the ALJs’ recommendation to be based soundly in record evidence and reasonable, we shall adopt it without further comment. Accordingly, we shall adopt the Company’s proposal wherein its rate design reflects the Company’s across-the-board revenue allocation, which we have approved, *supra*.

## **Scale Back**

**1. Positions of the Parties**

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

Valley submitted that the proposed scale backs of I&E and the OSBA, *infra*, are consistent with the Company’s proposed revenue allocation and should be approved in the event the Commission awards less than the Company's requested revenue increase. Valley M.B. at 92.

I&E and the OSBA both noted that Valley has proposed an across-the-board increase of 21.6% to all rate classes, excluding contract customers. Both Parties submitted that, in the event the Commission awards Valley an increase less than the full request, then it is reasonable that the Company’s rates be scaled back so that the percentage increase in these rates is the same regardless of the increase allowed by the Commission. I&E M.B. at 51-52; OSBA M.B. at 7.

The OCA asserted that, if the Commission approves a rate increase that is less than the Company’s requested revenue requirement, the Company’s proposed across-the-board allocation should be applied to the approved increase. Additionally, the OCA recommended that the customer charge should also only be increased by the system average increase authorized by the Commission in this proceeding. OCA M.B. at 68.

**2. ALJs’ Recommendation**

The ALJs recommended that Valley’s proportional scale back be adopted. The ALJs found it to be reasonable that the Company’s rates be scaled back so that the percentage increase in these rates is the same regardless of the increase ultimately allowed by the Commission. The ALJs also found this to be consistent with the Company’s proposed revenue allocation. R.D. at 84-85.

**3. Disposition**

No Party filed Exceptions on this issue with regard to the ALJs’ recommendation. Finding the ALJs’ recommendation to be based soundly in record evidence and reasonable, we shall adopt it. Accordingly, we shall adopt the ALJs’ recommendation that Valley should scale back its rates proportionately so that the percentage increase is the same for all rate classes that will experience an increase.

# **Miscellaneous Issues**

## **Reporting Requirements**

**1. Positions of the Parties**

I&E explained that its witness Mr. Cline accepted the Company's plant in service projections for the FTY and FPFTY, set forth in Valley Exhibit\_(HSG-1), Schedule C3(R). Nonetheless, I&E asserted that the Company should provide the Commission's Bureau of Technical Utility Service (TUS) and I&E with an update to this exhibit, showing actual capital expenditures, plant additions, and retirements by month for the twelve months ending December 31, 2019, followed by an additional update for actuals through December 31, 2020, no later than April 1, 2021. I&E claimed that, although the Commission has not yet implemented comprehensive regulations concerning the use of an FPFTY, the Commission has approved these same reporting requirements in multiple other base rate proceedings that used an FPFTY. In I&E’s view, this type of reporting is needed until such regulations are implemented. I&E M.B. at 52-54. I&E pointed out that in *UGI*,the Commission stated the need to ascertain the accuracy of the FPFTY projections and explained that pursuant to Section 315(e) of the Code,[[16]](#footnote-16) the Commission is authorized to audit the FPFTY results, after the fact, to determine whether they were accurate. *Id.* at 54 (citing *UGI* at 26).

Valley is of the opinion that the Commission should not impose additional reporting requirements that are not required by statute or regulation because it presents a regulatory burden on small utilities like Valley. Valley emphasized that it already submits numerous filings to the Commission each year, including Annual Reports required by the Commission's Regulations, and which include the type of detailed plant, expense, and sales data that I&E seeks. Valley also noted that the Commission has not adopted rules or regulations comprehensively addressing the requirements for public utilities utilizing the FPFTY. Therefore, Valley took the position that, until the Commission makes a broad determination on reporting requirements applicable to all NGDCs, the Company should not be required to provide the reports recommended by I&E. Valley M.B. at 93-94.

**2. ALJs’ Recommendation**

The ALJs found in favor of Valley and concluded that the updated filings regarding the Company’s plant in service projections should not be required at this time. The ALJs rejected I&E’s claim that the Commission has approved such reporting requirements in prior proceedings on the grounds that such reporting requirements were based upon the provisions of settlement agreements and were, therefore, voluntary. The ALJs reasoned that while the Commission may make such reporting requirements mandatory at the time it adopts comprehensive FPFTY regulations applicable to all similarly situated NGDCs, Valley should not be compelled to file additional reports that are not currently and uniformly applicable to all NGDCs. R.D. at 85-86.

**3. Exceptions and Replies**

In its Exception No. 6, I&E objects to the ALJs’ recommendation and restates its position that the Commission has accepted this reporting requirement in prior rate proceedings. I&E acknowledges the ALJs’ distinction that in such proceedings, the utility voluntarily agreed to this reporting requirement as part of a settlement agreement. Nonetheless, I&E submits that, although Valley has not agreed to this reporting requirement in the instant case, it is consistent with the public interest and within the Commission’s discretion to compel such reporting requirements. I&E insists that directing Valley to file updated information regarding actual capital expenditures, plant additions, and retirements will provide an “apples-to-apples” comparison in a form directly corresponding to a schedule provided in the rate filing of what the Company is projecting and actual plant in service. I&E submits that, by requiring this information, the Commission will afford TUS and I&E the ability to review the accuracy of the Company’s projections. I&E Exc. at 11-12.

In reply, Valley reiterates its argument that it already makes numerous filings with the Commission including Annual Reports, which entail detailed year-end plant expense, and sales data, and that the Company-provided quarterly updates following the initial rate filing in this proceeding. Valley also restates its position that imposing additional reporting requirements would constitute an unfair regulatory burden on a small utility such as Valley, when such reporting requirements are not applicable to all NGDCs. Valley R. Exc. at 20-21.

**4. Disposition**

We find that, on balance, and because reporting requirements are not uniform to all NGDCs, requiring additional reporting by Valley is unnecessary in this case. I&E had requested that Valley be required to provide the TUS and I&E with an update to its plant in service projections by updating Valley Exhibit\_(HSG-1), Schedule C3(R) showing actual capital expenditures, plant additions, and retirements by month for the twelve months ending December 31, 2019, followed by an additional update for actuals through December 31, 2020, no later than April 1, 2021. I&E Exc. at 11-12. This proposal was soundly rejected by the ALJs. R.D. at 85-86.

We agree with I&E that the Code provides the Commission broad power to require informational filings from utilities and that the Commission has accepted a reporting requirement such as that requested by I&E in other rate proceedings. I&E Exc. at 11-12. However, the imposition of additional reporting requirements is not required by statute or regulation. The ALJs noted that the Commission may include such requirements at such time as it adopts comprehensive FPFTY regulations, but the ALJs will not require the reporting by Valley in this proceeding. The ALJs emphasized that the proceedings cited by I&E in support of its request involved negotiated settlements where the utilities voluntarily agreed to the requested reporting. R.D. at 85-86.

In addition, a careful review of each case is advisable when considering the imposition of reporting beyond that required in the already heavily regulated utility industry. The instant case is distinguishable from I&E’s cited cases, in that there is no agreement by the utilities in the context of a negotiated settlement. Further, we find that requiring such augmented reporting is not in the public interest, because we have not adopted comprehensive FPFTY regulations defining reporting parameters. Finally, we find persuasive Valley’s argument that requiring increased reporting would impose an unfair regulatory burden on a small utility. R.D. at 85-86; Valley R. Exc. at 20-21.

We observe that, consistent with the regulatory requirements for NGDCs, Valley already submits numerous filings to the Commission each year, providing much of the information that I&E seeks. Valley R. Exc. at 20-21; Valley M.B at 92-93. Therefore, we adopt the ALJs’ recommendation on this reporting issue.

## **Proposed Tariff Changes**

Valley proposed a number of changes to its tariff, including changes to: (1) clarify existing defined terms consistent with Company practices; (2) clarify the Company’s Natural Gas Shortage and Emergency Conditions Policy; (3) revise the Company’s Facilities Expansion Policy to ensure recovery of reasonable facility expansion costs; (4) update fees for disconnection and reconnection due to customer violations or seasonal service; and (5) update the Automatic Meter Reading Equipment language to reflect current technologies.

### **Proposal to Clarify Existing Defined Terms Consistent with Company Practice**

**a. Positions of the Parties**

Valley proposed modifying or adding to its defined terms to clarify current Company practices, eliminate duplicative language, conform the definitions to proposed changes to the Natural Gas Shortage and Emergency Conditions Policy, and alphabetize the definitions. Specifically, Valley proposed to add a definition of “Daily Quantity” to reflect industry standards and the Company's current practices. Under the new definition, a customer’s Daily Quantity of gas would be the volume used in a 24-hour period beginning at 10 a.m. Eastern Standard Time or Daylight Savings Time, or as subsequently modified by Federal Energy Regulatory Commission natural gas standards. Valley St. 4 at 11-12; Valley M.B. at 95. No Party has opposed this addition that is consistent with established industry standards.

Valley also proposed to modify the definition of “Service” to eliminate language requiring the Company to maintain pressure sufficient to meet the “Customer’s requirements.” Valley offers that this change removes duplicative language, because the individual rate schedules in its tariff include pressure specifications. Valley St. 4 at 12; Valley M.B. at 95. No Party has opposed this modification.

Valley next proposes to change the definition of “Service Pipe” from extending “from the street main to the curb line” to extending from the “Company’s supply main to a metered Point of Delivery.” The change conforms the definition to the Company’s Facilities Expansion Policy. Valley St. 4 at 12-13; Valley M.B. at 95. No Party has opposed this conforming modification.

The Company proposes to add a definition for “System Maintenance Order” as the term is used in the proposed Natural Gas Shortage and Emergency Conditions Policy. Valley St. 4 at 13; Valley M.B. at 95. No Party has opposed this addition of a term used in its related policy.

Finally, Valley explained that, to avoid pagination issues, prior tariff supplements added defined terms to the end of the list, regardless of alphabetical order. This Company proposes to restore the correct order by alphabetizing all defined terms. Valley St. 4 at 13; Valley M.B. at 95. No Party has opposed this change.

**b. ALJs’ Recommendation**

The ALJs determined that each of the tariff additions, modifications, and re-ordering provide needed clarity and simplify the tariff for Valley’s customers, and thus are reasonable and in the public interest. Thus, the ALJs recommended approval of these uncontested tariff changes. R.D. at 86-87.

**c. Disposition**

We agree that the tariff modifications are supported by substantial evidence and provide needed clarity and simplify the tariff for Valley’s customers. We find the changes are reasonable and in the public interest. Thus, we affirm the ALJs’ recommendations that all of these tariff changes be approved.

### **Proposal to Clarify Valley’s Natural Gas Shortage and Emergency Conditions Policy**

**a. Positions of the Parties**

Valley proposed changes to its Natural Gas Shortage and Emergency Conditions Policy to add detail about the Company’s curtailment procedures and penalty provisions. Valley St. 4 at 13; Valley M.B. at 95. The Company explained that the prior Section B of the Policy has been deleted as unnecessary and the revised Section B replaces the former Section C and more comprehensively reviews the Company’s curtailment process, including pre-curtailment procedures intended to minimize curtailments. Additionally, the Company proposed to modify the penalty provisions to include a definition of “unauthorized use” and correct a typographical error. Valley St. 4 at 13; Valley M.B. at 95. No Party has opposed these explanatory and clarifying changes to the Policy.

**b. ALJs’ Recommendation**

The ALJs recommended approval of these uncontested changes, which provide additional explanation and clarity regarding Valley’s Natural Gas Shortage and Emergency Curtailment Policy for Valley’s customers. R.D. at 87.

**c. Disposition**

We agree with the ALJs that these important changes to critical gas management procedures and policies have merit and are supported by substantial record evidence. Accordingly, we approve them as reasonable and in the public interest.

### **Proposal to Update the Automatic Meter Reading Equipment Language to Reflect Current Technologies**

**a. Positions of the Parties**

The Company proposed to modify the Automatic Meter Reading Equipment language for Rate Schedules Large Industrial (I), Industrial Interruptible (IL), and Transportation Service (T) to reflect current technologies and costs. The Company proposed to clarify the costs associated with automatic meter reading equipment to include ethernet connections and/or wireless communication devices and wireless communication subscription plans. Valley St. 4 at 15; Valley M.B. at 95. No Party has opposed these tariff changes.

**b. ALJs’ Recommendation**

The ALJs recommended that these tariff modifications, which update and clarify current technologies and related costs for Valley’s customers, be approved as reasonable and in the public interest. R.D. at 87.

**c. Disposition**

We agree that the proposed changes to the relevant Rate Schedules are supported by substantial evidence of record, are appropriate and reflect current practices and associated costs. Thus, we approve these changes as reasonable and in the public interest.

### **Proposal to Modify Valley’s Facilities Extension Policy**

**a. Positions of the Parties**

Valley proposed modification of its Facilities Expansion Policy to clarify current practices and ensure recovery of reasonable facility expansion costs. Under its proposal, Valley would modify its Facilities Extension Policy to, clarify its right to adjust cost estimates, implement a third method for calculating Valley’s portion of service line extension costs, and allow customers to request a review of company records to determine whether a refund is necessary to account for customer connection in excess of the number used to calculate the company and customer investment in service and/or main extensions. The only challenge or opposition raised to these proposals is the OSBA’s opposition to Valley’s proposal to implement a third method for calculating Valley’s portion of service line extension costs. OSBA St. 1 at 9. Specifically, Valley proposed to implement a third option for calculating the Company’s portion of service line extension costs wherein Company contributions would be allowed for main or service line extensions up to the average cost of 200 feet of service and/or main extensions for new installations over the most recent 12-month period ending September 30. The Company submitted that its proposal addresses an unnecessary inequity in its current tariff rule. Valley St. 4 at 14-15; Valley M.B. at 96-98; Valley R.B. at 39-42.

I&E took no position on any of Valley’s proposals and OCA agrees with and supports Valley’s position on the line extension costs issue. OCA M B. at 70-74.

As explained by Valley in its Main Brief:

Currently, Valley’s tariff offers two options for customers seeking a Company contribution for a service line extension. Customers are entitled to a Company contribution for service line extensions of: 1) up to $6 per each additional dollar of anticipated annual revenues; or 2) the costs of 200 feet of service or main extensions. Valley Statement No. 4 at 14. As detailed in the Company's response to Interrogatory OSBA-Valley-II-1, the current method creates an unnecessary inequity. *See* OSBA Statement No. 1, Exhibit BK-1(V) (attaching Valley's response to OSBA-Valley-II-1). As stated therein, the average cost for 200 feet of service line or main extension for new installations over the 12-month period ending September 30, 2018 is $6,557. *See Id.* Under the current rule, a customer requiring a 200 foot extension costing $6,557 is entitled to a Company contribution, while a customer requiring a 300 foot extension that costs a total of $6,400 is not entitled to receive a full allocated contribution amount for the footage over 200 feet. *See Id.* Valley proposes to add a third option allowing for Company contributions for a main or service line extensions up to the average cost of 200 feet of service and/or main extensions for new installations over the most recent 12-month period ending September 30. *See Id.*

Valley M.B. at 96.

The OCA supported Valley’s position on the line extension costs issue. OCA St. 4-R at 7-10; OCA M.B. at 70-74. In so doing, the OCA witness Mierzwa, noted the following example as illustration of how the company’s current policy may provide unreasonable results:

 Customer A, with a lower than average (unit cost) of installation, may require a total of 250 feet of mains/service line investment as a cost of, say, $6,500, or $26 per foot. Customer B, with a greater than average (unit cost) of installation, may require a total of 200 feet of main/service line investment at a cost of, say, $6,800, or $34 per foot. Under the Company’s existing service extension policy, Customer B would not be required to pay a CIAC [Contributions in Aid of Construction] since the service extension does not exceed 200 feet. On the other hand, Customer A would be required to provide a CIAC equal to the cost to install facilities beyond 200 feet. Valley deems this outcome inequitable since Customer A is required to pay a CIAC even though Customer A’s total cost of installation ($6,500) is less than the total cost to extend service to Customer B.

OCA St. 4-R at 7-8; OCA M.B. at 73.

 In opposing Valley’s proposal, the OSBA argued:

The rationale behind the Company’s proposal to modify its existing policy is based on Valley’s claim that the current method of determining the allowable investment is inequitable. In the Company’s view, the current service extension policy does not treat customers with different (unit) installation costs equitably. However, as long as the Company’s unit installation costs vary across new installations, it is inevitable that some customers will receive a greater (or lesser) dollar investment allowance under a service extension policy that provides for a fixed allowance of 200 feet. Indeed, Mr. Kalcic [Brian Kalcic] testified that one should expect new customers to qualify for different allowable investment levels, whether due to differences in customer EBAR revenue credits or unit installation cost differences.

Since Valley’s proposal would permit the Company to install service extension facilities in excess of 200 feet (without requiring a CIAC) in certain circumstances, the Company’s proposal would effectively raise its existing proxy EBAR credit above the cost of 200 feet of service and/or main extension. However, Valley has provided no evidence to suggest that raising its allowable investment level is cost justified, or that doing so would ensure that its completed service extension projects remain economic. In short, the Company’s proposal to reduce the required level of CIACs going forward undermines the purpose of a CIAC, which is to offset that part of the cost of an extension that is not otherwise supported by an applicant’s expected revenue stream.

The OSBA opposes the Company’s proposed modifications to its Main Line Extension Policy because the proposal would shift a portion of the cost of main extensions from individual customer applicants of any class to general ratepayers, compared to Valley’s existing extension policy. Adoption of the proposed modification would not lower the Company’s cost of extending service to applicants, it merely would excuse the customer applicant from paying a portion of that cost and transfer the responsibility for that cost to existing (general) ratepayers thereby creating a subsidy.

OSBA M.B. at 9-10.

In response, Valley argued:

OSBA’s arguments should be disregarded. OSBA offers no empirical analysis supporting the association between the 200 feet of service line or main extension and the EBAR from customers. Particularly as the Company’s proposal preserves the average cost of a 200-foot extension as the upper limit on Company contributions under the proposed methodology, OSBA’s concerns regarding uneconomic line extension are unfounded. *See* Company Statement No. 4-R at 12. As stated by Valley witness Rogers “Valley is proposing a third method that merely allows all customers to access, if needed, the same minimum dollar investment available to any customer with an average 200-foot extension.”

Valley M.B. at 97.

The OCA’s witness Mierzwa further explained that, because the OSBA’s recommendation would result in the same fixed investment for each new customer within a customer class, it does not address cost differences that may exist in extending facilities to new customers. OCA St. 4-R at 10. Both Valley and the OCA argued that Valley’s proposal would appropriately recognize these potential cost differences. Valley M. B. at 98; OCA St. 4-R at 10.

Additionally, as summarized by the OCA:

Recognizing the benefit that low-cost natural gas can provide to residential ratepayers, other utilities have sought – and had approved—modifications to main extension policies that will facilitate the expansion of service. See, Pa. PUC v. Peoples Natural Gas Company, LLC, Docket No. R-2018-3006818, Order at 35 (October 3, 2019); Pa. PUC v. Columbia Gas of Pa., Docket No. R‑2015-2468056, Order at 14, 22 (June 19, 2015); see also, Pa. PUC v. Columbia Gas of Pa., Docket No. R-2015-2468056, Order at 21-22 (Dec. 3, 2015)(Order approving subsequent Partial Settlement on issue). Valley’s proposal also recognizes these benefits and enables the extension of natural gas service to unserved and underserved areas.

OCA M.B. at 74.

**b. ALJs’ Recommendation**

Finding the arguments of Valley and the OCA persuasive, the ALJs recommended that Valley’s proposal to implement a third method for calculation of Valley’s portion of service line extension costs be approved because the proposal will address the inequities in line extension costs present in Valley’s current main extension policy and, as such, will facilitate the expansion of natural gas facilities and service into unserved and underserved areas in Pennsylvania. R.D. at 87-90.

**c. Exceptions and Replies**

The OSBA argues that Valley offered no valid economic argument or cost justification in support of modifying its existing service extension policy. In the OSBA’s view, Valley’s proposal violates cost causation principles because it would shift a portion of the cost of main extensions from individual customer applicants of any class to general ratepayers, compared to Valley’s current policy. OSBA Exc. at 5-7.

Valley submits that the OSBA disregards the economic and public interest considerations addressed by the Company and supported by the OCA. Valley R. Exc. at 21-23. The OCA submits that the OSBA ignores cost differences that may exist in extending facilities to new customers and agrees with the ALJs’ recommendation that the Company’s proposed tariff modification be approved. OCA R. Exc. at 17‑20.

**d. Disposition**

Based upon our review of the record evidence and consideration of the arguments presented, we conclude that the ALJs appropriately recommended that Valley’s proposal to implement a third method for calculation of Valley’s portion of service line extension costs be approved. R.D. at 87-90.

As noted by Valley and OCA, the proposal will address the inequities in line extension costs present in Valley’s current main extension policy. Valley St. 4 at 14‑15; Valley M.B. at 96-98; Valley R.B. at 39-42; OCA St. 4-R at 10; OCA M.B. at 70‑74. We find persuasive Valley’s claim that the OSBA disregards the economic and public interest considerations addressed by the Company and supported by the OCA. Valley R. Exc. at 21-23. In addition, we agree with the OCA that the OSBA’s argument ignores cost differences that may exist in extending facilities to new customers. OCA R. Exc. at 17‑20.

For each of these reasons, we adopt the ALJs’ recommendation that the Company’s proposed tariff modification be approved as reasonable and supported by the record. R.D. at 87-90.

### **Disconnection/Reconnection Fees**

**a. Positions of the Parties**

Valley proposed in this proceeding to increase its current disconnection and reconnection fees by $10.00. Valley’s proposal would increase the fees for disconnections/reconnections occurring during working hours from $25.00 to $35.00 and increase fees for disconnections/reconnections occurring during non-working hours from $30.00 to $40.00. Valley St. 4 at 16; Valley M.B. at 98. In support of its proposed increase, Valley argued in its Main Brief that, “[t]en dollars is a modest increase to fees that were last increased in Valley’s 2007 rate case, which was almost thirteen years ago. Accordingly, the proposed increase to Valley’s reconnection and disconnection fees should be approved.” Valley M.B. at 99. It further argued that, “fees were increased to account for 13 years of inflation.” Valley R.B. at 42.

The OCA opposed the requested increase, arguing that Valley provided no cost-based justification for the increase. The OCA averred:

Section 1407(a) of the Public Utility Code provides that “a public utility may require a reconnection fee based upon the public utility’s cost as approved by the commission prior to reconnection of service following lawful termination of the service.” 66 Pa.C.S. § 1407(a)(emphasis added). The Company has not provided any evidence of its costs for the reconnection or disconnection of service. The fact that the fees have not changed since 2007 does not automatically mean that the Company’s costs for reconnection and disconnection have increased or that they have increased by $10. The OCA submits that the Company’s proposal should be denied because the Company has not met its burden of proof to demonstrate that the proposed increases to the reconnection and disconnection fees are cost-based, reasonable, or justified. The Company has the burden of proving that each and every component of its rate request is just and reasonable. Burleson at 1236. The Company has provided no calculations or evidence in support of its requested reconnection fee increase. Valley has failed to meet its burden of proof with respect to the proposed increases to the disconnection and reconnection fees and its request should be denied.

OCA M.B. at 70.

**b. ALJs’ Recommendation**

The ALJs agreed with the OCA and recommended that Valley’s proposal to increase its disconnection and reconnection fees be denied. Noting that the Code requires that such fees, while permitted, must be based upon the utility’s costs in providing the service, the ALJs emphasized that Valley had not provided evidentiary support for the increases, but instead, merely argued that the increases were being sought to account for thirteen years of inflation. The ALJs agreed with the OCA that such justification is not sufficiently cost-based, and that Valley had not supported its request with evidence demonstrating the costs associated with providing the services and the need for increases. Emphasizing the well-established tenet that utilities must prove that each and every element of a rate request is just and reasonable, *Burleson v. Pa. PUC*, 461 A.2d 1234, 1236 (Pa. 1983), the ALJs concluded that Valley had failed to do so with regard to the disconnection/reconnection fees increase. Accordingly, the ALJs recommended that Valley’s request to increase its current disconnection and reconnection fees by $10.00 be denied. R.D. at 91.

**c. Disposition**

No party, including Valley, excepted to the ALJs’ recommendation that the requested disconnection/reconnection fees increase be denied. We find that the ALJs accurately determined that Valley had failed to prove, with adequate record evidence, that this element of its rate increase request is just and reasonable. Accordingly, we adopt the ALJs’ recommendation that Valley’s request to increase its current disconnection and reconnection fees each by $10.00 be denied.

## **Unbundled Procurement Costs to be Recovered in Valley’s Gas Cost Rate (GCR)**

**1. Positions of the Parties**

Pursuant to the Commission’s Order of June 23, 2011 at Docket No. L‑2008-2069114, Valley proposes in this proceeding to unbundle procurement costs from delivery rates. Valley notes that it was provided a waiver of this requirement until its next base rate case by Commission order entered December 5, 2012 at Docket No. P‑2012-2321937. Valley M.B. at 99. Valley’s request in this proceeding is merely intended to come into compliance with these two Commission orders. No Party opposed the Company’s proposed unbundling proposal.

**2. ALJs’ Recommendation**

The ALJs concluded that because Valley’s unopposed proposal will bring it into compliance with the Commission’s orders at Docket Nos. L-2008-2069114 and P‑2012-2321937, they recommended that the Company’s proposal to unbundle procurement costs from delivery rates be approved. R.D. at 92.

**3. Disposition**

We concur that Valley’s unopposed proposal is supported by substantial record evidence and will bring it into compliance with the Commission’s Orders at Docket Nos. L-2008-2069114 and P-2012-2321937. Thus, we agree with the ALJs’ recommendation and approve the Company’s proposal to unbundle procurement costs from delivery rates.

# **Conclusion**

We have reviewed the record as developed in this proceeding, including the ALJs’ Recommended Decision, the Exceptions filed, and Replies filed in response thereto. Based upon our review, evaluation and analysis of the record evidence, we shall: (1) grant, in part, and deny, in part, the Exceptions filed by Valley; (2) grant, in part, and deny, in part, the Exceptions filed by I&E; (3) grant, in part, and deny, in part, the Exceptions filed by the OCA; (4) deny the Exception filed by the OSBA; and (5) adopt the ALJs’ Recommended Decision, as modified, consistent with this Opinion and Order; **THEREFORE,**

**IT IS ORDERED:**

1. That the Exceptions of Valley Energy, Inc., filed on March 13, 2020, are granted, in part, and denied, in part, consistent with this Opinion and Order.
2. That the Exceptions of the Bureau of Investigation and Enforcement, filed on March 12, 2020, are granted, in part, and denied, in part, consistent with this Opinion and Order.
3. That the Exceptions of the Office of Consumer Advocate, filed on March 13, 2020, are granted, in part, and denied, in part, consistent with this Opinion and Order.
4. That the Exception of the Office of Small Business Advocate, filed on March 13, 2020, is denied, consistent with this Opinion and Order.
5. That the Recommended Decision of Administrative Law Judges Steven K. Haas and Benjamin J. Myers, issued on February 28, 2020, is adopted as modified by this Opinion and Order.
6. That the corrections and modifications directed by this Opinion and Order reflected in the Valley Energy, Inc., Docket No. R-2019-3008209 (Commission Tables Calculating Allowed Revenue Increase), attached hereto, are adopted as in the public interest.
7. That Valley Energy, Inc. shall not place into effect the rates contained in Supplement No. 49 to Tariff Gas – Pa. P.U.C. No. 2, as filed.
8. That Valley Energy, Inc. 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 $469,097, to become effective for service rendered on and after May 1, 2020.
9. That as discussed in Section X.B of this Opinion and Order, Valley Energy, Inc. is also authorized to file tariff revisions to: (1) clarify existing defined terms consistent with Company practices; (2) clarify the Company's Natural Gas Shortage and Emergency Conditions Policy; (3) revise the Company's Facilities Expansion Policy to ensure recovery of reasonable facility expansion costs; and (4) update the Automatic Meter Reading Equipment language to reflect current technologies, consistent with this Opinion and Order.
10. That as discussed in Section X.B of this Opinion and Order, Valley Energy, Inc’s proposed tariff revision to update fees for disconnection and reconnection due to customer violations or seasonal service is denied, consistent with this Opinion and Order.
11. That Valley Energy, Inc. 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.
12. That Valley Energy, Inc. 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.
13. That, upon acceptance and approval by the Commission of the tariff supplements filed by Valley Energy, Inc., consistent with this Final Opinion and Order, the investigation, at Docket R-2019-3008209, should be marked closed.
14. That the Formal Complaint filed by the Office of Consumer Advocate in this proceeding at Docket Number C-2019-3011850 be dismissed and marked closed.
15. That the Formal Complaint filed by Athens Borough at Docket Number C-2019-3012397 be dismissed and marked closed.
16. That the Formal Complaint filed by South Waverly Borough in this proceeding at Docket Number C-2019-3012396 be dismissed and marked closed.
17. That the Formal Complaint filed by Larry E. Cole in this proceeding at Docket Number C-2019-3012219 be dismissed and marked closed.

 **BY THE COMMISSION,**



 Rosemary Chiavetta

 Secretary

(SEAL)

ORDER ADOPTED: April 16, 2020

ORDER ENTERED: April 27, 2020

**Pennsylvania Public Utility Commission**

**v.**

**Valley Energy, Inc.**

**Docket No. R-2019-3008209**

# **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**









**Notes to accompany Table II**

(1) No Party to this proceeding recommended any adjustments to the Company’s Cash Working Capital claims for Interest or Taxes. Further, as such adjustments would result in de minimus changes to the Company’s Rate Base, and ultimately to the Revenue Requirement, such adjustments on Tables IV and V have not been carried over or reflected in our adjustment to the Company’s Rate Base.

(2) This figure represents the net effect of the OCA’s accepted proposal that the Company’s Rate Base claim be modified to take into account the effect that plant retirements will have on the Company's Rate Base claim. *See* OCA St. 2, Schedule LKM-1. Therefore, this figure represents a reduction of $55,659 to Valley’s Plant in Service amount, and a corresponding reduction of $56,678 to Valleys Accumulated Depreciation amount to account for the retirement of Plant in service. [‑$55,659 - (-$56,678)=$1,019].

(3) Our adjustment to eliminate the three percent Inflation Factor is based on Valley’s Statement No. 1-R, Rebuttal Testimony of Howard S. Gorman, at 5. Account 928 was adjusted to reflect its removal at the annualized amount. Otherwise, this amount reflects all other individual accounts’ annualized amounts prior to the proposed three percent inflation increase.









1. Exceptions were originally due on March 11, 2020. However, as noted below, on March 2, 2020, I&E filed a Petition for Extension of Time to File Exceptions and Reply Exceptions (Petition), which was supported by the OCA and the OSBA and was not opposed by Valley. On March 6, 2020, the Commission issued a Secretarial letter granting I&E’s Petition and extending the due date for the filing of Exceptions to March 13, 2020 and the due date for the filing of Reply Exceptions to March 23, 2020. [↑](#footnote-ref-1)
2. A city gate is the point at which natural gas is transferred from an interstate or intrastate pipeline to a local natural gas utility. [↑](#footnote-ref-2)
3. Those rate cases, including the Recommended Decisions and Exceptions and Replies thereto, are addressed in separate Opinion and Orders. [↑](#footnote-ref-3)
4. Among other things, Section 1308(d) of the Code requires the Commission to render a final decision granting or denying, in whole or in part, the general rate increase requested by a public utility, within a general time frame not to exceed seven months from the proposed effective date of the utility’s proposed tariff supplement. *See* 66 Pa. C.S. § 1308(d); *see also* 52 Pa. Code § 53.31 (requiring a tariff proposing rate increase to be effective upon sixty days’ advance notice). Unless the utility voluntarily extends the suspension period, the Commission’s non-action within this timeframe means, by operation of law, the utility’s proposed general rate increase will go into effect, as proposed, at the end of such period. *See* 66 Pa. C.S. § 1308(d). [↑](#footnote-ref-4)
5. 1 Pa. C.S. § 1922(1), *PA Financial Responsibility Assigned Claims Plan v. English*, 541 Pa. 424, 430-431, 64 A.2d 84, 87 (1995). [↑](#footnote-ref-5)
6. We note that in the “Summary” portion of the “Rate Base” section of their R.D., the ALJs stated that the Parties agreed to “an EDIT balance of $91,477 and a reduction of the rate base by the same amount.” R.D. at 17. The Company’s initial claimed EDIT balance was $64,034 and it accepted the OCA’s proposed increase to the EDIT of $27,443, resulting in a final EDIT balance of $91,477 ($64,034 + $27,443). *See* Valley Exhibit\_(HSG-1), Schedule C1-6 (R); OCA St. 2 at 11, Schedule LKM‑6. As the ALJs noted, the Parties also agreed to a corresponding reduction to the Company’s rate base of $27,443. [↑](#footnote-ref-6)
7. The Rate Transport DDQ class refers to transportation-only customers taking service under Rate C. Valley St. 1 at 11. [↑](#footnote-ref-7)
8. 66 Pa. C.S. §§ 315(a) and 1308(d). [↑](#footnote-ref-8)
9. Valley noted in response to I&E-RE-31-D that this account should be titled “Miscellaneous General Expenses” and not “General Advertising.” OCA St. 1 at 17. [↑](#footnote-ref-9)
10. This excludes the commodity portion of the Uncollectible Expense in the amount of $45,369 to be unbundled for recovery through the GCR. *See* Valley M.B. at 49. [↑](#footnote-ref-10)
11. As will be discussed below, in the following chart, DCF refers to the Discounted Cash Flow Method, CAPM refers to the Capital Asset Pricing Model, RP refers to the Risk Premium Method, and CE refers to the Comparable Earnings Method. [↑](#footnote-ref-11)
12. As noted in our discussion of the final cost of common equity awarded to the Company, *infra*,the ALJs stated that, because Valley’s stand-alone CAPM ROE and DCF ROE were within 20 basis points, it appears that the Company’s DCF analysis is reasonable. R.D. at 68. The OCA challenged this statement in its Exception No. 8. [↑](#footnote-ref-12)
13. 66 Pa. C.S. §523. [↑](#footnote-ref-13)
14. Valley’s Replies to I&E’s Exception Nos. 4 and 5, and I&E and the OCA’s Replies to the Company’s Exception Nos. 7 and 8 were presented, in detail, earlier in the Fair Rate of Return section of this Opinion and Order. Therefore, aside from the following Replies of the Company to the OCA’s Exception No. 8, these Reply Exceptions will not be restated here. [↑](#footnote-ref-14)
15. We note that differences in the table are due to rounding. [↑](#footnote-ref-15)
16. 66 Pa. C.S. § 315(e). [↑](#footnote-ref-16)