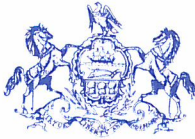


COMMONWEALTH OF PENNSYLVANIA



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December 22, 2020

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

Re: Pennsylvania Public Utility Commission  
v.  
Columbia Gas of Pennsylvania, Inc.  
Docket No. R-2020-3018835

Dear Secretary Chiavetta:

Attached for electronic filing please find the Office of Consumer Advocate's **REVISED** Exceptions in the above-referenced proceeding.

Copies have been served on the parties as indicated on the enclosed Certificate of Service.

Respectfully submitted,

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Enclosures:

cc: The Honorable Katrina L. Dunderdale (**email only**)  
Office of Special Assistants (**email only**: ra-OSA@pa.gov)  
Certificate of Service

\*300587

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission :  
v. : Docket No. R-2020-3018835  
Columbia Gas of Pennsylvania, Inc. :

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate's **REVISED** Exceptions, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 22<sup>nd</sup> day of December 2020.

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission,	:	Docket Nos.	R-2020-3018835
Office of Small Business Advocate,	:		C-2020-3019702
Office of Consumer Advocate	:		C-2020-3019714
	:		
v.	:		
	:		
Columbia Gas Pennsylvania, Inc.	:		

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**EXCEPTIONS OF THE  
OFFICE OF CONSUMER ADVOCATE**

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## **I. INTRODUCTION**

On April 24, 2020, Columbia Gas of Pennsylvania, Inc. (Columbia or the Company) filed Supplement No. 307 to Tariff Gas – Pa. P.U.C. No. 9 (Supplement No. 307) with the Pennsylvania Public Utility Commission (the Commission) to become effective June 23, 2020. Columbia is engaged in the business of furnishing natural gas service to approximately 433,000 residential, commercial, and industrial customers in portions of 26 counties in western, northwestern, southern, and central Pennsylvania. In Supplement No. 307, Columbia sought an increase in annual distribution revenues of \$100.4 million for a fully projected future test year (FPFTY) ending on December 31, 2021. According to Columbia's filing, the total monthly bill for residential customers using 70 therms per month, would increase from \$87.57 to \$103.19 (17.84%). Columbia's proposed rate increase, if approved, would produce a 7.98% overall rate of return on its original cost rate base, including a 10.95% return on common equity. Columbia also proposed the following Tariff revisions in its filing: (1) an increase in the residential customer charge from \$16.75 to \$23.00, or by 37.3%, (2) the elimination of the 3 percent deadband provision of its Weather Normalization Adjustment rider program, and (3) the introduction of a Revenue Normalization Adjustment rider.

The Office of Consumer Advocate (OCA) opposed any increase to Columbia's rates at this time as the Commonwealth as a whole, and particularly throughout Columbia's vast service territory, is still firmly in the grip of the COVID-19 pandemic along with the impacts to the health of the citizenry and the local economy. In her well-reasoned and thoughtful Recommended Decision (R.D.), Administrative Law Judge Katrina L. Dunderdale (Judge Dunderdale) concluded that Columbia's \$100.4 million rate increase request is not just and reasonable at this time and Columbia did not adequately support its request by evidence of record. R.D. at 1 and 408, ¶ 7.

Judge Dunderdale explicitly considered the economic and financial circumstances in Columbia's service territory and the ability of Columbia's customers, residential and business alike, to sustain any rate increases during this pandemic.

Specifically, Judge Dunderdale found that, if rates remain unchanged, Columbia will still have an opportunity to earn a rate of return, albeit a smaller one, in a range from 4% to 6% and Columbia could re-file for a rate increase when it has "collect[ed] specific data that will help Columbia Gas, the Commission, the advocates and the ratepayers to find the combination of rates, charges, fees and programs that will work best for Columbia Gas, its customers and its investors specifically, and the Commonwealth generally." R.D. at 51. If, in the alternative, the Commission chooses to follow a standard ratemaking path for Columbia and consider all elements of its base rate request at this time, Judge Dunderdale found that the record is clear that Columbia has not demonstrated with documentation and/or convincing evidence the need for a large increase in revenues and, therefore, recommended that many of the Company's FPFTY projected costs be denied or decreased. R.D. at 105-117. The OCA respectfully requests that the Commission approve Judge Dunderdale's Recommended Decision to deny the rate increase in its entirety.

In the alternative, if the Commission rejects Judge Dunderdale's recommendation of no rate increase, the OCA respectfully requests that the Commission accept all other recommendations provided by Judge Dunderdale in the R.D other than certain areas raised within these Exceptions where the Commission should modify the R.D. Specifically, in the area of universal service, the OCA submits that Judge Dunderdale erred in her conclusion that universal service costs should not be allocated to all customer classes. R.D. at 398-399. The OCA respectfully submits that the record developed in this case fully supports that the benefits of the universal service programs are broad, and that these programs that are public goods should be paid for by all customers. Additionally, the OCA submits that, while Judge Dunderdale correctly



concluded that the Company's low-income collection efforts should be improved, Judge Dunderdale did not specifically recognize that improvements in the customer outreach efforts were also needed and could aid in collection efforts. R.D. at 240-241.

The OCA also submits that certain aspects of Judge Dunderdale's rate of return conclusion, if adopted, could result in the grant of an overstated cost of equity for Columbia. Specifically, the OCA submits that Judge Dunderdale erred in adopting the I&E proxy group and erred by not specifying in the R.D. that the appropriate cost of equity for Columbia should be no higher than 8.50%, the return on equity recommended by the OCA if the Commission considers a "business as usual" case. R.D. at 183-185.

## **II. EXCEPTIONS**

**Exception No. 1:** Judge Dunderdale Erred In Her Decision That Columbia Should Not Allocate Universal Service Costs To All Customer Classes. (R.D. at 261-265, 293, 322-340, 363-364, 370-376, 381-382, 384-387, 390-393, 397-399; OCA M.B. at 159-185; OCA R.B. at 68-80)

Judge Dunderdale erred in her conclusion that universal service costs should not be allocated to all customer classes. R.D. at 398-399. The Recommended Decision provided:

The ALJ recommends the Commission reject the suggestion from OCA and CAUSE-PA that USP costs should be distributed among all the classes. The arguments carry merit and were accompanied by a breadth of evidence presented from its experts. To consider the societal impacts of poverty and low income are slightly outside the bailiwick of a base rate proceeding, absent a clear directive from the Commission to consider these societal and macroeconomic theories in a base rate proceeding. Although the Final CAP Policy Statement Order does not ban the allocation of USP costs among the rate classes, more than silence is needed before a base rate proceeding should consider a regulatory issue that carries such wide-ranging policy implications.

Alternatively, if the Commission grants Columbia Gas' request to consider all the elements in its base rate increase request, the ALJ recommends the Commission reject the current suggestions from OCA and CAUSE-PA to distribute USP costs among all the rate classes.

R.D. at 399 (footnotes omitted).

In her R.D., Judge Dunderdale stated that she found the arguments of the OCA and CAUSE-PA to be “persuasive” and that the arguments “carry merit and were accompanied by a breadth of evidence presented from its experts.” R.D. at 398-399. Judge Dunderdale ultimately, however, concluded that she would not consider the OCA and CAUSE-PA recommendation in this base rate proceeding without a clear directive from the Commission. R.D. at 399.

The OCA submits that Judge Dunderdale erred in her conclusion. The Commission has provided clear direction to consider this issue in a base rate proceeding. In the Final CAP Policy Statement, the Commission provided:

(b) In rate cases, parties may raise the issue of recovery of CAP costs, whether specifically or as part of universal service program costs in general, from all ratepayer classes. No rate class should be considered routinely exempt from CAP and other universal service obligations.<sup>1</sup>

In its Final CAP Policy Statement Order accompanying the adoption of this provision, the Commission stated:

This Order amends the CAP Policy Statement as indicated in Annex A to address recovery of CAP costs. Consistent with the discussion above, the Commission finds it appropriate to consider recovery of the costs of CAP costs [sic] from all ratepayer classes. Utilities and stakeholders are advised to be prepared to address CAP cost recovery in utility-specific rate cases consistent with the understanding that the Commission will no longer routinely exempt non-residential classes from universal service obligations.<sup>2</sup>

As can be seen, the Commission specifically intended for this issue to be addressed in a base rate proceeding with full consideration of all arguments regarding the allocation.

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<sup>1</sup> 52 Pa. Code § 69.265(b)(emphasis added).

<sup>2</sup> 2019 Amendments to Policy Statement on Customer Assistance Program, 52 Pa. Code §§ 69.261-69.267, Docket No. M-2010-3012599, Order at 97 (Order entered Nov. 5, 2019) (Final CAP Policy Statement Order)(footnotes omitted).

The Final CAP Policy Statement Order also provided “consistent with the comments of the Low Income Advocates and OCA, the Commission concludes that the General Assembly clearly identified the public purpose of these programs in the Competition Acts by requiring that their costs be ‘nonbypassable’ when a customer switches energy providers.”<sup>3</sup> Importantly, OCA witness Roger Colton explained that these programs should be examined as public goods. OCA St. 5 at 52-56.

In concluding, however, that “the societal impacts of poverty and low income are slightly outside the bailiwick of a base rate proceeding,” Judge Dunderdale overlooks that the doctrine of “public goods” applies to ratemaking proceedings. OCA witness Colton explained the concept of public goods:

Due to the nature of public goods, all customers receive benefits from public goods and, accordingly, the costs of such goods are spread over all customer classes. Each end user makes a financial contribution to the utility’s delivery of public goods. The “public goods” doctrine is applied in a variety of settings as a justification to spread designated utility costs over all customer classes.

In economic theory, public goods are those products and services that are valuable to society but which are undersupplied when society relies on private markets to provide them. Because they are needed and will not be made sufficiently available through private markets, the government must supply public goods. Classic examples of public goods include streetlights, city roads, and police protection.

OCA St. 5 at 52. The “public goods” doctrine is applied in a variety of settings to spread designated utility costs over customer classes. Id. Fire hydrants and the basic telecommunications network have been found to be a “public good” as a justification to spread network costs over all customer classes. OCA St. 5 at 52.

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<sup>3</sup> Final CAP Policy Statement Order at 88-98 (footnotes omitted).

As Mr. Colton explained, the same conclusion should be reached about universal service costs and the costs should be spread across all customer classes. OCA St. 5 at 52-56. OCA witness Colton recommended that the Commission adopt the National Regulatory Research Institute (NRRI) definition of public goods. OCA St. 5 at 52. Mr. Colton quoted NRRI's definition of public goods:

A public good can be defined as “any publicly induced or provided collective good” that “arise[s] whenever some segment of the public collectively wants and is prepared to pay for a different bundle of goods and services than the unhampered market will produce.” (note omitted). In sharp contrast to the private-good model. . . , the emphasis of the public-good model is on the *total* societal benefits—both direct and indirect—associated with network modernization. As applied to the telecommunications network, the public-good model is based upon the premise that the costs of achieving and supporting a modern, state-of-the-art network infrastructure are ultimately borne by the general body of ratepayers as opposed to limited subsets of customers who exhibit a high demand for specific new services. The public-good model is conducive to establishing social policies which provide for a “supply driven definition” of infrastructure.

\* \* \*

Under the public-good model, infrastructure investment[s] that are in the “public interest” are mandated by regulatory commissions, which act as surrogates for marketplace forces for the very reason that those forces break down either because of the enormous risks involved because of uncertainty with respect to costs and demand or both, or because of the intangible or unmeasurable society benefits which are not valued by the marketplace. (emphasis in original).

OCA St. 5 at 53 (footnote omitted).

OCA witness Colton testified that NRRI helps to guide the Commission's consideration of universal service cost allocations in the following ways:

- First, universal service is a “publicly induced or provided collective good” as described by the NRRI.
- Second, it is clear from prior Pennsylvania proceedings, that NRRI was correct in referring to such a “collective good” as one that not all ratepayers would choose to pay for. Indeed, the fact that the Pennsylvania General Assembly mandated that a universal service charge be “nonbypassable” indicates that the General Assembly

understood this aspect of a “public good” and that it affirmatively decided that ratepayers could not avoid this cost by switching suppliers.

- Third, the Pennsylvania universal service programs are consistent with NRRI’s statement that the emphasis is on “the *total* societal benefits.” Indeed, these benefits include not simply the benefits to participating customers, but also, in the words of NRRI, the benefits “both direct and indirect.” Pennsylvania’s CAP programs, as a public good, clearly fit this notion of generating not only direct social benefits, but also a wide range of indirect social benefits to all customer classes.
- Fourth, the finding that universal service is a “public good” has cost allocation implications to it. As NRRI points out, “the costs of achieving and supporting a modern, state-of-the-art network infrastructure are ultimately borne by the general body of ratepayers.” While some ratepayer groups would limit the allocation of costs only to those customers who “use” the service of a universal service program, accepting this decision is at fundamental odds with universal service being determined to be a “public good.”

Finally, the very fact that the public benefits of Pennsylvania’s universal service programs such as CAP are hard to quantify is one of the reasons that universal service should be found to be a public good with costs allocated to all ratepayers. As NRRI points out, the public good approach applies “for the very reason that those [market] forces break down. . .because of. . . the intangible or unmeasurable society benefits which are not valued by the marketplace.”

OCA St. 5 at 53-54.

CAUSE-PA witness Miller also agreed that universal service costs should be considered a “public good” with costs allocated to all customer classes. Mr. Miller testified:

Energy insecurity impacts all customer classes (industry, business, commerce, educational institutions, hospitals, local and state governments, and other residential consumers) in specific and identifiable ways. The responsibility to provide universal access to life-sustaining utility service should be shared by all utility consumers. Poverty is a broad societal problem, impacting all customers and customer classes and requiring a collective, societal solution. While the most *direct* benefits of universal service programs are derived by program participants, who by definition are *part of* the residential customer class, there are a multitude of societal benefits which inure to non-residential ratepayers which inure to non-residential ratepayers that should not be ignored. As a public good, the cost of ensuring affordable access to very basic human needs should be borne by all those enjoy the benefits of the public utility.

CAUSE-PA St. 1 at 39.

As the Commission has recognized, there is no statutory or appellate prohibition that limits the recovery of universal service costs from the residential class. As the Commission stated:

We note there is no statutory or appellate prohibition that limits the recovery of CAP costs, whether specifically calculated or as part of total universal service costs, to funding from the residential class, while not mandatory, is permissible:

Thus, under *Lloyd*, there is no statutory requirement that the funding for special programs come only from those who benefit from the programs. However, the lack of such a requirement does not mean that funding for special programs must come from those who do not benefit.

*MEIUG v. Pa. PUC*, 960 A. 2d. 189, 202 (2008), citing *Lloyd v. Pa. PUC*, 904 A.2d 1010 (Pa. Cmwlth. 2006).<sup>4</sup>

See also, Pa. PUC v. PGW, Docket No. R-2017-2586783, slip op. at 75 (Order entered Nov. 8, 2017).

The reasons offered by Judge Dunderdale for denying the OCA and CAUSE-PA's proposal to allocate universal service costs to all customers are not consistent with the Commission's CAP Policy Statement, the Final CAP Policy Statement Order, or the doctrine of "public goods." Judge Dunderdale's recommendation also does not recognize the wide ranging benefits provided by the universal service programs that were discussed by OCA witness Colton. OCA St. 5 at 34-57. The OCA submits that the Commission should reject Judge Dunderdale's determination to delay this issue or to retain the current allocation. Rather, the Commission should take up this issue in this case and find that Columbia's universal service costs should be allocated to all customer classes.

By way of summary, as the evidence here shows:

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<sup>4</sup> Final CAP Policy Statement Order at 92-93 (footnotes omitted).

- In Columbia’s service territory, 53,918 customers with income at or below 150 percent of the Federal Poverty Level (FPL) do not participate in CAP, and there are an additional 33,124 customers between 151-200% of the FPL who are ineligible for the program but pay the costs of the program. As OCA witness Colton testified, “allocating universal service costs over all customer classes would help improve the affordability of CGPA bills to these nearly 90,000 residential customers (53,918 + 33,124 = 87,042 who are reasonably viewed as income-challenged, but not participating in, or not eligible for, CGPA’s universal service programs.” OCA St. 5 at 30-33; see also, OCA M.B. at 165.
- Poverty is not just a residential customer class problem. Broad economic factors throughout the Columbia Gas service territory contribute to low-income customers’ inability-to-pay. These factors are not limited to residential customer class. See, OCA St. 5 at 34-39; OCA M.B. at 166-169; OCA R.B. at 73-74.
- Universal service programs provide an economic benefit to businesses. OCA St. 5 at 40-51; OCA M.B. at 169-176. Universal service programs are often provided to low wage earners. OCA St. 34-39; OCA M.B. at 174-176.
- The programs help to address the financial stressors that impact overall employee productivity for these low wage earners and help to support the local economies of the Columbia service territory. OCA St. 5 at 45-51; OCA M.B. at 169-176.
- In addition to addressing utility payment problems, home energy affordability programs can help address trends toward housing abandonment, reductions in educational attainment, and adverse health outcomes for payment-troubled utility customers. OCA St. 5 at 42-43; OCA M.B. at 171; see also, OCA St. 5 at 44-47.
- Universal service programs help to control the need to provide local government services, the cost of which is largely borne by non-residential taxpayers. There is a direct connection between unaffordable home energy bills and the costs of providing public health services. OCA St. 5 at 42-43; OCA M.B. at 171; see also, OCA St. 5 at 44-47.
- Programs have the effect of improving business profitability by reducing business costs, including reducing absenteeism and turnover, and increasing employee productivity. OCA St. 5 at 57; see also, OCA St. 5 at 49-50; OCA M.B. at 174-176.
- Allocation of universal service costs is consistent with sound ratemaking principles. One well-accepted tenet of utility ratemaking is that certain expenses incurred by the public utility are for “public goods.” The costs of Columbia’s universal service program should be considered a “public good” that should be allocated across all customer classes. OCA St. 5 at 52-56; OCA M.B. at 176-182; OCA R.B. at 73-74.

After an extensive discussion of the wide ranging benefits of universal service programs,

Mr. Colton summarized as follows:

Based on the data and discussion above, I find that programs such as the Pennsylvania universal service programs, directed toward preserving basic home energy service and relieving financial stress about a household's capacity to meet its fundamental household needs on a month-to-month basis, address a societal-wide problem that is not limited to the residential customer class. The problems that are related to unaffordable home energy are not "caused" by the residential class. Nor does the CGPA universal service programs deliver benefits that are limited to the residential class.

Accordingly, the costs of those programs should be allocated and spread over all of CGPA's customer classes. No reason exists for the residential class to be charged with paying the entire cost of programs that have the effect of improving business profitability by reducing business costs, including reducing absenteeism and turnover, and increasing employee productivity.

OCA St. 5 at 57; OCA M.B. at 180-181.

OCA witness Colton recommended that universal service charges should be allocated between customer classes on a competitively neutral basis. OCA St. 5 at 58; see also, OCA M.B. at 181-182; OCA R.B. at 66-67. Mr. Colton recommended that the allocation be based on the percentage of revenue provided by each customer class at base rates. OCA witness Colton explained the cost impact on each customer class of the proposed allocation of universal service costs. He testified:

Given that the future expenditures on CGPA universal service programs are not now known and measurable, I estimate the cost impacts of my recommendation using the past two complete years. CGPA reports that it collected \$32,333,857.91 in Universal Service Revenues in 2018. CGPA reports that it collected \$29,215,919.18 in Universal Service Revenues in 2019. (OCA-IV-17). The distribution of 2018 and 2019 Universal Service Revenues, had this allocation been in effect for those two years, is presented in Schedule RDC-4. I note that it is the percentage of allocation that I recommend, not the dollar allocation. Should the dollar of revenue at base rates differ based on the decisions in the proceeding, the percentages would change accordingly.



OCA St. 5 at 58; see also, OCA M.B. at 181.

For the reasons set forth in the OCA’s Main Brief and Reply Brief, as well as in these Exceptions, the OCA submits that universal service costs should be allocated to all customer classes. OCA M.B. at 159-185; OCA R.B. at 68-80. The OCA submits that the Commission should adopt the OCA and CAUSE-PA’s proposal to allocate the costs of universal service programs to all customers.

**Exception No. 2:** Judge Dunderdale Erred In Her Determination That Columbia Should Not Expand Its Outreach Efforts. (R.D. at 187-189, 191-193, 210-211, 218-225, 233-234, 240-241; OCA M.B. at 122-130; OCA R.B. at 56-58)

Judge Dunderdale erred in her determination that Columbia does not need to expand its low-income customer outreach efforts. R.D. at 240-241. While Judge Dunderdale correctly concluded that the Company’s low-income collection efforts should be improved, Judge Dunderdale did not specifically recognize that the customer outreach efforts were also needed and could aid in collection efforts. The purpose of the OCA’s outreach recommendation was to address the “payment difficulties that exist within its confirmed low-income customer population” that were found in Columbia’s June 2020 Management Audit. OCA St. 5 at 12. The OCA submits that additional outreach efforts should be combined with the collection efforts recommended by the Universal Services Advisory Committee.

The OCA’s Customer Assistance Program (CAP) collection policy recommendations and outreach recommendations were proposed to work together to address increasing arrearages for Confirmed Low-Income customers. OCA St. 5 at 6-28. Judge Dunderdale correctly found that the Company’s current CAP collections policies are not adequate and adopted OCA witness Colton’s recommendation that Columbia address the issue by submitting to its Universal Service Advisory Committee the question of how customer payments on CAP bills can be pursued through a

reasonable collections process. R.D. at 238, 240-241; OCA St. 5 at 11. OCA witness Colton also found that a significant number of Confirmed Low-Income customers are in arrears and that the Company's CAP outreach does not appear to be reaching a significant segment of the Confirmed Low-Income population that could benefit from CAP, in particular those customers at or below 50% of the Federal Poverty Level. OCA M.B. at 122; OCA St. 5 at 13-14, Table 3. Mr. Colton recommended additional steps that the Company should take to improve its community-based, grass-roots outreach in order to better reach low-income customers in its communities and to address the Confirmed Low-Income customer arrearages. OCA St. 5 at 28. This is particularly critical for customers with incomes between 0-50% of FPL.

In addition to improvements to the Company's collection efforts, the OCA submits that Columbia should be directed to improve its low-income customer outreach in order to help improve its collection efforts. OCA witness Colton's recommendations are designed to leverage trusted resources in the community in order to reach otherwise hard to reach low-income customer populations. OCA witness Colton recommended that the "Outreach and Communication Plan incorporate the following principles:

- Rather than relying primarily on call center contacts as described above, use the community as a means of identifying and engaging the hard-to-reach population.
- Rather than relying primarily on staff contacts as the means of identifying low-income customers, focus on relationship-building.
- Rather than relying primarily on customers initiating contacts (whether to apply for assistance, or to be in contact with a "self-declaration"), go to the community (reaching them "where they live, work, shop, play and pray") rather than making the community come to you.

- Rather than relying primarily on CGPA communications (as well as government officials) as described above, rely on grassroots “trusted messengers” from within the community.

OCA St. 5 at 26-27; see also, OCA M.B. at 123.

The OCA submits that the additional outreach efforts, especially those targeted to customers with incomes between 0-50% of FPL, will help to increase enrollment in CAP. In addition, as set forth in the Commission’s Management Audit, this will also help Columbia reduce its residential arrears.

**Exception No. 3:** Judge Dunderdale’s Alternative Recommendation Is Flawed By Not Specifying That The Appropriate Cost Of Equity Should Be No Higher Than 8.50%, As Supported By The OCA. (R.D. at 180-185; OCA M.B. at 48-111; OCA R.B. at 30-31, 38-50)

As part of Judge Dunderdale’s alternative recommendation, Judge Dunderdale rejected the Company’s requested 10.95% cost of equity as overstated, based upon flawed approaches, and inclusive of an unjustified “strong management performance” increment. R.D. at 181-185. Judge Dunderdale recommended the adoption of: 1) the OCA’s proposed capital structure of 50% debt, 50% equity as leading to just and reasonable rates and balancing the interests of the Company and ratepayers; 2) the Company’s long-term and short-term debt cost rates, stated by the OCA as a blended rate of 4.52%; 3) I&E’s approach to identification of a proxy group and the resulting group; and 4) I&E’s proposed use of the Discounted Cash Flow (DCF) model to calculate a cost of equity, with the use of the Capital Asset Pricing Model (CAPM) as an alternative means to verify the reasonableness of the return. R.D. at 180-185. The R.D. did not recommend a specific cost of equity and overall cost of capital for Columbia. However, Judge Dunderdale pointed to the OSBA position that the Commission’s award of a 9.85% ROE to an electric utility in 2018 and

today's low risk free rate (10-year Treasury note) implies that Columbia should receive an ROE in the 7.63% range. R.D. at 185.

The OCA's exception to Judge Dunderdale's alternative recommendation concerning an appropriate cost of capital for Columbia is comprised of two concerns. First, the OCA is opposed to Judge Dunderdale's recommended adoption of I&E's seven-company proxy group and rejection of the OCA's ten-company approach. R.D. at 183-184. Second, Judge Dunderdale erred by not specifying that the appropriate cost of equity for Columbia should be no higher than the 8.50% as recommended by OCA witness O'Donnell, as part of the R.D.'s alternative recommendation. See, R.D. at 180-185. If the Commission proceeds under the R.D.'s alternative recommendation, the Commission should adopt a cost of equity that is no higher than the OCA recommended 8.50% cost of equity, as based upon a proper DCF and consideration of Mr. O'Donnell's CAPM results, and appropriate to the current low-cost capital environment.

- A. Judge Dunderdale Erred In Recommending Adoption Of The I&E Proxy Group, As Part Of The R.D.'s Alternative Recommendation. (R.D. at 183-184; OCA M.B. at 63-64, 82-84; OCA R.B. at 41-43; OCA St. 3 at 21-24; OCA St. 3R at 5-7)

Judge Dunderdale recommended the adoption of I&E's proxy group, based upon I&E's screening criteria. R.D. at 183-184. The R.D. described the Columbia proxy group and the OCA proxy group as comprised of nine companies based upon the Gas Group evaluated by the Commission's Bureau of Technical Utility Service in its Quarterly Earnings Report. R.D. at 183. The R.D. description is in error. OCA witness O'Donnell evaluated a larger group of companies than either the Company or I&E, providing more data points and a more robust analysis to support the OCA cost of equity recommendation of 8.50% for Columbia. OCA M.B. at 63-64, 82-84; OCA R.B. at 41-43. The different proxy groups evaluated by the Company and I&E contributed to their overstated cost of equity estimates of 10.9% and 9.86%, respectively.

Judge Dunderdale erred in not adopting OCA witness O'Donnell's cost of capital approach based upon an evaluation of "the full group of gas utilities compiled and followed by *Value Line*." See, OCA M.B. at 82-84; OCA R.B. at 41; OCA St. 3 at 21; OCA St. 3R at 6. The number of gas utilities needed to develop a reasonably reliable comparable group is important. OCA St. 21. In recent years, the number of companies has dwindled due to acquisitions and mergers. OCA St. 3 at 21; OCA St. 3R at 6. The ten companies evaluated by OCA witness O'Donnell are: Atmos Energy Corp.; Chesapeake Utilities Corporation; New Jersey Resources Corp.; NiSource, Inc.; Northwest Natural Holding Co.; ONE Gas, Inc.; South Jersey Industries, Inc.; Southwest Gas Holdings; Spire, Inc.; and UGI Corp.

Mr. O'Donnell evaluated nine of the *Value Line* gas group companies as the OCA proxy group, based upon financial and market data through July 17, 2020. OCA M.B. at 64, 66-67. Mr. O'Donnell conducted a separate cost of equity evaluation of NiSource, Inc., Columbia's parent company, for the same time period. OCA M.B. at 64, 83-84; OCA R.B. at 41; OCA St. 3 at 21, 24; OCA St. 3S at 15-16. NiSource, Inc. is both included in the *Value Line* gas group and the ultimate corporate parent of Columbia Gas. Mr. O'Donnell conducted the separate evaluation of NiSource because NiSource represents the most direct link to Columbia. OCA M.B. at 83; OCA St. 3 at 24; OCA St. 3S at 15-16. Indeed, a utility subsidiary's credit rating is often closely linked to the credit rating for the parent. OCA M.B. at 83. An analysis performed specifically on NiSource provides the Commission with a large body of knowledge of investor expectations specific to Columbia's corporate parent. OCA St. 3S at 15-16. The OCA cost of equity recommendation for Columbia Gas is soundly based upon Mr. O'Donnell's methodical evaluation<sup>5</sup> of financial data and forecasts for all ten companies included in the *Value Line* gas group.

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<sup>5</sup> A summary of the OCA's Main Brief overview of the OCA's affirmative case is included in the R.D. See, R.D. at 172-175. For the details of the OCA's affirmative case on cost of capital, including issues such as the

Unlike the Company, OCA witness O'Donnell included UGI Corp. in the OCA proxy group. OCA M.B. at 63, 82-84; OCA St. 3 at 73-74. Mr. O'Donnell explained that the Company's decision to exclude consideration of UGI Corp., but include Chesapeake Utilities, was not reasonable. OCA M.B. at 63-64; OCA St. 3 at 21, 73-74. Both companies operate a diverse portfolio of businesses, which include natural gas utility service. Mr. O'Donnell stated "for consistency purposes, and in consideration of the fact that both companies are included by Value Line within their Natural Gas Utility Industry, I did not feel it appropriate to include one diverse company within my proxy group, while simultaneously excluding another." OCA St. 3 at 23-24.

The OCA opposed a cost of equity based upon I&E's proxy group. OCA R.B. at 43. I&E witness Keller evaluated a smaller proxy group comprised of seven companies, excluding New Jersey Resources, Southwest Gas Holdings and UGI Corp. OCA R.B. at 43; OCA St. 3R at 5. OCA witness O'Donnell acknowledged I&E's application of screening criteria, but considered the resulting seven-company group too small. OCA St. 3R at 6-7. Mr. O'Donnell testified:

...I've always found analysts removal of certain companies within a proxy group to be inherently subjective. In addition, removing companies from a group that is already small can result in data integrity issues.

OCA St. 3R at 7. Indeed, as Mr. O'Donnell noted, I&E witness Keller removed a single growth rate for Northwest Natural out of concern that the *Value Line* projected growth rate would have an unreasonable impact on I&E's DCF analysis. OCA St. 3R at 7.

OCA witness O'Donnell disagreed with the Company's and I&E's position that NiSource should not be separately evaluated. As Mr. O'Donnell explained, inclusion of NiSource in the proxy group dilutes consideration of information most connected to Columbia. OCA M.B. at 64.

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components of Mr. O'Donnell's DCF analyses, the OCA respectfully refers the Commission to the OCA Main Brief, Reply Brief, and testimony. OCA M.B. at 48-61, 78-99; OCA R.B. at 41-43; OCA St. 3 at 3-72; OCA St. 3R at 5-12.

It is not possible to conduct a cost of equity evaluation of Columbia directly, but it is possible to do so for NiSource as a publicly traded company followed by *Value Line* and others. OCA M.B. at 84; OCA St. 3 at 41-42. Mr. O'Donnell's separate analysis of NiSource also avoided the problem of circularity inherent in the inclusion of NiSource in the Company's and I&E's respective proxy groups. OCA M.B. at 64; OCA St. 3S at 15-16.

The breadth of data presented for all ten companies in Mr. O'Donnell's schedules KWO-1 to KWO-4 and summarized in Mr. O'Donnell's direct testimony provide the Commission with a robust basis to adopt a cost of equity no higher than the OCA recommended 8.50% cost of equity for Columbia, should the Commission adopt the R.D.'s alternative recommendation. OCA M.B. at 90-91; OCA St. 3S at 15-16. In contrast, the nine-company Company proxy group and the seven-company I&E proxy group provide the Commission with a less informative base of information. In the event the Commission adopts the R.D.'s alternative recommendation, the Commission should adopt the OCA's cost of equity approach, based on evaluation of data for the ten companies included in the *Value Line* Gas Group as presented by OCA witness O'Donnell.

B. The Appropriate Cost Of Equity For Columbia Should Be No Higher Than The 8.50% Recommended By The OCA, As Part Of The R.D.'s Alternative Recommendation. (R.D. at 183-185; OCA M.B. at 78-95; OCA R.B. at 38, 40-43)

The R.D. rejected the Company's cost of equity of 10.95% as overstated and based upon flawed approaches. The R.D. agreed with I&E's reasoning that the Company's calculated return on equity is flawed in five ways: "(1) the weights given to the results of the Company's CAPM, RP, and CE analyses; (2) certain aspects of Columbia's discussion of risk; (3) Columbia Gas' application of the DCF including the forecasted growth rate and leverage adjustment used; (4) Columbia's inclusion of a size adjustment, reliance on the 30-year Treasury Bond for the risk-free rate, and the use of a double-adjusted beta in the CAPM analysis; and (5) the Company's request

for an additional 20 basis points for ‘strong management performance’ is unjustified.” R.D. at 184-185. The OCA concurs with Judge Dunderdale that the Company’s cost of equity is overstated, flawed, and should not be adopted, for the reasons set forth in the OCA briefs and testimony. OCA M.B. at 61-63, 65-78.

Judge Dunderdale’s alternative recommendation supported a cost of equity determination based upon a DCF analysis and consideration of CAPM results as a check on reasonableness, based upon I&E’s proxy group. R.D. at 183-184. However, the R.D. did not identify specific DCF inputs or a recommended cost of equity to replace the Company’s requested 10.95%. However, as part of the alternative recommendation, Judge Dunderdale pointed out “OSBA’s argument that Commission precedent implies Columbia Gas should receive a ROE in the 7.63% range....” R.D. at 185.

1. The OCA Cost Of Equity Recommendation Is Soundly Based.

Apart from the difference in proxy group discussed above, OCA witness O’Donnell’s 8.50% cost of equity recommendation is based upon DCF analyses and a CAPM used as a check on the reasonableness of the CAPM results. OCA M.B. at 50, 78-95; OCA R.B. at 41-43. Mr. O’Donnell recommended 8.50% as the middle of his DCF range, the model he believed is the most accurate model in use. OCA M.B. at 79, 82; OCA St. 3 at 71-72.

In his rebuttal testimony, Mr. O’Donnell provided as concise summary of his application of the DCF model and development of an appropriate dividend yield and growth rate:

I derived my DCF results by first utilizing Forecasted Annualized Dividend Yields based on three separate time periods (*i.e.*, 13-weeks, 4-weeks, and 1-week) provided by *Value Line*, plus the following growth rates for my 10 company comparable proxy group:

- Historical EPS, DPS, and BPS growth rates over a 10-year period and a 5-year period provided by *Value Line*;



- Forecasted EPS, DPS, and BPS growth rates from *Value Line*;
- Average plowback growth rate (*i.e.*, percent retained to common equity) provided by *Value Line*;
- 3-year projected EPS growth rate provided by the *Center for Financial Research and Analysis*; and
- 3 to 5-year EPS growth rate provided by *Charles Schwab*.

My DCF results are presented within **Exhibit KWO-1** and **Exhibit KWO-4** to my originally pre-filed direct testimony.<sup>6</sup>

OCA M.B. at 85-86; OCA St. 3R at 7-8.

Mr. O'Donnell examined each company's forecasted dividend yield from *Value Line* through July 2020 to develop a range of dividend yields, based upon the three time periods. OCA M.B. at 86. Mr. O'Donnell employed this averaging approach over multiple time periods to minimize the possibility of an isolated event skewing the DCF results. OCA M.B. at 87; OCA St. 3 at 46. As a result, Mr. O'Donnell identified a 3.3% to 3.5% dividend yield range for the nine-company group and a 3.5% to 3.6% range for NiSource. OCA M.B. at 87.

As noted above, OCA witness O'Donnell considered five different sources of information – historic and forecasted – to develop his DCF growth rates. Information about historical growth rates and forecasted growth rates are widely available to investors to use in development of their expectations and would be used by prudent investors. OCA M.B. at 88; OCA St. 3 at 48; OCA St. 3S at 22. Mr. O'Donnell did not limit his growth rate examination to only earnings growth rates, since the DCF formula is dependent on future dividend growth. Mr. O'Donnell analyzed earnings

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<sup>6</sup> The abbreviations in Mr. O'Donnell's testimony include: "EPS" for "earnings per share," "DPS" for "dividends per share," and "BPS" for "book value per share."

per share, dividends per share, and book value per share earnings growth rates to provide a robust, systematic analysis of available financial information. OCA M.B. at 89; OCA St. 3 at 56.

Mr. O'Donnell evaluated the resulting growth rate information against the backdrop of the ten-year history of high demand and solid growth for natural gas service, the impact of the COVID-19 pandemic on equity markets and the extent to which that info was reflected in the growth rate forecasts, and remarks by Federal Reserve Chairman Jerome Powell in May 2020 setting forth an expectation of a long recovery for the United States economy. OCA M.B. at 89-90. Upon review, Mr. O'Donnell determined it would be appropriate to accord more weight to forecasted figures than historic figures in his DCF analyses. OCA M.B. at 89; OCA St. 3 at 55.

Mr. O'Donnell identified a dividend yield range of 3.3% to 3.5% and a growth rate range of 4.0% to 6.0%, which produced a DCF range of 7.3% to 9.5% for the proxy group. For NiSource, Mr. O'Donnell identified a dividend yield range of 3.5% to 3.6%, combined with a growth rate range of 4.0% to 6.0%, producing a DCF range of 7.5% to 9.6%. The OCA cost of equity recommendation of 8.50% in a "business as usual" approach is based upon Mr. O'Donnell's systematic analyses of the breadth of financial information available to investors and consistent with the DCF model, coupled with Mr. O'Donnell's professional experience, assessment of economic factors, and the need to balance the interests of Columbia shareholders and consumers. See, OCA M.B. at 49, 54, 78-80, 90, 95; OCA R.B. at 41-43; OCA St. 3 at 6-17, 54 -57.

Although Mr. O'Donnell considers the DCF the superior model, Mr. O'Donnell conducted CAPM analyses as a check. OCA M.B. at 78-82, 91-93; OCA St. 3 at 39-41, 60-61, 69. Mr. O'Donnell developed the current market risk premium for use in his CAPM using data for changes in the yields for 30-year Treasury bonds. Mr. O'Donnell chose the 30-year Treasury bond because this time period is the longest available in the marketplace, thereby affording consumers the

longest protection at the risk-free rate. OCA M.B. at 91-93; OCA St. 3 at 6-7 (Chart 1), 63. Mr. O'Donnell tracked the change in the yield on 30-year Treasury bonds since Columbia's prior rate case in 2018, noting an overall decrease, with an average value of 1.89%. OCA M.B. at 91-93; OCA St. 3 at 6-7 (Chart 1), 68. Mr. O'Donnell also took note of the decreases in the federal funds rate by the Federal Open Market Committee's (FOMC) in response to the pandemic's impact on the economy. OCA St. 3 at 63-64. The OCA approach is different than the Company's use of 30-year Treasury bond data and unrealistic forecasts in Mr. Moul's CAPM, and so is not affected by the R.D.'s rejection of the Company's CAPM risk free rate. OCA M.B. at 80-82; R.D. at 184-185.

Mr. O'Donnell developed a range from which he determined his CAPM results by utilizing the change in the yield curve of 30-year Treasury bonds since December 2019 for a risk-free rate averaging 1.89%; an equity risk premium range from 4.0% to 6.0% (based upon historical data as well as forecasts); and an average beta value of 0.85 for the ten companies (proxy group and NiSource) over the preceding quarter. OCA M.B. at 92-93; OCA St. 3 at 62-68; OCA St. 3R at 9-10.

The OCA recommended 8.50% cost of equity is the middle of Mr. O'Donnell's DCF range (7.50% to 9.50%) and also above his CAPM range (5.50% to 7.50%). Mr. O'Donnell also considered the impact of the COVID-19 pandemic on the economy, interest rates, growth prospects for the economy and utility industry, as well as the interests of Columbia Gas customers who will be asked to pay for an increase in rates, if approved by the Commission. OCA M.B. at 50-51, 62-63, 78-80, 90-96; OCA R.B. at 30, 36, 39, 42-43; OCA St. 3 at 6-17, 54 -57; OCA St. 3R at 8-9; OCA St. 3S at 12, 17-20. In the event the Commission adopts the R.D.'s alternative recommendation, the Commission should adopt a cost of equity of no more than 8.50%.

2. The I&E Recommended Cost Of Equity Of 9.86% Is Overstated.

The OCA notes that the R.D. provided a review of the I&E position, but the R.D. did not endorse adoption of the I&E's recommended 9.86% cost of equity, as part of the R.D.'s alternative recommendation. The OCA agreed with many of I&E's criticisms of the Company's cost of equity claim, such as Mr. Moul's DCF leverage adjustment and management performance claim. See, OCA M.B. at 51, 72, 75-76; OCA R.B. at 40. However, OCA witness O'Donnell did not agree with I&E's proposed 9.86% cost of equity. OCA M.B. at 49, 51, 80, 95; OCA R.B. at 43; OCA St. 3R at 3-12; OCA St. 3S at 2-3.

First, OCA witness O'Donnell determined that I&E's recommended cost of equity of 9.86% "is not reflective of current market conditions, and if accepted by the Commission, will allow Columbia Gas of Pennsylvania to over-earn in a market reflective of much lower capital costs." OCA St. 3R at 3; OCA St. 3S at 3. Mr. O'Donnell described the significant decrease in the 30-year Treasury bond yield curve (181 basis points) since December 2018 to July 17, 2020's 1.33% rate. OCA St. 3R at 3-4. Mr. O'Donnell also noted that changes in the DJUA are "indicative of investors accepting a lower cost of capital on their investments." OCA St. 3R at 4.

Mr. O'Donnell noted that I&E witness Keller used a different approach to identification of dividend years and growth rates. Mr. O'Donnell disagreed in particular with I&E's reliance on forecasted growth rates and exclusion of consideration of historical growth rates. OCA St. 3R at

8. Mr. O'Donnell explained:

... I strongly believe that historical growth rates should be used as part [of] the basis for an analyst's recommendation. Forecasted growth rates are also very important, but they are just that, in that they represent forecasts and estimates.

OCA St. 3R at 8. Mr. O'Donnell stated that consideration of historical growth rates is all the more important in light of the COVID-19 pandemic and economic uncertainties. OCA St. 3R at 8. The OCA recommended cost of equity is 8.5% and lower than I&E's 9.86% due to Mr. O'Donnell's

“use of forecasted annualized dividend yields over the various periods previously identified, forecasted growth rates from a variety of sources, and also my use of historical growth rates....” OCA St. 3R at 8-9.

Further, I&E witness Keller’s CAPM does not serve as a meaningful check on his DCF results. Mr. O’Donnell identified differences as to how he and I&E witness Keller identified a risk-free rate (OCA: 1.89%, I&E: 1.22%) and beta (OCA: 85, I&E: 82). OCA St. 3R at 9-10. Mr. O’Donnell faulted I&E witness Keller’s use of an overall market return of 10.35% to identify 9.13% as the I&E equity premium, a sharp contrast to the OCA’s 4.0% to 6.0% equity premium range. OCA St. 3R at 10. Mr. O’Donnell examined how I&E witness Keller arrived at the 10.35% overall market return based on several forecasted returns for the next 3 to 5 years. Mr. O’Donnell disputed the reasonableness of 10.35% as the overall market return as unrealistic “given the current economic circumstance, even when examining market trends prior to the impacts felt by the Covid-19 pandemic .... [M]arket experts are not expecting the market to earn double-digit returns in the future.” OCA St. 3R at 10.

Mr. O’Donnell explained that the OCA 8.50% cost of equity is more reasonable than I&E’s 9.86% when the history of Columbia’s frequent base rate case filings are considered, as well as consideration of the current economic conditions brought on by the pandemic, and Columbia’s implementation of a DSIC. OCA St. 3R at 12. The I&E cost of equity recommendation does not properly account for these factors and for Columbia’s low risk profile. OCA St. 3R at 12.

If the Commission adopts the R.D.’s alternative recommendation, the Commission should adopt a cost of equity rate which is no higher than 8.50%, for the reasons set forth in the OCA briefs and testimony.

### III. CONCLUSION

For the reasons set forth above, the OCA respectfully requests that the Recommended Decision be approved except as set forth in these Exceptions.

Respectfully submitted,

/s/ Darryl Lawrence

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