**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17120**

Public Meeting held June 17, 2021

Commissioners Present:

Gladys Brown Dutrieuille, Chairman, Joint Statement

David W. Sweet, Vice Chairman, Joint Statement

John F. Coleman, Jr.

Ralph V. Yanora

Pennsylvania Public Utility Commission R-2020-3018929

Office of Consumer Advocate C-2020-3022400

Office of Small Business Advocate C-2020-3022414

Philadelphia Area Industrial Energy Users Group C-2020-3022745

v.

PECO Energy Company – Gas Division

**\*\* NON-PROPRIETARY VERSION \*\***

**OPINION AND ORDER**

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**BY THE COMMISSION:**

Before the Pennsylvania Public Utility Commission (Commission) for consideration and disposition are the Exceptions of PECO Energy Company – Gas Division (PECO, or the Company), the Commission’s Bureau of Investigation and Enforcement (I&E), the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), and the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania (CAUSE-PA), filed on April 26, 2021, to the Recommended Decision (R.D.) of Deputy Chief Administrative Law Judge (ALJ) Christopher P. Pell, issued on April 12, 2021, in the above-captioned proceeding. PECO, I&E, the OCA, the OSBA, and the Philadelphia Area Industrial Energy Users Group (PAIEUG)[[1]](#footnote-2) filed Replies to Exceptions on May 3, 2021.[[2]](#footnote-3) Additionally, on May 3, 2021, PAIEUG filed a Motion to Strike (Motion), seeking to have certain portions of the OSBA’s Exceptions stricken. The OSBA filed an Answer to the Motion on May 24, 2021.

For the reasons discussed below, we shall: (1) grant, in part, and deny, in part, the Exceptions filed by PECO and I&E; (2) deny the Exceptions filed by the OCA, the OSBA, and CAUSE-PA; (3) deny the request set forth in PAIEUG’s Letter; and (4) grant PAIEUG’s Motion.

Additionally, as discussed below, PECO proposed rate changes that would have increased its total annual operating revenues by $68.7 million, or approximately 8.9%, based on a fully projected future test year (FPFTY) ending June 30, 2022.[[3]](#footnote-4) In this Opinion and Order, we shall approve an annual revenue increase of $29,118,484 to the Company’s *pro forma* revenue at present rates of $590,014,312 or approximately 4.94%.

# Background

PECO is a corporation duly incorporated and validly subsisting under the laws of the Commonwealth of Pennsylvania with its principal office in Philadelphia, Pennsylvania. PECO provides electric delivery service to approximately 1.6 million customers and natural gas delivery service to more than 534,000 natural gas customers through its certificated service area, which includes all or portions of five counties and encompasses approximately 2,100 square miles in southeastern Pennsylvania with a population of approximately four million people. PECO is a subsidiary of Exelon Corporation (Exelon). Another subsidiary of Exelon, Exelon Business Services Company (the Service Company or EBSC), provides certain corporate and administrative services to Exelon’s electric and natural gas utility subsidiaries. PECO M.B. at 1.

PECO last filed for a rate increase in gas base rates in March 2010. PECO’s current rate filing requests a rate increase of $68.7 million or 8.9% of its total Pennsylvania jurisdictional gas operating revenues, which is anticipated for the FPFTY ending June 30, 2022.[[4]](#footnote-5) PECO made various revisions and updates to its rate increase request during this proceeding. PECO’s final revenue increase request is $65.976 million, approximately $2.7 million less than its original request. PECO M.B. at 1-2, Appendix A, Table I.[[5]](#footnote-6)

PECO stated its principal reason for the rate request is its substantial investment in new and replacement gas utility plant to maintain and enhance the safety and reliability of its gas distribution system. PECO projects that it will need to invest approximately $1.2 billion in gas utility plant between July 1, 2020 and June 30, 2024. PECO M.B. at 3 (citing PECO St. 1 at 5-7; PECO St. 2 at 2-5).

PECO also submitted that due, in large part, to the substantial investment in utility plant and declining residential per-customer usage since 2011, the Company’s natural gas operations are projected to produce an overall return on invested capital of only 5.74% for the FPFTY. PECO provided that the indicated return on common equity under present rates is anticipated to be only 7.40%, which it claims is far less than required to provide the Company with a reasonable opportunity to attract capital. PECO M.B. at 3-4.

# History of the Proceeding

On September 30, 2020, PECO filed Tariff Gas – Pa. P.U.C. No. 4 (Tariff No. 4) to become effective on November 29, 2020. Tariff No. 4 contained proposed changes in rates, rules, and regulations calculated to produce an increase of approximately $68.7 million or 8.9% in additional annual distribution revenue.[[6]](#footnote-7)

On October 6, 2020, I&E filed a Notice of Appearance. On October 14, 2020, the OCA filed a Public Statement, Notice of Appearance, and Formal Complaint at Docket No. C-2020-3022400. On October 15, 2020, the OSBA filed a Verification, Public Statement, Notice of Appearance and Formal Complaint at Docket No. C‑2020‑3022414. On October 22, 2020, CAUSE-PA filed a Petition to Intervene.

By Order entered October 29, 2020, the Commission suspended the implementation of Tariff No. 4 by operation of law, pursuant to 66 Pa. C.S. § 1308(d), until June 29, 2021, unless permitted by Commission Order to become effective at an earlier date, and instituted an investigation into the lawfulness, justness, and reasonableness of the rates, rules, and regulations proposed. The Commission assigned the matter to the Office of Administrative Law Judge (OALJ) for the prompt scheduling of such hearings as may be necessary and issuance of a Recommended Decision.

On November 5, 2020, PAIEUG filed a Formal Complaint at Docket No. C-2020-3022745.

On November 9, 2020, PECO filed Supplement No. 1 to Tariff Gas – Pa. P.U.C. which suspended the effective date of the rates, rules, and regulations proposed in Tariff No. 4 until June 30, 2021.

On November 9, 2020, ALJ Pell conducted a telephonic prehearing conference. Counsel for PECO, I&E, the OCA, the OSBA, CAUSE-PA and PAIEUG participated in the hearing.

By Order dated November 12, 2020, ALJ Pell granted PECO’s Motion for Protective Order.

On December 10, 2020, the ALJ conducted two telephonic public input hearings. Eight individuals testified at the public input hearing. For more information on the public input hearing, *see* R.D. at 5-8.

On December 22, 2020, PECO, I&E, the OCA, the OSBA, and CAUSE-PA served Direct Testimony. Rebuttal Testimony was served by PECO, the OCA and PAIEUG on January 19, 2021.

On February 9, 2021, the OCA, I&E, the OSBA, CAUSE-PA, and PAIEUG served Surrebuttal Testimony.

Also on February 9, 2021, Counsel for PECO, contacted the ALJ to advise that the Parties were working towards settlement as well as preparing for hearings. On behalf of the Parties, Counsel for PECO requested cancellation of hearings on February 16, 2021, to permit additional settlement time. ALJ Pell granted that request via email on February 10, 2021, and cancelled the hearing scheduled for February 16, 2021.

On February 12, 2021, Counsel for PECO contacted ALJ Pell on behalf of all the Parties to advise that the Parties anticipated that hearings would still be required. Counsel for PECO further advised that the Parties agreed that only one day of hearings would be required and requested that the hearing scheduled for February 17, 2021, be cancelled, and the hearing be held on February 18, 2021. Out of concern that the hearings may take longer than anticipated by the Parties, the ALJ denied the request via email on February 12, 2021.

On February 17, 2021, the evidentiary hearing was conducted as scheduled. During the hearing, PECO presented its witnesses’ rejoinder testimony, and also made its witnesses available for cross examination by the other Parties. All other Party witnesses were excused from appearing at the hearing since no Parties requested to cross examine them and ALJ Pell did not have any questions for them. PECO, I&E, the OCA, the OSBA, CAUSE-PA, and PAIEUG each moved to have their witnesses’ testimonies and exhibits entered into the record. As there were no objections, all of the Parties’ testimonies and/or exhibits were admitted into the record during the hearing. The hearing scheduled for February 18, 2021, was cancelled on the record during the February 17th hearing.

On March 3, 2021, PECO, I&E, the OCA, the OSBA, CAUSE-PA, and PAIEUG filed Main Briefs. All of these Parties filed Reply Briefs on March 15, 2021.

In the Recommended Decision, issued on April 12, 2021, ALJ Pell recommended that PECO’s Tariff No. 4, which proposed changes in rates, rules, and regulations calculated to produce an increase of approximately $68.7 million, or approximately 8.9% in additional annual distribution revenue, be denied because the Company did not meet its burden of proving by a preponderance of the evidence the justness and reasonableness of every element of its requested increase. Instead, the ALJ recommended the approval of an increase in annual operating revenue in the amount of $23,892,217, or approximately 4% over present rates. Under the recommended increase, an average residential customer’s monthly bill would increase by approximately $3.90, or 5%. R.D. at 1, 419.

As previously noted, PECO, I&E, the OCA, the OSBA, and CAUSE-PA filed Exceptions to the Recommended Decision on April 26, 2021. Also on April 26, 2021, PAIEUG filed its Letter observing an administrative issue within the Recommended Decision.

On May 3, 2021, PECO, I&E, the OCA, the OSBA, and PAIEUG filed Replies to Exceptions. Additionally, PAIEUG filed its Motion.

On May 24, 2021, the OSBA filed an Answer to PAIEUG’s Motion.

# Legal Standards

At issue here is the Company’s request for a general base rate increase, which is governed by Section 1308(d) of the Pennsylvania Public Utility Code (Code), 66 Pa. C.S. § 1308(d). Section 1308(d) of the Code provides the procedures for changing base 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).[[7]](#footnote-8) “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) (*City of Lancaster*). There is no single way to arrive at just and reasonable rates, and “[t]he [Commission] has broad discretion in determining whether rates are reasonable” and “is vested with discretion to decide what factors it will consider in setting or evaluating a utility’s rates.” *Popowsky v. Pa. PUC*, 683 A.2d 958, 961 (Pa. Cmwlth. 1996) (*Popowsky II*).

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. *Pennsylvania Gas and Water Co. v. Pa. PUC*, 341 A.2d 239, 251 (Pa. Cmwlth. 1975) (citations omitted). In determining a fair rate of return, the Commission must adhere to the constitutional standards established by the United States Supreme Court in the seminal cases *Bluefield Water Works and Improvement Co. v. Public Service Comm’n of West Virginia*, 262 U.S. 679, 692-93 (1923) (*Bluefield*) and *Federal Power Commission v. Hope Natural Gas Co.*,320 U.S. 591, 603 (1944) (*Hope Natural Gas*). In *Bluefield*, the Supreme 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 692-93. Twenty years later, in *Hope Natural Gas*, the Supreme Courtreiterated:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

*Hope Natural Gas*, 320 U.S. at 603.

The Commission is required to investigate all general rate increase filings. *Popowsky II*, 683 A.2d at 961. 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. 66 Pa. C.S. § 315(a); s*ee also,* *Lower Frederick Twp. Water Co. v. Pa. PUC*, 409 A.2d 505, 507 (Pa. Cmwlth. 1980) (*Lower Frederick*); *see also*, *Brockway Glass Co. v. Pa. PUC*, 437 A.2d 1067 (Pa. Cmwlth. 1981). Section 315(a) of the Code provides 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.

66 Pa. C.S. § 315(a). The evidence necessary to meet that burden must be substantial. *Lower Frederick* at 507.

In general rate increase proceedings, 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*, 116 A.2d 738, 744 (Pa. 1955).

However, in proving that its proposed rates are just and reasonable, a public utility need not 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. 301, 359-360 (1990).

Additionally, Section 315(a) of the Code 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. 66 Pa. C.S. § 315(a). The burden of proof must be on the party who proposes a rate increase beyond that sought by the utility. *Pa. PUC v. Metropolitan Edison Company*,Docket No. R‑00061366, 2007 Pa. PUC LEXIS 5 (Order entered January 11, 2007). The mere rejection of evidence contrary to that presented 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).

Finally, 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); *also see, generally, University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984).

# Overall Rate Increase Request

## Positions of the Parties

In this base rate increase filing, PECO has requested a $66.2 million[[8]](#footnote-9) increase to its revenue requirement. PECO claimed that it had presented substantial evidence fully supporting the proposed revenue increase. Noting that this was its first natural gas rate increase filing in over a decade, PECO argued that the Commission should reject each of the adjustments to its rate base, revenue, expenses, and rate of return proposed by other Parties. PECO contended that its rate design was based in the proper application of well-established principles of cost allocation and revenue allocation and will result in just and reasonable rates for all of PECO’s customers. PECO M.B. at 4‑6.

PECO also requested that the Commission approve the Company’s expanded energy efficiency and conservation (EE&C) programs and neighborhood gas pilot rider (NGPR) for customers, which it claimed were reasonable and in the public interest. PECO requested that the Commission reject other Parties’ proposals for allegedly unwarranted expansions of low-income customer programs and changes in cost allocation in light of PECO’s current comprehensive offerings or those that are presently pending before the Commission. PECO M.B. at 7*.* PECO submitted that the Commission has made clear that the COVID-19 pandemic does not change the traditional ratemaking standards historically applied by the Commission. PECO R.B. at 1-2. PECO cited the Commission’s decisions in *Columbia Gas* and Pennsylvania American Water’s recent rate case[[9]](#footnote-10) as support for the premise that it is appropriate to allow rate increases during the current pandemic. PECO M.B. at 13. PECO noted that in each of those cases, the Commission acknowledged that its ratemaking methodologies require consideration of evidence of the impact of the COVID-19 pandemic, but that the ratemaking standards historically applied by the Commission have not changed.

I&E submitted that PECO failed to present substantial credible evidence to support its requested revenue increase. As noted in Section VI.A.1, *infra, I*&E proposed adjustments that would reduce the revenue increase to $26.3 million. I&E M.B. at 5. I&E did not assert that the Commission should reject the rate increase request in its entirety due to the COVID-19 pandemic.

The OCA opposed any increase to PECO’s rates at this time. The OCA asserted that, throughout the Commonwealth as a whole, and particularly within PECO’s service territory, ratepayers are still being impacted devastatingly by the COVID-19 pandemic. The OCA claimed that its unrebutted evidence of record demonstrated that PECO is not in need of immediate rate relief, because PECO’s current and near-term financial outlook is stable. The OCA argued that PECO currently has sufficient revenues to continue to provide safe and reasonable service, to continue its construction activities, to pay all of its expenses and to earn a profit. OCA M.B. at 8.

The OCA claimed that its witnesses Mr. Scott Rubin and Mr. Roger Colton provided extensive and unrebutted testimony about the harm the pandemic has wrought on the general economy and the livelihoods of Pennsylvania citizens and businesses and, particularly, PECO’s customers. OCA M.B. at 13-19. The OCA detailed the significant impacts the COVID-19 pandemic has had on unemployment rates, income loss, and other economic indicators within Pennsylvania and the PECO service territory. OCA M.B. at 13‑19. The OCA submitted that any revenue increase at this time, considering the totality of the situation, will not result in rates that meet the just and reasonable rates standard of Section 1301 of the Code, 66 Pa. C.S. § 1301. The OCA argued that an analysis as to the affordability of increased rates on the ratepayers is a crucial consideration in determining whether rates are just and reasonable. *Id.*

The OCA asserted that the Commission’s responsibility, under constitutional requirements,[[10]](#footnote-11) is to weigh the substantial evidence brought forth by the OCA’s witnesses related to the unique COVID-19 pandemic situation to set just and reasonable rates. Specifically, the evidence of the impacts of the COVID-19 pandemic on the components of the Company’s claimed cost of service — a fair rate of return, projected expenses and projected capital expenditures — will be included in the Commission’s consideration of important ratemaking principles such as gradualism and rate affordability in arriving at just and reasonable rates. OCA R.B. at 3-9 (citing *Columbia Gas*, at 48-51 (“[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.”).[[11]](#footnote-12) The OCA thus submitted that it is fully within the Commission’s power to deny PECO’s requested increase to prevent further hardship for customers struggling financially during this pandemic. The OCA claimed that it introduced substantial evidence of the weakened financial situation in which many customers in PECO’s service territories find themselves a year into the unprecedented COVID-19 pandemic and that increasing rates on PECO’s customers during this time would further exacerbate the financial situation for customers, particularly those customers of low to moderate incomes. OCA R.B. at 3-9*.*

The OCA further asserted that PECO did not introduce sufficient evidence to meet its burden of proof that raising rates will be just and reasonable despite the extent of harm it will inflict on its customers. The OCA argued that PECO has not demonstrated that its revenues are nearing such a state of insufficiency that it will not have enough funds to cover all of its expenses and still have the opportunity to earn a fair rate of return. Thus, the OCA requested that the Commission exercise its broad authority and discretion to reject PECO’s requested new rates because PECO failed to meet its burden of proof in light of the toll increased rates would have on PECO’s customers who are struggling financially to navigate the COVID-19 pandemic. OCA R.B. at 3-9*.*

The OSBA submitted that the Commission should do the following: (1) limit PECO’s Return on Equity (ROE) to no more than the 8.75%; (2) grant no upward adjustment to PECO’s awarded ROE for the Company’s management performance; (3) adopt either the COSS presented by the OSBA or the COSS presented by the OCA; (4) adopt any of the Rate GC revenue allocation proposals of PECO, the OCA, or I&E; (5) adopt the revenue allocation proposals for the TS-F and TS-I classes presented by either the OSBA or the OCA; (6) apply the OSBA’s hybrid scale back mechanism to any reduction in the overall proposed revenue increase; (7) adopt PECO’s proposal to continue to recover costs for the Company’s Universal Service programs for low-income customers from the Rate GR residential class; (8) adopt PECO’s revised proposed customer charge for Rate GC of $28.55 per month; (9) adopt PECO’s revised proposed declining block rates for Rate GC as set forth in PECO’s rebuttal testimony; (10) adopt PECO’s revised proposal for rate differentials between the small and large customers in Rates TS-F and TS-I; (11) adopt PECO’s revised proposal to eliminate the Rate IS margin sharing mechanism; (12) limit Rate L service to the regular high load factor customers as it was intended and designed; (13) require that transportation of PECO’s standby supply gas be made using the transportation rates within the TS-F and TS-I tariffs; and (14) adopt strict policies and procedures regarding the use of negotiated rates for larger customers. The OSBA maintains that PECO has not met its burden with respect to negotiated rates for five of its six Rate NGS customers, and that PECO’s claimed revenue increase should be reduced by the amount of the unjustified rate discounts to these five customers. OSBA M.B. at 2-3.

CAUSE-PA argued that it is both unjust and unreasonable for PECO to raise rates on essential natural gas service because the economic impact of the COVID‑19 pandemic continues to unfold in unpredictable and uncertain ways. CAUSE-PA asserted that the evidence in this proceeding is clear that the breadth and severity of poverty in PECO’s service territory – and across the state – is growing at alarming rates and that the pandemic has taken an especially heavy toll on both the economic and public health of low-income and minority households, which already faced disproportionately high energy costs compared to higher income households before the pandemic. *Id.* CAUSE-PA submitted that raising rates on natural gas to power heat and hot water, essential to curbing the spread of COVID-19 – would increase already high rates of involuntary termination, exacerbating the disproportionate health impacts of the pandemic on low-income communities and communities of color and prolonging the longer-term economic recovery for these same households. CAUSE-PA M.B. at 6‑8*.*

CAUSE-PA claimed that PECO’s existing rates are already categorically unaffordable for a substantial portion of PECO’s residential customer class – even for those enrolled in PECO’s Customer Assistance Program (CAP). To avoid further exacerbating existing unaffordability, CAUSE-PA urged the Commission to instead approve its proposals for targeted reforms to PECO’s existing universal service programs and policies, as well as additional short-term measures capable of addressing the economic devastation caused by the ongoing COVID-19 pandemic. CAUSE-PA M.B. at 6*.*

CAUSE-PA submitted that substantial unrebutted record evidence in this proceeding shows that the COVID-19 pandemic has had a severe detrimental impact to the economic climate in PECO’s service territory and on PECO’s customers’ ability to afford service – especially so for low-income communities and communities of color. CAUSE-PA therefore urged the Commission to review the substantial level of rate unaffordability in PECO’s service territory and the substantial harms that result – both before and through the pandemic. CAUSE-PA M.B. at 11-12.

PAIEUG did not present any testimony on the issue of whether any rate increase should be permitted during the COVID-19 pandemic. However, PAIEUG recognized that several other parties, including the OCA, the OSBA, and I&E, have raised significant concerns regarding whether such an increase is appropriate. PAIEUG agreed that the Commission must fully review PECO’s request, including the issues raised by I&E, the OCA, and the OSBA to ensure that any rate increase request is just and reasonable. PAIEUG M.B. at 5.

PAIEUG emphasized that the Commission recently acknowledged in *Columbia Gas* that it has broad discretion in determining whether rates are reasonable, and the Commission has the authority to decide what factors it will consider in setting or evaluating a utility’s rates. PAIEUG M.B. at 5-6 (citing *Columbia Gas* at 44). To that end, the Commission is permitted to consider and weigh important factors in setting rates, including quality of service, gradualism, and rate affordability. PAIEUG M.B. at 6 (citing *Columbia Gas* at 48). PAIEUG submitted that the Commission must consider the unique circumstances the COVID-19 pandemic has brought about with respect to changes in service, market forces, and the economy. Specifically, PAIEUG suggested that the Commission should review PECO’s proposed requested rate increase in combination with the arguments set forth by the OCA, the OSBA and I&E and in light of current circumstances. PAIEUG contended that only then could the Commission ensure that PECO’s resulting rates are just, reasonable, and appropriate for all customers. PAIEUG M.B. at 6.

## Recommended Decision

In considering the OCA’s and CAUSE-PA’s requests that the rate increase request be denied in its entirety, the ALJ reiterated the arguments of the various Parties opposing PECO’s rate increase and PECO’s response thereto. The ALJ noted PECO’s argument that the Commission recently concluded in the *Columbia Gas* case that the economic effects of the COVID-19 pandemic are, by themselves, not a basis for the denial of a rate increase. R.D. at 15 (citing *Columbia Gas* at 48-51). The ALJ also observed PECO’s further claim that the evidence presented in this proceeding demonstrated that PECO’s existing rates are not sufficient to generate a sufficient return on investment. R.D. at 15.

The ALJ reasoned that the Commission had addressed similar COVID-19 arguments in the recent *Columbia Gas* case. In that case, the Commission stated:

[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 II*, 683 A.2d at 961. Included in the Commission’s broad ratemaking authority is the authority to approve alternative rates and rate mechanisms, including formula rates as well as decoupling mechanisms, performance-based rates, and multiyear rate plans.

R.D. at 15 (citing *Columbia Gas* at 44)

In response to concerns about increasing rates amidst the COVID-19 pandemic, the Commission further stated:

Thus, it is our responsibility under the applicable legal and constitutional standards to weigh evidence and unique considerations related to the COVID-19 pandemic in setting just and reasonable rates, and our continued use of traditional ratemaking methodologies permit our consideration of important ratemaking principles, like gradualism and rate affordability, in relation to this pandemic.

\* \* \*

While we acknowledge the gravity of these unemployment statistics, it has not been demonstrated in this case with substantial evidence or explanation that the impact of *any* rate increase on unemployed customers will lead to harm that outweighs all other valid ratemaking concerns “especially the polestar – cost of providing service.” *Lloyd*, 904 A.2d at 1020. Furthermore, taking the approach of denying any rate relief due to rising unemployment numbers among residential customers is inconsistent with our prior rate orders issued during this pandemic: specifically, the *PGW Rate Order*, the *UGI Gas Rate Order*, and the *PWSA Rate Order*, where we granted rate increases despite rising unemployment numbers across the Commonwealth due to the pandemic. No party in this proceeding has offered a rational basis to justify a different treatment under the circumstances here. Indeed, we are not persuaded by the argument that the final rates in the other cases were the results of settlement agreements, as that fact alone does not change the reality that such settlements would not be effective unless approved under our ratemaking authority, and we clearly acknowledged the need for revenue increases during this pandemic for these companies by approving the settled-upon rate increases after we found that such settlements were in the public interest and resulted in just and reasonable rates. *See PGW Rate Order, UGI Gas Rate Order, PWSA Rate Order* (*citations omitted*).

R.D. at 15-16 (citing *Columbia Gas* at 48, 51-52).

The ALJ concluded that the COVID-19 pandemic clearly has had a tremendous negative impact on the citizens and businesses of Pennsylvania; but pursuant to the Commission’s decision in *Columbia Gas*, the pandemic alone is not sufficient reason to outright deny PECO’s request for rate relief. Bearing that in mind, the ALJ stated that he had carefully examined the evidence and positions presented by PECO and the opposing parties with regard to PECO’s cost of service and other ratemaking concerns raised using the traditional ratemaking methodologies. As a result of that examination, the ALJ recommended that the Company receive a reduced revenue increase of $23,892,217. R.D. at 17. The ALJ explained the basis for this recommendation in his lengthy and detailed Recommended Decision, which is discussed in detail throughout this Opinion and Order.

## OCA Exception No. 1, CAUSE-PA Exception No. 1, and Replies

In its Exception No. 1, the OCA argues that the ALJ erroneously relied upon the Commission’s recent decision in *Columbia Gas* for the proposition that the COVID-19 pandemic alone is not sufficient reason to outright deny PECO’s request for rate relief. The OCA contends that the Commission did not set a precedent precluding the denial of a rate increase for all utilities during the COVID-19 pandemic in that case; but rather, it determined that the Commission must weigh the facts and evidence presented in each case regarding the effects of the COVID-19 pandemic and the substantial customer hardships presented to determine whether a rate increase is warranted at this time. OCA Exc. at 3-4.

The OCA submits, however, that the ALJ did not give full weight to the hardships faced by many of PECO’s customers due to the COVID-19 pandemic when evaluating PECO’s need for a rate increase under traditional ratemaking methods. The OCA points to its introduction of substantial evidence of the impact the pandemic has had on unemployment rates, income loss, and other economic indicators within Pennsylvania and the PECO service territory. OCA Exc. at 4 (citing OCA M.B. at 13-19; OCA R.B. at 4-8). The OCA submits that this evidence should have been weighed more heavily when considering the Company’s claims, in particular, the Company’s cost of equity claim. OCA Exc. at 4.

The OCA argues that the evidence in this proceeding indicates that some of PECO’s claims do not adequately reflect or recognize the current economic climate and the impacts of the pandemic. The OCA notes, for example, that PECO developed its test year budgets based upon a modified budgeting process from data and estimates that were done prior to the COVID-19 pandemic. OCA Exc. at 4 (citing OCA M.B. at 32-35; OCA. R.B. at 11-13). In addition, the OCA makes several claims that the Company heavily relies on inflation factors, rather than on known and measurable data, to justify substantial increases for certain expense categories. OCA Exc. at 4 (citing OCA M.B. at 48-51 and 55-56; OCA R.B. at 24-28 and 30-32).

The OCA also claims it presented substantial evidence that PECO will continue to be financially stable in the absence of any rate increase. For example, in the HTY as of June 2020, the Company indicated it was earning a rate of return of 7.61% at present rates. *See* PECO St. 3, Exh. MJT-3, Sch. A-1. Thus, the OCA argues, PECO is financially stable at present, almost meeting its proposed rate of return of 7.70%. Moreover, the OCA submits that even before making any adjustments to the Company’s filing in this case, including the Company’s claimed capital expenditures and expenses necessary to set just and reasonable rates, the evidence demonstrates that PECO is projected to earn a 5.74% rate of return in the FPFTY ended June 30, 2022, which includes a return on equity of 7.40%. OCA Exc. at 5 (citing PECO M.B. at 3; PECO St. 3, Exh. MJT-1 Revised, Sch. A-1). Accordingly, the OCA takes the position that even accepting PECO’s entire claim and denying a rate increase would still allow the Company the ability to sufficiently raise capital while recognizing the needs of ratepayers during the significant economic crisis and public health emergency. OCA Exc. at 5 (citing OCA R.B. at 2, 8, and 10).

In addition, the OCA insists that as presented by OCA witness Mr. Kevin O’Donnell in the FPFTY when the Company’s claims and proposal are adjusted consistent with the OCA’s recommendations, PECO would over-earn above a market-derived return on equity of 8.75%. OCA Exc. at 5 (citing OCA M.B. at 9, 74-75, 78, 82-83, and 94-95; OCA R.B. at 2, 44-45, and 50-51). Thus, the OCA argued that the Company should be subject to a rate *decrease* of approximately $11.4 million under the traditional ratemaking methods. OCA Exc. at 5-6(citing OCA M.B. at 8; OCA R.B. at 3, 18). Accordingly, the OCA asserted that keeping rates at current levels will still allow the Company to earn a market-derived return on equity above 8.75% on the *pro forma* FPFTY basis. OCA Exc. at 6.

Lastly, the OCA claims that the Company’s proposed consumer protections during the COVID-19 pandemic are not sufficient to provide relief to customers during this time. In the OCA’s view, without sufficient protections in place to assist those customers, any increase in PECO’s rates will disproportionately impact customers currently struggling to make ends meet. OCA Exc. at 6.

For these reasons, the OCA submits that the ALJ failed to consider the OCA’s legally viable position that PECO’s rate increase could and should be denied in its entirety because of the pandemic’s impact on its customers. The OCA submits that the substantial customer hardship caused by the COVID-19 pandemic significantly outweighs PECO’s need for a rate increase, especially considering that a rate increase is not necessary at this time and the lack of any further assistance offered for customers. Therefore, the OCA respectfully requests that the Commission consider the OCA’s evidence presented in this proceeding and deny PECO’s request for rate relief. OCA Exc. at 6.

In its Exception No. 1, CAUSE-PA similarly argues that the ALJ erred in failing to adequately consider the unprecedented economic uncertainty created by the pandemic, which it claims has undeniably fallen hardest on low-income communities. CAUSE-PA Exc. at 4 (citing CAUSE-PA M.B. at 9). CAUSE-PA points to the testimony of its witness Mr. Mitchell Miller wherein he testified against raising rates in the midst of the pandemic due to the profound impact on the ability of residential consumers to pay their current utility rates. Mr. Miller further recommended that PECO be required to implement equitable emergency pandemic provisions to address the unprecedented utility debt crisis. CAUSE-PA Exc. at 4 (citing CAUSE-PA St. 1 at 7-9, 38‑41). The OCA also recommended that PECO not be permitted to increase rates and that PECO be required to establish an Emergency COVID-19 Relief Plan (ERP) due to the significant long-term economic crisis created by the COVID-19 pandemic.CAUSE‑PA Exc. at 4 (citing OCA M.B. at 132).

CAUSE PA notes that in his Recommended Decision, ALJ Pell rejected CAUSE-PA’s and the OCA’s program adjustment recommendations because he determined that they were “not necessary at this time.” R.D. at 265.[[12]](#footnote-13) CAUSE-PA argues that granting a rate increase without requiring additional COVID-19 mitigation measures fails to appropriately balance the interest of consumers who have been economically impacted by the pandemic. CAUSE-PA Exc. at 5.

CAUSE-PA points to Mr. Miller’s testimony that, “[I]t is clear that the pandemic will have deep and lasting impacts on our economy that cannot be accurately assessed or accounted for in the context of this rate proceeding.” Consequently, Mr. Miller recommended that the Commission deny PECO’s proposed rate request in its entirety, and take immediate steps to address categorical unaffordability within PECO’s CAP program. CAUSE-PA Exc. at 5-6 (citing CAUSE-PA R.B. at 8-9; CAUSE-PA St. 1 at 9). According to CAUSE-PA, Mr. Miller extensively addressed the severe economic impact that the COVID-19 pandemic has had on low- and moderate-income households, especially for predominantly low-income communities and communities of color. Mr. Miller recommended that PECO be required to implement emergency pandemic provisions to help equitably address the growing utility debt crisis. *Id*. CAUSE-PA Exc. at 6 (citing CAUSE‑PA St. 1 at 9-20, 29-30, 38-41).

CAUSE-PA asserts that the pandemic, which has fallen hardest on low-income communities and communities of color, has worsened existing struggles, leading to unprecedented levels of consumer debts and a staggering number of residential consumers eligible for terminations. CAUSE-PA Exc. at 8-9 (citing CAUSE-PA M.B. at 15-16). According to CAUSE-PA, these communities have been hit harder and will take longest to recover from the economic impact. CAUSE-PA Exc. at 9 (citing CAUSE‑PA St. 1 at 7-8).

CAUSE-PA argues that the COVID-19 pandemic has had a severe detrimental impact to the economic climate in PECO’s service territory and on PECO’s customers’ ability to afford service, especially for low-income communities and communities of color. CAUSE-PA reasons that even before the pandemic took hold, a large swath of PECO’s customer base was already unable to afford natural gas service – with nearly 1 in 5 (19%) of PECO’s low-income consumers facing involuntary termination for nonpayment in 2019. CAUSE-PA stresses its position that the inability to afford natural gas service can have a deep and lasting negative impact on low-income families – triggering eviction, poor health outcomes, and family separation. COVID-19 program and policy mitigation are vital to ensure that consumers can remain connected to natural gas services in their home – especially if PECO’s rates increase, which will further exacerbate unaffordability for low-income customers. CAUSE-PA R.B. at 14. The decision to increase rates just as terminations begin to proceed will undoubtedly further exacerbate this economic harm and the resulting high levels of termination and uncollectible expenses incurred across low-income communities. In 2008, during the most recent economic crisis before the COVID-19 crisis, 87.9% (nearly 9 out of 10) of PECO’s confirmed low-income natural gas customers were terminated for nonpayment, versus just 6.2% of residential customers overall (including low-income customers). CAUSE-PA avers that immediate and substantial action must be taken to prevent a similar utility termination crisis in PECO’s service territory. Thus, any increase in rates must be mitigated by appropriate COVID-19 pandemic programming and policy adjustments to protect against further harm to economically vulnerable consumers. CAUSE-PA Exc. at 4-10 (citing CAUSE-PA M.B. at 2, 11-13; CAUSE-PA R.B. at 13‑14).[[13]](#footnote-14)

PECO asserts in its Replies to Exceptions that the ALJ properly recommended the rejection of the “no increase” proposals of the OCA and CAUSE-PA. PECO points out that ALJ Pell reviewed the arguments of the OCA and CAUSE-PA against any rate increase that they now reiterate. According to the Company, the OCA relies on a theory of its witness, Mr. Rubin, that the Commission can set utility rates outside the traditional zone of reasonableness because an unspecified number of customers might not be “willing and able” to pay any rate increase, PECO’s existing rates allegedly provide a fair rate of return, and the Commission cannot have “any certainty” about FPFTY data. Similarly, PECO notes CAUSE-PA’s argument in favor of a legal standard that rates must be “reasonably affordable” and its opposition to any increase based on historical data on the economic effects of COVID-19 in 2020. According to PECO, the Commission should disregard the arguments of both Parties. PECO R. Exc. at 2.

PECO submits that the ALJ carefully reviewed the OCA’s and CAUSE‑PA’s evidence and arguments and appropriately determined that they are not a valid basis for departing from the Commission’s analysis in *Columbia Gas* that the COVID-19 emergency does not justify disregarding traditional ratemaking methodologies and principles. PECO agrees with the ALJ’s conclusion that “the pandemic alone is not sufficient reason to outright deny PECO’s request for rate relief,”noting that the ALJ acknowledged the impact of the COVID-19 pandemic on individuals and businesses in Pennsylvania. PECO R. Exc. at 2 (citing R.D. at 14-16).

PECO submits that none of the arguments offered in the OCA’s Exception No.1 demonstrate that the ALJ erred in concluding that PECO is entitled to a rate increase, notwithstanding the effects of the pandemic. First, PECO claims that contrary to the OCA’s assertions, the ALJ did not blindly follow *Columbia Gas* as “precedent precluding denial of a rate increase for all utilities” during the pandemic. Instead, PECO asserts that the ALJ explicitly reviewed the arguments and evidence provided by the OCA (and CAUSE-PA), including the financial hardships created by COVID-19. PECO stresses the ALJ’s conclusion that those Parties had not furnished any valid basis to depart from the “just and reasonable” rate standard embodied in traditional methods for determining a utility’s revenue requirement. PECO R. Exc. at 3. PECO contends that, in light of that analysis, the ALJ properly reached the same conclusion of the Commission in both *Columbia Gas* and *PAWC* – the negative economic effects of COVID-19 do not warrant summarily rejecting a utility’s rate increase request.PECO R. Exc. at 3 (citing R.D. at 17; *Columbia Gas* at 51; *PAWC* at 42, 46).

PECO also contends that the ALJ fully considered and properly rejected the OCA’s assertion that the revenue requirement underlying PECO’s rate increase request “did not adequately reflect the current economic climate and the impacts of the pandemic.” To the contrary, PECO notes that it prepared updated budgets as the basis for this case after voluntarily delaying its filing at the beginning of the pandemic. Responding to OCA witness Mr. Rubin, who questioned the reliability of PECO’s FPFTY data, PECO notes the explanation of its witness Mr. Paul Hibbard (the former chair of the Massachusetts Department of Public Utilities), as follows:

While [Mr. Rubin] talks about all the impacts to people and businesses, he does not connect any of his hyperbolic statements on the impacts of the pandemic to data or analyses in the record that are somehow unknowable or structurally flawed . . . The fact that the Company developed its data and forecasts during the pandemic does not invalidate the results; rate cases always rely on forecasts in the face of uncertain future conditions, and Mr. Rubin has not presented any evidence demonstrating how the degree of accuracy in the forecasts used in this case is any different than other rate cases. To the contrary, there is no reason to assume a priori that the impacts of COVID-19 in any way compromise the data and forecasts used by the Company in their filing, and there is no reason for the Commission to conclude that any diminished credence should be assigned to PECO’s projections for the FPFTY.

PECO R. Exc. at 3-4 (citing PECO M.B.at 12; PECO St. 11-R at 19).

PECO claims that the OCA is mistaken that PECO’s current rates furnish a fair rate of return, because the argument ignores all of PECO’s FPFTY investment in new plant and equipment and uses an inadequate return on equity recommended by its own witness (coupled with a “hypothetical” capital structure that the Commission rejected in *Columbia Gas*). PECO thus asserts that the ALJ properly rejected the OCA’s adjustments as unsupported and unprecedented. PECO R. Exc. at 4.

PECO also disagrees with the OCA and CAUSE-PA’s contentions that the Commission should not grant PECO a rate increase because, in their view, the Company’s programs to assist customers in dealing with the pandemic are inadequate. PECO argues that the ALJ appropriately determined that the initiatives were unnecessary.[[14]](#footnote-15) PECO submits that for all of these reasons, the ALJ properly rejected the arguments of the OCA and CAUSE-PA that no rate increase should be granted in light of the pandemic. PECO R. Exc. at 1, 2-5.

In its Replies to Exceptions, I&E disagrees with the OCA’s assertion that the ALJ did not give adequate consideration to the hardships faced by customers as a result of the COVID-19 pandemic and requests that the Commission reject the OCA’s Exception No. 1. I&E asserts that the ALJ correctly reasoned that he carefully examined the evidence and positions presented by PECO and the opposing parties with regard to PECO’s cost of service and other ratemaking concerns raised using the traditional ratemaking methodologies. I&E R. Exc. at 14-15 (citing R.D. at 17). I&E submits that as a result of that examination, the ALJ properly recommended that the Company receive a reduced revenue increase of $23,892,217. *Id.* I&E points to the ALJ’s explanation that the Commission addressed similar COVID-19 arguments on pages 48-51 of its recent decision in *Columbia Gas* and properly concluded, based on *Columbia Gas*, that while the pandemic has had a tremendous negative impact on the citizens and businesses of Pennsylvania, “the pandemic alone is not sufficient reason to outright deny PECO’s request for rate relief.” I&E R. Exc. at 15 (citing R.D. at 17). Based on the forgoing, I&E asserts that the ALJ was correct to reject the arguments of the OCA and CAUSE-PA and to recommend that the Company receive a reduced revenue increase of $23,892,217. I&E R. Exc. at 13-15.

## Disposition

We shall deny the Exceptions of the OCA and CAUSE-PA advocating outright denial of any rate increase to PECO at this time. We adopt the ALJ’s well-reasoned approach to exercise our broad discretion to consider the variety of factors influencing the determination of just and reasonable rates. Consistent with our prior rate orders issued during the COVID-19 pandemic, we have carefully examined through the lens of balanced and informed judgment, how the rates approved today will impact both customers and PECO. We reiterate our opinion stated in *Columbia Gas*, that the continued use of traditional ratemaking methodologies during this pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards. In addition, similar to our finding in that case, after careful scrutiny, we determine that there is a lack of substantial evidence in this record to support the OCA’s and CAUSE-PA’s recommendation to completely deny the Company’s requested rate increase due to the pandemic. Accordingly, consistent with the discussion herein, we shall deny the OCA’s Exception No. 1 and CAUSE-PA’s Exception No. 1.

It is well-settled that the Commission must ensure that a public utility’s base rates are just and reasonable and not unduly discriminatory. *See* 66 Pa. C.S. §§ 1301, 1304. Furthermore, “[i]n determining just and reasonable rates, the PUC has discretion to determine the proper balance between interests of ratepayers and utilities . . . the PUC is obliged to consider broad public interests in the rate-making process.” *Popowsky I*, 665 A.2d at 812 (citations omitted); *see also* *Hope Natural Gas*, 320 U.S. at 603 (the “fixing of ‘just and reasonable’ rates, involves a balancing of the investor and the consumer interests . . .”).

Regarding our discretion in fixing just and reasonable rates, the Pennsylvania Supreme Court explained:

There is ample authority for the proposition that the power to fix “just and reasonable” rates imports a flexibility in the exercise of a complicated regulatory function by a specialized decision-making body and that the term “just and reasonable” was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices

charged to utility customers and returns on capital to utility investors consonant with constitutional protections applicable to both.

*Popowsky I*, 665 A.2d at 812 (citations omitted).

We agree with the ALJ that our evaluation of PECO’s rate increase request must extend beyond the potential effect upon customers in the context of the COVID-19 pandemic and consider the utility’s financial condition – achieving the statutorily derived rates balance under traditional ratemaking. Consistent with our approach in *Columbia Gas,* we will not forego the use of our traditional ratemaking methodologies for setting a public utility’s base rates due to the impact of and uncertainty surrounding this pandemic. However, we emphasize that after careful review of the applicable legal standards, constitutional standards, and our prior rate orders, this 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 II*, 683 A.2d at 961. Included in our broad ratemaking authority is the authority to approve alternative rates and rate mechanisms, including formula rates as well as decoupling mechanisms, performance-based rates, and multi-year rate plans. 66 Pa. C.S. § 1330(b)(1)(i)-(v).[[15]](#footnote-16)

It is well-established in utility parlance that a set of ratemaking norms[[16]](#footnote-17) have been developed over time and consistently utilized by parties in rate cases before the Commission to determine the appropriate level of a utility’s requested revenue increase in accordance with all applicable legal and constitutional standards. These norms, or traditional ratemaking methodologies,[[17]](#footnote-18) are used to determine a utility’s cost of providing service, or its revenue requirement,[[18]](#footnote-19) and to determine appropriate rate structure, which includes, among other things, the appropriate allocation of the revenue requirement to various customer classes. However, as discussed in more depth below, we reject the notion that our continued use of these traditional ratemaking methodologies to determine the utility’s cost of service somehow inherently limits our consideration and weighing of important factors or principles in setting just and reasonable rates, such as quality of service,[[19]](#footnote-20) gradualism,[[20]](#footnote-21) and rate affordability,[[21]](#footnote-22) during this pandemic.

Under these traditional methodologies, a utility’s cost of service, or revenue requirement, is determined typically through the examination of the following two main components: (1) the allowed total expense claim, plus (2) the allowed return on investment. The allowed total expense claim typically includes the utility’s operating expenses,[[22]](#footnote-23) depreciation expense, and taxes that are found to be prudent, reasonably necessary, and fully substantiated in the FPFTY. [[23]](#footnote-24) The allowed return on investment is typically determined by multiplying the utility’s allowed rate base claim by the fair rate of return.[[24]](#footnote-25) The allowed rate base claim is typically found to be the net plant (gross plant less accumulated depreciation) plus any other capital items reasonably necessary to provide utility service funded with investor capital, as fully substantiated in the FPFTY.[[25]](#footnote-26) Meanwhile, the fair rate of return is typically calculated based on the utility’s capital structure and the cost of capital[[26]](#footnote-27) during the period in issue.

While these ratemaking norms provide a rational and methodical way to analyze and determine the utility’s cost of service, they also permit the consideration and weighing of important factors or principles in setting just and reasonable rates, such as quality of service, gradualism, and rate affordability. This is true in both normal and extraordinary circumstances, such as the COVID-19 pandemic.[[27]](#footnote-28) We remain of the opinion that the applicable legal standards that require the Commission to balance between the interests of the utility’s customers, investors, and the public interest, require the Commission, by necessary implication, to weigh evidence or unique considerations related to changes in service, market forces, and the economy. Thus, it is our responsibility under the applicable legal and constitutional standards to weigh evidence and unique considerations related to the COVID-19 pandemic in setting just and reasonable rates, and our continued use of traditional ratemaking methodologies permit our consideration of important ratemaking principles, like gradualism and rate affordability, in relation to this pandemic. Moreover, the traditional ratemaking methodologies permit consideration of evidence presented regarding the risks, uncertainties, and impact of the COVID-19 pandemic in determining various components of a utility’s cost of service, or revenue requirement. As discussed, in detail, in the remaining sections of this Opinion and Order, such components include, for example, a fair rate of return, projected expenses, and projected capital spending.

With regard to a fair rate of return, for example, it is consistent with the constitutional standards articulated in *Bluefield* and *Hope Natural Gas* to give weight to an expert witness’ opinion on rate of return that considers, rather than disregards, a major market event’s demonstrated effect on general opportunities for investment and the financial markets’ expectations for maintaining and supporting credit and raising capital.[[28]](#footnote-29) The Supreme Court stated that a fair return[[29]](#footnote-30) on rate base is one that is “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 . . .” *Bluefield*, 262 U.S. at 692-93. In addition, the Court stated, the “return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks.” *Hope Natural Gas*, 320 U.S. at 603. Indeed, the Court further recognized that “[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 692-93.

With respect to projected capital expenditures, for example, evidence of the changes, risks, and uncertainties created by this pandemic will continue to raise questions related to spending priorities in the FPFTY, both in terms of: (1) O&M expense claims; and (2) capital investments. With respect to expenses, the Commission is charged with determining whether the utility’s projected expenses “are reasonably necessary to provide service…” during the prospective period in which its rates will be in effect. *City of Lancaster Sewer Fund v. Pa. PUC*, 793 A.2d 978, 982 (Pa. Cmwlth. 2002). This standard permits an examination by parties and the Commission of whether the utility’s proposed specific expense claims in the FPFTY are “reasonably necessary to provide service” during the pandemic, which may lead to a trimming of certain expenses. At the same time, such an examination may lead to an increase in spending in certain expense categories where expenses are tied to the pandemic and directly related to increased costs, such as cleaning, sanitation, or providing personal protective equipment. Additionally, in the area of adjustments to rate base, the Commission has wide discretion. *Pennsylvania Power & Light Company v. Pa. PUC*,516 A.2d 426 (Pa. Cmwlth. 1985); *UGI Corp. v. Pa. PUC*, 410 A.2d 923, 929 (Pa. Cmwlth. 1980); *Duquesne Light Co. v. Pa. PUC*,99 A.2d 61, 69 (Pa. Super. 1953). However, the adjustments must be supported by sound reasons. *Philadelphia Suburban Water Co. v. Pa. PUC*,394 A.2d 1063 (Pa. Cmwlth. 1978).

Because of the many variables involved, determining the reasonableness of spending priorities related to expenses and capital investments in the midst of the pandemic ultimately will become a matter of judgement for the Commission, governed by the evidence presented in the record and guided by this agency’s regulatory expertise. *See generally Lower Paxton Township v. Pa. PUC*, 317 A.2d 917, 921 (Pa. Cmwlth. 1974); *see also* *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); *see also* *Pa. PUC v. PPL Electric Utilities Corporation*, Docket No. R‑2015‑2290597 (Order entered December 28, 2012).

Based on the foregoing, while we acknowledge that the COVID-19 pandemic is a significant socio-economic event, we agree with the ALJ’s recommendation that rejects the complete denial of PECO’s requested rate relief due to the pandemic’s impact and that undertakes a careful review of the case utilizing traditional ratemaking methodologies. We note that our continued use of traditional ratemaking methodologies, as discussed *supra*: (1) allows for the factoring in of important ratemaking principles, such as quality of service, gradualism, and rate affordability, in setting just and reasonable rates during this pandemic; and (2) requires consideration of evidence of the impact of this pandemic in determining the Company’s cost of providing service. Thus, in our opinion, the continued use of traditional ratemaking methodologies during this pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards.

Furthermore, we find the justifications set forth in the OCA’s and CAUSE‑PA’s Exceptions to completely deny the Company’s requested rate increase are not supported by substantial evidence in this record. First, with regard to the pandemic’s impact on customers, these Parties cited continued high unemployment rates in the working population in PECO’s service area. While we acknowledge the gravity of the level of unemployment, it has not been demonstrated in this case with substantial evidence or explanation that the impact of *any* rate increase on unemployed customers will lead to harm that outweighs all other valid ratemaking concerns “especially the polestar – cost of providing service.” *Lloyd*, 904 A.2d at 1020. Furthermore, taking the approach of denying any rate relief due to rising unemployment numbers among residential customers is inconsistent with our prior rate orders issued during this pandemic. *See Pa. PUC v. Philadelphia Gas Works*, Docket No. R-2020-3017206 (Order entered November 19, 2020); *Pa. PUC v. UGI Utilities, Inc.- Gas Division,* Docket No. R-2019-3015162 (Order entered October 8, 2020); and *Pittsburgh Water and Sewer Authority*,Docket Nos. R-2020-3017951, R-2020-3017970 (Order entered December 3, 2020). No party in this proceeding has offered a rational basis to justify a different treatment under the circumstances here.

PECO offers substantial explanations in its Replies to Exceptions about the basis for its projected increases in expenses and rate base investments in the FPFTY in support of its requested rate relief. This alone indicates that a proper exercise of our discretion requires us to carefully examine the evidence and positions presented by all Parties with regard to the Company’s cost of service and other ratemaking concerns using the traditional ratemaking methodologies, rather than to outright disregard the requested rate relief due to the pandemic. More specifically, in its Replies to Exceptions, PECO submits that it presented evidence in this proceeding to show that its expenses have not declined due to the pandemic. We address the Company’s expense, rate base and related claims more specifically, below, consistent with our decision to fully evaluate the rate increase request under traditional ratemaking methodologies.

We adopt the ALJ’s recommendation to undertake a complete examination of the Company’s rate increase request, therein acknowledging: (1) the continued use of traditional ratemaking methodologies during this pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards; and (2) there is a lack of substantial evidence in this record to support an outright denial of the Company’s requested rate increase due to the pandemic. Accordingly, the OCA’s first Exception and CAUSE-PA’s first Exception are denied.

In consequence, the remainder of this Opinion and Order shall address our review of the evidence and arguments presented by the Parties in this proceeding relating to PECO’s requested revenue increase for the purpose of determining just and reasonable rates based on traditional ratemaking methodologies.

# Rate Base

As discussed above, PECO has requested that the Commission approve an increase in annual operating revenues of $66,279,000, which represents an approximate $2.5 million reduction to PECO’s initial increase request of $68,812,000.[[30]](#footnote-31) *See* PECO Exh. MJT-1, Sch. A-1; PECO Exh. MJT-1 Revised, Sch. A-1. PECO Exhibit MJT-1 Revised illustrates the changes that PECO made to the revenue requirement previously presented in PECO Exhibit MJT-1. These changes were made to reflect: (1) more recent data or the Company’s revised position on certain issues previously set forth in interrogatory responses; (2) the Company’s decision to adopt certain adjustments proposed by the Parties; and (3) corrections to the Company’s initial filing.[[31]](#footnote-32),[[32]](#footnote-33)  More specifically, the Company updated its claims for five components of rate base that are based on 13‑month historic averages and to reflect derivative changes in cash working capital (CWC) attributable to those changes. The five components that are based on the 13‑month average balances are: (1) gas storage inventory; (2) customer deposits; (3) customer advances for construction (CAC); (4) materials and supplies; and (5) prepaid expenses.

The Company based its requested increase on a FPFTY ending June 30, 2022, which is designed to provide PECO with the opportunity to earn an overall rate of return of 7.64%, including a 10.95% return on common equity, on a claimed rate base of approximately $2.464 billion. *See* PECO Exh. MJT-1 Revised, Schs. A-1, B-7, and C-1. According to PECO, its final claimed rate base of $2,463,555,000 reflects all adjustments adopted by the Company in this proceeding, which consists of the original cost of its utility plant in service as of June 30, 2022 (adjusted actual plant balances at June 30, 2020, to reflect those plant additions and retirements forecasted to occur during the FTY and FPFTY), including allocated common plant, as well as requested allowances for a pension asset, materials and supplies, CWC, and gas storage inventory, and ratemaking deductions for accrued depreciation, CAC, customer deposits, accumulated deferred income taxes (ADIT), and the regulatory liability for excess ADIT.[[33]](#footnote-34) *See* PECO M.B. at 14 (citing PECO Exh. MJT-1 Revised, Schs. C-1 and C-2). The Company asserted that its rate base claim – based on plant projected to be in service at the end of the FPFTY – properly reflects PECO’s fully forecasted FPFTY plant in service balances totaling $3,537,669,000, as well as the $35.1 million of investor-supplied funds represented by the pension asset that have not been recovered in the Company’s base rates. PECO M.B. at 25.

PECO noted that only two rate base items remain in dispute. First, witnesses for I&E and the OCA proposed adjustments to reduce PECO’s claimed plant in service balances as of June 30, 2022. In addition, both I&E and the OCA objected to PECO’s claim for rate base recognition of a pension asset that arises because of a difference in the calculation of pension costs for ratemaking purposes in Pennsylvania and under Generally Accepted Accounting Principles (GAAP). PECO R.B. at 6.

## Utility Plant In Service/Depreciation Reserve/Accumulated Deferred Income Taxes (ADIT)

As the depreciation reserve authorized for recognition in the revenue requirement is dependent upon the plant in service balances claimed at the end of the FTY and the FPFTY, the accumulated deferred income taxes (ADIT), reflected as an offset to rate base, will likewise change as plant in service balances are adjusted. The credit balance of ADIT reflects the timing differences arising from the accelerated depreciation method authorized in the tax basis of accounting, but not in the accrual basis of accounting, which employs book depreciation. The ADIT captures the cumulative differences between book and tax deductions and is unwound over the life of the assets that generated the timing difference.[[34]](#footnote-35) Therefore, the Parties’ positions concerning utility plant in service, depreciation reserve, and ADIT will be discussed and disposed of concurrently.

### Positions of the Parties

The Company’s forecasted additions and retirements to plant in service, as well as the allocated common plant, for the FTY and the FPFTY are shown on Schedules C-2 and C-8 of PECO Exhibits MJT-2 and MJT-1 Revised, respectively. According to these schedules, PECO is projecting net plant additions (gross plant additions less retirements, including allocated common plant) of $369,425,000 (*i.e.,*$292,123,000 ‑ $16,592,000 + $93,894,000) for the twelve months ending June 30, 2021, and $395,764,000 ($322,146,000 - $16,592,000 + $90,210,000) for the twelve months ending June 30, 2022. PECO Exhs. MJT-1 Revised and MJT-2, Sch. C-2; PECO Exh. MJT-1 Revised, MJT-2, and MJT-3, Sch. C-8. PECO attributes the continued increases in projected plant additions to its commitments to investing in new gas utility plant and replacing aging infrastructure, including accelerated main and services replacement, meter replacement, regulator replacements, mapping enhancements, and security upgrades. PECO St. 1 at 9-18; PECO St. 2 at 2-3. In this regard, PECO projects that it will need to invest approximately $1.2 billion in new or replacement gas utility plant between July 1, 2020 and June 30, 2024. PECO M.B. at 14.

Two issues have been presented related to PECO’s forecasted investment in plant in service during the FPFTY. First, the OCA challenged PECO’s budgeted data for FPFTY plant additions and proposed an allowance only at the Company’s forecasted level of plant additions for the FTY, without an allowance for any plant additions during the FPFTY. OCA St. 2 at 14; OCA Sch. LKM-2. Second, I&E witness Mr. Cline proposed to reduce PECO’s claimed plant in service balances for the Natural Gas Reliability project described in PECO witness Mr. Ronald A. Bradley’s direct testimony to eliminate investments in gas utility plant that Mr. Cline asserted will not be placed into service during the FPFTY. I&E St. 3 at 11-12 (citing PECO St. 1 at 17); I&E Exh. 3, Sch. 2, p. 3; I&E St. 3-SR at 5-6 (citing PECO St. 1-R at 18-20). The OSBA, CAUSE‑PA, and PAIEUG did not take any positions on any rate base issues.

The OCA submitted that PECO’s projected plant additions for the FPFTY should not be relied upon in the development of the appropriate rate base used to determine the amount of revenue the Company will have the opportunity to recover through rates, as they have not been shown to be supported by sufficient evidence. Specifically, OCA witness Mr. Morgan found that the Company’s projections were based on outdated budgeting information that was supported by vague and inconsistent data and did not appropriately factor in the impacts of the COVID-19 pandemic. Therefore, the OCA recommended reducing the Company’s claimed rate base by $271 million, reflecting its proposal to disallow $305,555,000 of FPFTY net plant additions and making the necessary derivative adjustments to the Company’s claimed portion of common plant, accumulated depreciation, and ADIT.[[35]](#footnote-36) OCA St. 2 at 7-15; OCA St. 2‑SR at 2-10; OCA Sch. LMK-4.

The OCA stated that “the Company has been unable to provide detailed support for its plant in service additions and, in some instances, the total plant additions during the FTY and FPFTY are not the same amount where comparing different source documents with data request responses.” OCA St. 2 at 10. The OCA indicated that the cause for such inconsistencies and inadequate data supporting the rate increase request may have been caused by the “abbreviated” approach taken by PECO in the preparation of its FTY and FPFTY budgets for the instant proceeding. The OCA’s witness, Mr. Morgan, cited to PECO witness Mr. Robert J. Stefani’s direct testimony in his explanation of PECO’s normal budgeting process. OCA St. 2 at 7-8 (citing PECO St. 2 at 11-12). Mr. Morgan explained how the Company’s budgeting process involves a four-month (or more) period, beginning in June of each year, during which its five-year Long Range Plan (LRP) is updated on a rolling basis. *Id*. In this instance, Mr. Morgan explained that the process to update PECO’s LRP began in June 2019 and was completed in January 2020 for a March 2020 filing, well before the onset of the COVID-19 pandemic. As a result of PECO delaying the filing of the instant rate case due to the COVID-19 pandemic, in July 2020, PECO began updating its January 2020 approved budget, which was finalized in August 2020, for the preparation of its capital and operating budgets for the FTY and the FPFTY. Given that the Company’s normal budgeting process takes at least four months to complete, the OCA expressed concern over the accuracy of projections produced over a two-month period during a period of great economic volatility, based upon a LRP that was prepared before the pandemic began. OCA St. 2 at 10-12.

Contrary to the OCA’s contention, PECO argued that it employed a rigorous process to develop its FTY and FPFTY capital and operating budgets, consistent with the process reviewed by the Commission during its Focused Management and Operations Audit of PECO in 2014. PECO M.B. at 16-17. The Company contended that, in order to align with its delayed filing, it refreshed its January 2020 approved budget with the most up-to-date information to accommodate the use of a HTY ending June 30, 2020. PECO continued that the budget reflected the Company’s current information regarding customer load, capital expenses, operating and maintenance (O&M) expenses, depreciation and amortization expense, and interest and tax expense. In addition, since this update occurred approximately four months into the COVID-19 emergency, the update reflected impacts resulting from the pandemic. As noted by Mr. Stefani, “the budget process utilized to develop the FTY and FPFTY cost of service was neither abbreviated nor independent of the Company’s normal budget process.” PECO St. 2-R at 3. Mr. Stefani also pointed out that the budget was fully reviewed and authorized by the Company’s senior management. PECO M.B. at 17. PECO explained that its FTY and FPFTY budgets reflect “the standard inputs to PECO’s well-established gas forecasting process, including weather normalization based on 30‑year averages, historical sales and customer growth trends, and economic forecasts provided by PECO’s third-party vendor.” PECO St. 2-R at 3. Moreover, the Company points to the Commission’s recent decisions in *Columbia Gas* and *PAWC*, noting that the proper course is to examine this data, and not to simply reject a requested rate increase due to the pandemic. PECO M.B. at 17-18 (citing *Columbia Gas* at 52-53; *PAWC* at 45‑46).

PECO also argued that it is unreasonable to assume, as Mr. Morgan has, that the Company’s FTY and FPFTY claims for plant in service are unachievable due to the COVID-19 pandemic. As both Mr. Bradley and Mr. Stefani noted, some projects were delayed during the HTY, but PECO does not expect the in-service dates of any of the projects it expects to complete in the FTY or FPFTY to be delayed. PECO St. 1-R at 3-4; Tr. at 217-18, 246-47. In addition, the Company asserted that its capital expenditures through 2020 demonstrate that the Company mitigated the delays caused by the COVID-19 pandemic. PECO explained that it has spent approximately $274 million of its $277 million 2020 construction budget – approximately 99% of its target – and anticipates that it will be fully caught up on its construction budget by June 2021. PECO M.B. at 18. In summary, PECO contended that the OCA’s conclusion that the Company’s FPFTY plant in service projections are unreliable is unsupported and contrary to the substantial evidence presented by the Company. PECO M.B. at 19.

As previously indicated, I&E also took issue with PECO’s FPFTY claim for plant additions. After making the necessary derivative adjustments to the Company’s accumulated depreciation, I&E recommended that $47,624,803 of the projected $82,481,428 in claimed plant additions be disallowed for PECO’s Natural Gas Reliability project. This would result in a reduction to the Company’s claimed rate base of $46,820,803.[[36]](#footnote-37) I&E M.B. at 16-17; I&E St. 3-SR at 6, 9. The Company’s Natural Gas Reliability project consists of three components: (1) the installation of 11.5 miles of gas main; (2) capital upgrades to the Company’s West Conshohocken liquefied natural gas (LNG) facility; and (3) the construction of a new gate, or reliability station. PECO M.B. at 19-20. I&E averred that, according to PECO’s response to IE-RB-4-D, only 28% of the project is completed, with $33,888,385 spent to date. *See* I&E Exh. 3, Sch. 2 at 3. I&E witness Mr. Cline explained that the completion date of the project as specified by PECO, is June 2023, and that the remaining cost of the project is $87,141,561, or $34,856,625 per year ($87,141,561 ÷ 2.5 years) on a linear basis.[[37]](#footnote-38) Mr. Cline suggested that the Company is unlikely to spend the majority of the remaining project costs in the FPFTY (*i.e*., 94.6% of remaining costs ($82,481,428 ÷ $87,141,561) x 100%), and therefore, recommended a reduction to the Company’s claim for plant additions in the FPFTY, allowing only for the linearly determined remaining cost share in the FPFTY, or $34,856,625. I&E M.B. at 6, 15-17; I&E R.B. at 11.

PECO argued that Mr. Cline mistakenly treated the three components of the Natural Gas Reliability project as a single, linear project, when, in fact, the three components will be constructed, placed into service, and then be available to provide service to customers independently. Therefore, PECO asserts that any disallowance of the expenditures related to the 11.5 miles of gas main and the construction of a new gate station would deny the Company the benefit of assets in rate base that will be serving customers in the FPFTY. PECO M.B. at 20. PECO’s explanation included a long discussion of PECO’s laddered budgeting process and how it eventually arrived at its projections. PECO M.B. at 16-19. I&E argued that it sought clarity on this issue from the start and PECO’s responses changed throughout the litigation process. I&E R.B. at 10. PECO further argued that no adjustment to the Company’s FPFTY additions is warranted because PECO actually claimed only two of the three components of the Natural Gas Reliability project to be completed and in service during the FPFTY: (1) the installation of 11.5 miles of gas main; and (2) the construction of the new gate, or reliability station. The Company contended that these two components of the project will be placed in service and made available to provide service to customers by the second quarter of 2022 (*i.e*., during the FPFTY). PECO further argued that even though it only claimed two components of the project in its rate base, it had updated its estimated completion dates, indicating that approximately 50% of the aggregate costs will be spent in 2021, the new reliability station and 11.5- mile gas main are scheduled to be in service by the end of the FPFTY, and that the entirety of the Natural Gas Reliability project is scheduled to be in service by the end of 2022. PECO St. 1-R at 18-20.

### Recommended Decision

The ALJ disagreed with, and thus rejected, the OCA’s proposal to disallow all of PECO’s claimed FPFTY plant additions. ALJ Pell acknowledged that, although PECO offered testimony indicating that it did not expect the impact of the COVID-19 pandemic to delay the in-service dates of any of the projects forecasted to be completed in the FTY or the FPFTY, the Company did not prove conclusively that it would meet its targeted in-service dates. R.D. at 47. Notwithstanding, the ALJ did not recommend the adoption of the OCA’s proposed adjustment for the following reason:

However, I do not agree with the OCA’s position that there is not any support for PECO’s planned plant additions for the FPFTY. I do believe that there is sufficient evidence in the record to support an addition to rate base for planned plant additions in the FPFTY.

*Id.* The ALJ, however, agreed with I&E’s approach in calculating PECO’s plant in service because he found I&E’s calculations were reasonable and supported by the record. Therefore, the ALJ recommended the Commission reduce the plant in service included in the FPFTY rate base by $47,624,803 and reduce the related FPFTY balance of depreciation reserve by approximately $804,000.  *Id*.

### PECO Exception No. 1 and Replies

In its Exception No. 1, PECO submits that the Commission should reject the ALJ’s recommendation that adopts I&E’s proposed adjustment which disallows $47,624,803 of PECO’s claimed plant additions for the Natural Gas Reliability project, as well as the concomitant reduction of $804,000 to PECO’s accumulated depreciation, because it is based on incorrect data and faulty assumptions. PECO Exc. at 4-8. PECO argues that the ALJ’s recommendation adopting I&E’s proposed adjustment is contrary to I&E’s own exhibit,[[38]](#footnote-39) which shows that $38.5 million of the proposed disallowance was not included in the Company’s claim.[[39]](#footnote-40) *Id*. at 4. PECO explains that its claim of $82,481,428 for the Natural Gas Reliability project only reflects two of the three constituents of the project as FPFTY additions. *Id*. at 5. PECO further contends that I&E erred in its calculation in using 2.5 years as the remaining future construction period because Mr. Cline mistakenly assumed that the in-service dates for the two constituent components of the Natural Gas Reliability project claimed by PECO would be the same as the June 2023 estimated in-service date for the LNG upgrade component. Therefore, PECO maintains that no adjustment to its FPFTY plant additions is warranted because I&E’s proposal to disallow $47,624,803 of PECO’s claim for the Natural Gas Reliability project is based upon a flawed calculation. *Id.* at 7-8.

In its Replies to PECO’s Exception No. 1, I&E submits that the ALJ correctly concluded that its calculations are reasonable and supported by the record. I&E R. Exc. at 3 (citing R.D. at 47). Therefore, I&E requests that the Commission reject PECO’s Exception No. 1, which presents an argument that attempts to reinterpret the Company’s own direct, rebuttal and oral rejoinder testimony. I&E R. Exc. at 2.

### OCA Exception No. 2 and Replies

In its Exception No. 2, the OCA argues that the ALJ erred when he denied the OCA’s adjustment to remove from PECO’s rate base its planned plant additions for the FPFTY. OCA Exc. at 6. Further, the OCA argues that while it agrees with ALJ Pell’s decision to remove a portion of the Natural Gas Reliability project from rate base, as proposed by I&E, that adjustment does not adequately recognize that PECO’s projections fail to support the plant additions identified by the OCA’s expert witness. The OCA invokes *Columbia Gas* to support its position that its proposal to disallow PECO’s projected plant additions for the FPFTY is supported by “sound reasons.” *Id*. at 7.

The OCA maintains that PECO’s abbreviated approach calls into question the projected plant additions and their accuracy.[[40]](#footnote-41) The OCA explains its failed attempts to obtain the data upon which PECO’s test year budgets were created, only to be met with the Company’s conclusory statements that it is on track to meet its planned plant addition targets, supported by high-level summary data, showing some projects would not be completed until well after the end of the FPFTY. OCA Exc. at 8-9 (citing OCA St. 2, App. B at 31; PECO St. 1-R at 4). In contrast, the OCA asserts that the OCA and I&E have demonstrated the Company’s failure to provide sufficient evidence to support its planned plant additions, including the planned Natural Gas Reliability station and other projects included in the Company’s rate base claim. OCA Exc. at 9 (citing I&E St. 3 at 11).

In its Reply to the OCA’s Exception No. 2, PECO counters that the ALJ properly rejected the OCA’s recommendation based on the substantial evidence supporting PECO’s budgeted data for FPFTY plant additions and the absence of any credible support for the OCA’s position. PECO R. Exc. at 6 (citing R.D. at 20-23, 47). PECO reiterates that the LRP budget, including the FTY and the FPFTY, that was approved by senior management in January 2020 was thoroughly refreshed in July 2020 and, therefore, reflects the most current data available. PECO R. Exc. at 7. The Company maintains that the OCA’s recommendation is based on misconstrued statements in PECO’s testimony and discovery responses and echoes the argument from PECO’s Main Brief and testimony that unrefuted record evidence establishes that PECO has almost entirely recovered from the COVID-19 pandemic related construction delays it experienced in the early months of the pandemic: the Company was able to spend 99% of its 2020 construction budget, and there will be no impact on the work scheduled for completion in the FTY and FPFTY. *Id.* (citing PECO M.B. at 18-19; PECO St. 1-R at 3‑4). Furthermore, in response to the OCA’s reliance on the Commission’s recent decision in *Columbia Gas*, in support of its proposal to disallow PECO’s projected FPFTY plant additions, the Company points out that in *Columbia Gas,* the OCA proposed an adjustment based on a three-year average and not a complete disallowance of FPFTY plant additions.[[41]](#footnote-42)

I&E’s response to the OCA’s Exception No. 2, merely incorporates its response to PECO’s Exception No. 1 by reference as if fully set forth therein, stating that ALJ Pell correctly recommended that the Company’s claim for plant additions in the FPFTY be reduced by $47,624,803. I&E R. Exc. at 15-16 (citing R.D. at 47).

### Disposition

On consideration of the record evidence in this proceeding, we shall grant PECO’s Exception No. 1, deny the OCA’s Exception No. 2, and modify the recommendation of the ALJ, consistent with the following discussion.

Regarding the OCA’s proposal to reduce the Company’s claimed rate base by $271 million, reflecting its proposal to eliminate PECO’s projected FPFTY net plant additions, we concur with the ALJ that there is sufficient evidence in the record to support an addition to rate base for planned plant additions in the FPFTY. Although there may have been confusion surrounding PECO’s budgeting process, given the fact that the Company chose to delay its filing of this rate case in the context of the initial days of the COVID-19 pandemic and the resulting process used to update its budgets, it is not reasonable to simply ignore PECO’s projected plant additions for the FPFTY determined through its budgeting process, regardless of how “abbreviated” it may have been in this case. Therefore, we shall deny the OCA’s Exception No. 2.

At the same time, however, we do not agree with the ALJ’s recommendation to apply a downward adjustment of $47,624,803 to the Company’s net plant additions projected for the FPFTY. We are not persuaded by I&E’s argument that PECO failed to provide the necessary information to adequately validate its FPFTY plant additions related to the Natural Gas Reliability project. Rather, we find that PECO has met its burden of proof and has provided substantial evidence regarding the necessity of the Natural Gas Reliability Project and the in-service dates of the phases of the Reliability project that have been included in the Company’s rate base claim. Our review of the record indicates that PECO provided testimony and detailed responses to I&E’s discovery requests regarding the Reliability Project and specific claims for its FPFTY plant additions in this proceeding. *See* I&E Exh. 3, Sch. 2 at 3.

Additionally, as PECO asserted, its claim of $82,481,428 for the Reliability Project only reflects two of the three components of the project as FPFTY additions. Accordingly, we find that it would be error to assume that the in-service dates for two of the components of the Natural Gas Reliability project claimed by PECO would be the same as the June 2023 estimated in-service date for a third component of the project. Thus, in our view, the adjustments in the Recommended Decision related to PECO’s proposed FPFTY plant additions are not justified. As such, we shall grant PECO’s Exception No. 1 and modify the ALJ’s recommendation on this issue.

## Pension Assets

As previously noted, PECO claimed a rate base recognition of $35.1 million as a Pension Asset based upon the difference between PECO’s calculation of pension costs for ratemaking purposes in Pennsylvania and PECO’s calculation of pension expense under the required GAAP rules governing pension administration. PECO R.B. at 6. Specifically, PECO Exhibit MJT-1 Revised includes PECO’s accumulated prepaid pension expenses, *i.e.*, PECO’s claimed $35.1 million Pension Asset. The Company claimed that including the $35.1 million Pension Asset in rate base was reasonable and necessary to earn a rate of return on the accumulated past pension expense actually paid by the Company, which has otherwise yet to be capitalized for financial accounting purposes. Both I&E and the OCA objected to PECO’s claim for rate base recognition of actuarial accounts reflected as accumulated uncapitalized Pension Asset.

### Positions of the Parties[[42]](#footnote-43)

PECO argued that the Pension Asset consists of $35.1 million of investor-supplied capital in the form of cash contributions to the Company’s pension fund. According to PECO, those contributions were not permitted to be included in PECO’s plant accounts under the applicable GAAP rules governing pension fund contributions, but they should be included in PECO’s plant accounts for rate making purposes. PECO claimed the Pension Asset as an expense recoverable in rate base in the present case because, otherwise, PECO alleged, the Company will never recover the carrying costs incurred on the $35.1 million investor-supplied funds.[[43]](#footnote-44) PECO M.B. at 22.

PECO asserted that, for rate making purposes, pension costs should typically be calculated based upon a cash contribution method for the expense account in ratemaking, based upon a utility’s cash contribution to its pension fund; however, federal rules established under GAAP applicable to pension funds require use of an accrual method for such expenses under plant accounts. Specifically, under GAAP, the Company is required to determine pension costs based on the rules set forth in the Financial Accounting Standards Codification Topic 715 or (ASC 715).[[44]](#footnote-45) PECO St. 3-R at 10-11.

PECO asserted that the sole use of ASC 715 for calculation of pension expenses results in an annual difference between the amount of pension costs which PECO argues should be recoverable in rates established by the Commission, *i.e.*, based on cash contributions, and the amount of pension costs reflected on the accounting records of the Company, *i.e*., based on ASC 715, formerly SFAS 87. PECO MB at 22. PECO asserted that the Pension Asset claimed represents the accumulated amount of the difference related to the portion of the pension costs that is capitalized and included in utility plant accounts. PECO’s claimed Pension Asset reflects the accumulated difference between: (1) the amount of pension costs actually paid by the Company; and (2) the amount of pension costs permitted to be included in PECO’s plant accounts, per the ASC 715. *Id.*; PECO St. 1at 17, 55; PECO St. 3-R at 10.

PECO further argued that the $35.1 million Pension Asset should be included in rate base to permit the Company to recover its associated costs, consistent with the Commission’s treatment of a similar Pension Asset claimed in rate base in the three previously approved settlements of rate case proceedings for Duquesne Light Company (Duquesne Light).[[45]](#footnote-46) Although PECO conceded that settlements are not precedential, it asserted that the rationale for the Commission’s prior approval of an adjustment to rate base for a pension asset in the prior Duquesne Light settlements is similarly applicable to PECO’s proposed adjustment to rate base for the calculated Pension Asset. PECO M.B. at 24.

PECO maintained that the ALJ should reject the Pension Asset-related adjustments to rate base, proffered by I&E and the OCA because those adjustments would exclude PECO’s claimed $35.1 million Pension Asset from rate base. PECO countered the objections of both I&E and the OCA, *infra,* on the grounds that the rationale for the claimed pension asset previously approved by the Commission in the Duquesne settlements is equally applicable in the present case. PECO M.B. at 24.

I&E recommended disallowance of the Company’s claim of the $35.1 million Pension Asset addition to rate base, in its entirety, and argued that the Commission should make the associated adjustment to reduce the claimed rate base by $35,059,000. I&E described the difference between the GAAP accounting requirements for use of an accrual method for plant accounts, and the typical cash contribution method for the expense account in ratemaking, as a “mismatch.” I&E asserted that differences between GAAP expense and cash contributions, which may fluctuate in any given year, are not a valid reason to inflate the rate base, as proposed by PECO. I&E’s position was that the “mismatch” between the two accounting methods illustrates that there is no actual infusion of capital or funds by the investors/stockholders that should be eligible for return on investment. Rather, I&E concluded that the rules governing pension contributions illustrate that the required pension contributions are amortized to reflect the contributions’ actual usefulness over time for the purpose of funding employee pensions. For this reason, I&E maintained that the accumulated balance of the pension asset should not be categorized or described as a utility asset that is used and useful in providing utility services to ratepayers, and therefore, should not be included as an eligible asset in the rate base claim to recover the associated carrying cost by earning a return on it. Therefore, I&E asserted that, for ratemaking purposes, the Commission should disallow PECO’s Pension Asset as an addition to rate base. I&E M.B. at 17, 18; I&E R.B. at 12‑13; I&E St. 1 at 47-50; I&E St. 1-SR at 41-48.

I&E rejected PECO’s argument that the Company’s Pension Asset reflects investor contributions it will have neither recovered as an operating expense nor capitalized to utility plant because the capitalized amounts are based on costs determined pursuant to ASC 715. In addition, I&E rejected the Company’s position that the Pension Asset of $35.1 million is investor-supplied capital that should be assumed for ratemaking purposes to be included in PECO’s plant accounts to recover the previously unrecovered associated carrying cost, and that PECO is not seeking recovery of prior carrying costs in this case. I&E disagreed and asserted that the Pension Asset of $35.1 million should not be included in PECO’s plant accounts to recover the previously unrecovered associated carrying cost. I&E M.B. at 18.

I&E also argued the Commission should reject PECO’s reliance on the three black-box settlements in the Duquesne Light rate cases, as well as PECO’s assertion that because I&E did not appear to assert any opposition to the Pension Asset’s inclusion in rate base in those cases, the Commission should infer that this constitutes I&E’s agreement to PECO’s Pension Asset’s inclusion in rate base in the present case. I&E asserted that “black box” settlements allow the Parties to reach a negotiated compromise on the part of the Parties and expressly does not represent the positions the Parties would have adopted during litigation. I&E further asserted that the Company’s argument, to apply the prior settlement as “precedent,” would defeat the Commission’s policy of encouraging settlements by disregarding the fact that the settlement, by its express nature, does not bind the Parties to their respective positions in any future rate cases. I&E M.B. at 19; I&E R.B. at 13.

I&E also rejected the Company’s assertion that, in theory, the fluctuating nature of the claimed Pension Asset, which would operate to raise rates in the present case, would also work to reduce rates, in future cases, should the Pension Asset result in the “net credit” rather than a required contribution. I&E rejected PECO’s rationale that the fluctuating nature of the Company’s pension obligations warranted inclusion of the Pension Asset in the present case. I&E submitted that a better understanding of the fluctuating nature of pension funds and required contributions, under the GAAP rules governing pensions, is that differential amounts or the above described “mismatch,” both positive and negative, *i.e.*, pension asset/pension liability, between the amount recorded for accrual accounting purposes per GAAP and the amount of annual cash contributions, are resolved over time and will match or change to a liability account. I&E M.B. at 19‑20.

Therefore, I&E argued that in any given year, the difference between allowable GAAP expense reflected in plant accounts and the Company’s cash contributions should not be viewed as a valid addition to the plant amounts in rate base. In I&E’s view, doing so would be an unreasonable inflation to the rate base. Accordingly, I&E reinforced its position that PECO’s claim to include the $35.1 million Pension Asset in the present case should be denied. I&E M.B. at 19-20; I&E R.B. at 13‑14.

Like I&E, the OCA recommended disallowance of the Company’s claim of the $35.1 million Pension Asset addition to rate base. The OCA described the Company’s request to include the Pension Asset in rate base, as the Company seeking to earn a return on the accumulation of past pension expense that has yet to be capitalized for financial accounting purposes. According to the OCA, the Company’s claim should be denied, based on the fact that the capitalization of the pension expense is governed by the applicable GAAP rules, which should determine when the expense should be included in the Company’s capital accounts, and thus, the Company’s rate base. The OCA characterized the Company’s argument that the Pension Asset will be “unrecoverable” unless included in the present rate case as inaccurate. Rather, the OCA countered that the Pension Asset will be included in the Company’s rate base in future years, when under the applicable GAAP rules, it is appropriate to do so for financial accounting purposes. OCA M.B. at 37-38.

The OCA argued that based on the nature of the claim for a Pension Asset, the Company’s claimed amount of $35.1 million is not appropriate for inclusion in the Company’s rate base. The OCA submitted that including the Pension Asset in the rate base would inappropriately allow the Company to earn a return on an unamortized pension expense, which the Commission has disallowed in the past. Moreover, the OCA took the position that because the amounts currently reflected in the Pension Asset have not yet been capitalized for financial accounting purposes, and may not for some time, these amounts will not be depreciated or amortized and will remain on the Company’s books for a number of years, resulting in the Company over-earning on these amounts if they are included in rate base as proposed. OCA M.B. at 40-41 (citing *Pa. PUC v. Pa. Power Co.*, 1982 Pa. PUC LEXIS 154 at \*117-18 (*Penn Power 1982*)).

Specifically, the OCA argued that the “mismatch” between the cash accounting method and the required GAAP actuarial accounting method for pension funds, which results in the Company’s calculated Pension Asset of $35.1 million, does not qualify as a capital investment which should be eligible for inclusion in rate base. As explained by the OCA’s witness, Mr. Morgan, this gap in financial accounting is to be booked to the Company’s Account 186 – Miscellaneous Deferred Debits. The OCA noted that this is not a capital investment account, but is rather a deferred debit, or current asset. As current assets are not generally included in a Company’s rate base, the OCA maintained that, under the applicable GAAP rules, the Company’s Pension Asset should remain on the Company’s books and should not be amortized until the ASC 715 amount exceeds the Company’s Cash Contribution. The OCA concluded that the Company’s claim for the Pension Asset, if allowed, would inappropriately include an unamortized expense item in rate base before it is ripe for inclusion. OCA M.B. at 39-42; OCA St. 1‑SR at 13-19.

Like I&E, the OCA asserted that the ALJ should reject the Company’s reliance on black-box settlements as precedent for inclusion of the Pension Asset in rate base in the present case, arguing that to do so would have a chilling effect on the settlement process itself, if a party’s position in a prior settlement were to be held against it in a subsequent proceeding. OCA M.B. at 41-42; OCA R.B. at 17.

Finally, the OCA rejected the Company’s proposition that the Pension Asset is comparable to the capitalized portion of salaries and wage expense, asserting these cash outlays are indistinguishable and should be treated the same for rate making purposes. The OCA submitted that the Company’s position inappropriately compares two different concepts. The OCA noted that a *portion* of pension expense, like salaries and wage expenses, must be capitalized and included in the Company’s capital accounts. The OCA maintained that the inclusion in rate base should be limited to the portion of pension expense which, like wages and salaries, is capitalized for financial accounting purposes and *excludes* those portions which have not yet been capitalized for financial accounting purposes. Therefore, the OCA argued that the Commission should deny the Company’s claim to include the Pension Asset in rate base, and thereby reduce the Company’s rate base by $35,059,000. OCA M.B. at 42; OCA R.B. at 17.

### Recommended Decision

The ALJ agreed with the positions of I&E and the OCA that PECO’s inclusion of the claimed $35.1 million Pension Asset as part of the rate base should be disallowed. The ALJ concluded that the Company’s recovery of the Pension Asset is appropriate as set forth under the GAAP rules, utilizing the actuarial method under the ASC 715 (and formerly SFAS 87), rather than as recoverable in the present rate proceeding as an addition to rate base. R.D. at 48

The ALJ’s analysis turned on the conclusion that, as argued by I&E and the OCA, the unique nature of the regulated pension accounts and the required funding and financial accounting methods under GAAP, all weigh against allowing rate recovery for PECO’s calculated Pension Asset. The ALJ concluded that the expenses determined under the ASC 715 allow reasonable and necessary rate recovery of the portion of the pension expense capitalized under the GAAP rules and does not provide for the recovery of the accumulated costs incurred by the Company to finance the required contributions to their pension plans. R.D. at 48.

Specifically, the ALJ adopted the position that the Pension Asset is not appropriate for inclusion in rate base, because, as the ASC 715 expense is based on accrual, not cash basis, it is expected that the amount of the pension expense recorded is generally different than the actual amount of annual contributions required of the Company. The ALJ agreed with I&E’s reasoning that, while the ASC 715 expense fluctuates and may be positive or negative in any given year, over the life of the pension plan, the Company’s total contributions are expected to equal the total ASC 715 expense. Therefore, the ALJ agreed with I&E that the more reasonable approach would be to include the pension expense in the rate base, as a capitalized expense over time, as required under the applicable GAAP rules and ASC 715. Ultimately, the ALJ agreed with I&E’s assessment that PECO’s accumulated balance of the Pension Asset should not be categorized or described as a utility asset that is “used and useful in providing utility services to ratepayers,” and as such, should not be included as an eligible asset in the rate base claim to recover the associated carrying costs. R.D. at 48.

Additionally, the ALJ found unpersuasive PECO’s citation to the three Duquesne Light “black box” settlements in support of its claim that pension contributions should be included in rate base. The ALJ pointed to I&E’s contention that “black box” settlements are negotiated and reflect a compromise of all parties. The ALJ also explained that such negotiated settlements contain “Settlement Condition” language indicating that the settlement reflects a compromise of competing positions in that specific proceeding and is made without prejudice to a party’s position in future proceedings. According to the ALJ, allowing the outcome of a prior Commission‑approved settlement to impact the outcome of a litigated proceeding might hinder settlements in future rate cases, contrary to the Commission’s preference for negotiated settlements. R.D. at 49.

Based on the above, the ALJ recommended that the Commission reject PECO’s claim for the inclusion to rate base of PECO’s $35.1 million Pension Asset.

### PECO Exception No. 2 and Replies

In its Exception No. 2, PECO asserts that the ALJ erred in rejecting ratemaking recognition of the Company’s Pension Asset. Specifically, PECO alleges that the ALJ excluded rate recognition of the Company’s $35.1 million pension asset based on the incorrect conclusion that investor-supplied capital is not used to meet the Company’s pension contribution. PECO Exc. at 8-16 (citing R.D. at 26-29, 34-36, 42-46, and 48-49).

PECO asserts that it was a reversible error to deny rate base recognition of the Pension Asset, both because it is reasonable and necessary to include the Company’s accumulated pension costs which are not included in rate base by the application of the GAAP rules and the calculation of the pension expense under the ASC 715; and because a pension asset similar to PECO’s was approved by the Commission for inclusion in rate base in three prior base rate cases for another electric utility during the 2010 to 2018 period. PECO Exc. at 8 (citing R.D. at 48; PECO M.B.at 22-25; PECO R.B.at 13-16).

Namely, PECO argues that the ALJ improperly disregarded compelling reasons to apply the same rationale to the instant proceeding that the Commission adopted in Duquesne Light’s three successive rate proceedings. According to PECO, it was a reversible error for the ALJ to disregard the implication of the three prior cases involving Duquesne Light, on the basis that the cases were resolved by “black box” settlements. PECO characterizes the ALJ’s decision to decline to give any weight to the Commission’s approvals for Duquesne Light Company of a pension asset similar to PECO’s proposed Pension Asset, as having “sidestepped” the contradiction of disallowing a pension asset for PECO in the present case, while approving the same claim for another utility. PECO further asserts it was an error for the ALJ to adopt I&E’s and the OCA’s position that the Commission’s prior decisions are not applicable because they were granted in the context of settlements. PECO Exc. at 8‑9.

PECO also submits that the ALJ improperly ignored the material facts relevant to the prior settlements, which indicated that the pension asset issue was “carved out” from the settlement terms, and, therefore, should not be viewed in the context of the settlement, but as a separate term.PECO Exc. at 8-9, 13 (citing R.D. at 49; *Pa. PUC v. Duquesne Light Co.*, Docket No. R-2018-3000124 *et al.* ( Order entered December 20, 2018); I&E St. 3 at 35-36 (identifying pension costs capitalized by Duquesne Light based on recognition of a pension asset as a claim that I&E was not opposing); *Pa. PUC v. Duquesne Light Co.*, Docket No. R-2010-2179522 (Statement in Support of Settlement on Behalf of the Office of Consumer Advocate, p. 4, “This [settlement] represents a ‘black box settlement’ with the limited exceptions of Other Post-Employment Benefits (OPEBs) and pensions.”)).

Based on the underlying facts of the prior Duquesne Light rate cases, which, the Company argues, are material to the application of those cases in the present matter, PECO asserts that denial of its claim for recognition of its Pension Asset would:

create an irreconcilable conflict with the position the OCA had taken in three prior Duquesne Light rate cases and with the Commission’s approval of Duquesne Light’s pension asset in each of those cases – approvals that were based on the OCA’s substantive support of Duquesne Light’s claim and I&E’s total non-opposition to the pension asset claim in those prior proceedings.

PECO Exc. at 16.

Additionally, PECO asserts that the ALJ also erroneously reached his conclusion to deny the Company’s claim based on arguments by I&E and the OCA that PECO’s Pension Asset arises because of a “mismatch” between the ways pension costs are calculated for ratemaking purposes and under GAAP. PECO continues that the ALJ then incorrectly concluded that the Pension Asset does not represent a “real infusion of capital or funds by the investor/stockholders.” (PECO Exc. at 11-12 citing R.D. at 48). According to PECO, although the “mismatch” exists, its existence does not diminish the reality of the cash contributions the Company makes to its pension plan. Rather, PECO claims that the “mismatch” highlights the fact that the pension costs the ratemaking process assumes to be capitalized are not actually included in the Company’s plant accounts. PECO further argues that pension costs are a portion of total employee compensation. Therefore, PECO argues that the calculated pension costs should be treated just as the salary and wage component of employee compensation. PECO Exc. at 12-13.

In short, PECO asserts that each of the ALJ’s purported bases for rejecting PECO’s Pension Asset is factually and conceptually erroneous. Accordingly, PECO submits that the Commission should overturn the ALJ’s recommendation to disallow the inclusion in rate base of the Company’s $35.1 million Pension Asset. PECO Exc. at 16.

In their Replies, both I&E and the OCA argue that the ALJ properly recommended that PECO’s claimed $35.1 million Pension Asset be excluded from rate base. Both Parties submit that the ALJ correctly agreed with I&E and the OCA that PECO’s Pension Asset is not a reasonable or necessary inclusion in PECO’s rate base, where the allowable pension expense is appropriately calculated pursuant to applicable GAAP rules, as required by the ASC 715. I&E R. Exc. at 3; OCA R. Exc. at 2.

Regarding the underlying calculations to arrive at PECO’s Pension Asset, the OCA specifically references the discrepancy between cash and actuarial accounting methods, and notes that this creates the accounting “mismatch” which will reverse in future years over the life of the pension, and therefore should not be included in rate base. The OCA further opines that allowing such costs in rate base would permit rate base recovery on previous pension expense in violation of Commission precedent. OCA R. Exc. at 2-4 (citing R.D. at 48-49; OCA M.B. at 37-42; OCA R.B. at 15-17; PECO Exc. at 8-16).

The OCA summarizes the position of I&E and the OCA regarding the relevant accounting aspects of PECO’s Pension Asset. According to the OCA, these positions, as adopted by the ALJ, warrant the conclusion that “the Pension Asset does not represent any future infusions of cash by the Company during the Company’s test years, nor does it relate to any utility property that is used and useful in providing utility service.” The OCA continues, as follows:

It is undisputed that the Company’s claim for the Pension Asset represents cumulative differences between (1) the portion of pension expense that the Company assumes to be capitalized for ratemaking purposes (i.e., capitalization rate multiplied by the Company’s cash contribution) and what is actually capitalized to the Company’s plant accounts for financial accounting purposes (i.e., capitalization rate multiplied by the Company’s pension expense for financial reporting purposes). The mismatch arises in any given year and can go either way, but cumulatively to date is an asset of $35.1 million that is booked to the Company’s Account 186 – Miscellaneous Deferred Debits.

As OCA witness Morgan testified, however, the Company’s Account 186 is not a capital investment account, but is rather comprised of current assets, which are generally not included in rate base. Indeed, the Company acknowledged that the Pension Asset does not get depreciated or amortized like a typical capital investment account. As stated by Company witness Stefani:

The pension asset on PECO’s balance sheet represents cumulative cash contributions made by PECO in excess of PECO’s cumulative pension cost and does not get amortized to expense. The change in the pension asset represents annual contributions paid by PECO to the pension trust and annual pension cost accounted for in accordance with ASC 715.

OCA R. Exc. at 3 (citations omitted).

Based on the unique nature of the accounting requirements for the Company’s pension contributions, as summarized above, both I&E and the OCA argue that ALJ Pell correctly determined that PECO’s Pension Asset neither represents any future infusions of cash by the Company during the Company’s test years, nor relates to any utility property that is “used and useful in providing utility service.” I&E R. Exc. at 3-4; OCA R. Exc. at 3 (citing R.D. at 48 I&E M.B. at 17-18).

With respect to PECO’s reliance on three prior “black box” settlements involving Duquesne Light Company, both I&E and the OCA argue that the ALJ correctly found PECO’s reliance on those cases to be unpersuasive. Specifically, I&E asserts that the ALJ properly found that the terms of the settlement reflect a negotiated settlement of the terms involved, and therefore cannot establish an underlying rational for approval of any given term in a subsequent case, including the present case. Further, I&E stresses that there is standard language set forth in each settlement that expressly provides that the Parties are not bound by the positions taken in a settlement in any future proceeding. I&E R. Exc. at 4.

Therefore, both I&E and the OCA argue that the ALJ correctly recommended that the Company’s claim for a $35,059,000 Pension Asset in rate base be denied.

### Disposition

PECO’s claim, that its accumulated Pension Asset of $35.1 million is a reasonable and necessary addition to rate base to allow a return on those investor-supplied funds, is based upon the underlying premise that pension contributions are, for rate making purposes, indistinguishable from other capitalized expenses included in rate base, such as employee salaries. We disagree. Based upon our review of the record, the unique nature of pension contributions, PECO’s Exception No. 2, and the Replies thereto, we agree with the ALJ’s recommended disallowance of PECO’s claim for the $35.1 million Pension Asset from rate base. Therefore, for the reasons discussed more fully below, we shall deny PECO’s Exception No. 2, and adopt the ALJ’s Recommendation, thereby reducing the Company’s claimed rate base by $35,059,000.

At the outset, we shall address PECO’s reliance on Duquesne Light’s prior rate case settlements as precedent for approving PECO’s claim to include its Pension Asset in rate base. We agree with I&E and the OCA, and expressly reject PECO’s assertion, that prior rate case settlements should be afforded precedential value regarding any term approved thereunder. As the ALJ properly noted, rate case settlements are the product of compromise and should not be afforded precedential value. Further, as a general matter, such settlements routinely provide that the parties to these settlements are not bound by any term or position taken thereunder in any subsequent proceedings. To hold otherwise would have a chilling effect on the settlement process itself.

Accordingly, we reject PECO’s claim that the ALJ committed reversible error in failing to apply terms that the Parties agreed to in prior rate case settlements as precedent in the present case.

Regarding the question of whether to approve PECO’s proposal to include the $35.1 million Pension Asset in rate base, our analysis begins with the understanding that the Pension Asset arises due to the unique nature of the applicable accounting requirements for pension expenses in addition to the employer’s obligation to comply with specific pension funding requirements.

As previously noted, employers are obligated under GAAP rules and ASC 715 for financial reporting of pension expenses. These rules require that employers recognize the cost of their pension plans on an actuarial, not cash basis. Because of this unique requirement, the amount of pension expense calculated pursuant to ASC 715 is generally different than the actual amount of the employers’ contributions. As I&E and the OCA correctly described, this creates the financial accounting “mismatch” between the cash account method and the actuarial method required by ASC 715.

However, as noted by I&E and the OCA, over the life of the pension plan, the employers’ total contributions are expected to equal the total expense calculated under ASC 715. Over the course of the life of the pension, the fund can experience investment gains and losses thereby triggering resulting negative or positive expense calculations under ASC 715, which would determine whether the employer is required to make an additional pension contribution to meet funding requirements.

Generally, the employer’s funding requirements are also governed by federal standards. Employers use actuaries to determine the amounts deemed necessary to contribute to the plans to meet future pension obligations. The employers’ funding obligations, therefore, fluctuate, and are often different from the calculated ASC 715 expense in any given year.

In the present case, PECO, while experiencing a Pension Asset, proposes that it should be permitted to recover the accumulated financing costs for the employer contributions, by the inclusion of the Pension Asset in rate base, rather than restricting PECO’s recovery of pension expense to the pension expense as calculated pursuant to ASC 715.

Upon consideration of the Company’s position and the arguments posed by I&E and the OCA in opposition to allowing the Company to include the Pension Asset in rate base, we agree with I&E and the OCA that the Company’s pension expense is appropriately calculated and capitalized pursuant to ASC 715. Like the ALJ, we are not persuaded that inclusion of the Company’s Pension Asset in rate base is a reasonable and necessary means of recovery of PECO’s pension expense. As illustrated by I&E and the OCA, Pension Assets and accrued pension liabilities calculated under GAAP rules and ASC 715 fluctuate over time and are intended to equal employer’s contributions over the life of the pension. Here, we note that PECO’s points to only three cases before the Commission in which a pension asset was approved to be included in rate base, and, in contrast to the present case, each of those cases were resolved by settlements, rather than a fully-litigated examination of this complex question, and thus cannot be used for precedential purposes. We also note that while PECO theorizes that the occurrence of a pension liability would result in a corresponding reduction of rate base, PECO never previously asserted a pension liability as a basis for reducing its rate base, and in this proceeding, failed to identify a single example of any utility doing so before this Commission.

Based upon our analysis of the unique financial accounting and funding requirements associated with calculating employers’ pension expense and funding requirements, we conclude it would be unreasonable to establish that a company’s pension asset should be allowed to be recovered in rate base. In striking the appropriate balance between the interests of the company and the consumer in establishing just and reasonable rates, we conclude the better practice is to continue the existing practice of establishing the employers’ allowable pension expense by the recovery of PECO’s pension expense as calculated and capitalized under the ASC 715. Accordingly, we shall deny PECO’s Exception No. 2.

## Neighborhood Gas Pilot Rider (NGPR)

PECO’s NGPR was authorized by the Commission’s Order in *Petition of PECO Energy Company for Approval of Three Proposals Designed to Increase Access to Natural Gas Service*, Docket No. P‑2014‑2451772 (Order entered October 1, 2015). In that Order, the Commission approved a settlement, which, in part, contained a request that PECO be permitted to implement a Neighborhood Gas Pilot Program (NGPP) for residential customers. The NGPP was designed to increase access to gas service by allowing a customer to pay the contribution in aid of construction (CIAC) for a main extension through a fixed monthly surcharge, or the NGPR, over a period of twenty years, or as an up-front, lump sum payment.[[46]](#footnote-47) A pertinent aspect of the NGPP is that PECO assign all NGPP related investment costs and associated revenues to the appropriate classes through its base rates.

As explained by PECO, the NGPP originally had a three-year term and the Company’s investment under the program was limited to no more than: (1) $10 million over three years; and (2) $4 million for any particular year. On January 17, 2019, the pilot was extended from three to five years (now ending March 31, 2021) and the overall pilot investment limit was increased from $10 million to $25 million. PECO St. 9 at 11. As discussed, *infra*, in addition to certain modifications to the NGPP, the Company is proposing to extend the NGPP for five years beginning July 1, 2021 and to increase the annual NGPP cost to $7.5 million. PECO M.B. at 86.

The ALJ referenced his discussion on pages 267 through 268 of the Recommended Decision, discussed, *infra* where he recommended an annual allowance of $5 million for the Company’s NGPP, rather than the $7.5 million requested by the Company. In accordance with that recommendation, the ALJ recommended a reduction of $2.5 million to the Company’s claimed rate base for the NGPP. R.D. at 50.

Given that no Party has filed Exceptions on this issue and in consideration of our discussion in Section X.C of this Opinion and Order, *infra*, we find the ALJ’s recommendation to be reasonable. Accordingly, we shall adopt the ALJ recommendation regarding the NGPP and NGPR without further comment.

## Cash Working Capital

PECO originally included a claim for CWC of $3,223,000, which it later revised to $3,437,000, to reflect changes made in components of the CWC calculation, as described by PECO witness Michael J. Trzaska. PECO Exh. MJT-1, Schs. A-1, C-4; PECO Exh. MJT-1 Revised, Schs. A-1, C-4; PECO St. 3-R at 2-3. In the Recommended Decision, the ALJ explained that CWC represents the funds needed to pay O&M expenses and taxes that, on average, are incurred in advance of the utility’s receipt of revenues. PECO explained that it derived its CWC requirement using the accepted, Commission-approved lead-lag method. PECO St. 3 at 16-22. In addition, both I&E and the OCA agreed that the lead-lag method should be used in determining the CWC. I&E M.B. at 50; OCA M.B. at 42.

Although PECO included its CWC methodology as an uncontested item in its Main Brief, I&E and the OCA have both recommended adjustments to the Company’s CWC claim concomitant on their respective adjustments to the Company’s O&M expenses, discussed, *infra*. However, notwithstanding its opposition to the expense claim adjustments set forth by I&E and the OCA, PECO noted its agreement that the Company’s CWC should be recalculated if the Commission orders any changes to the Company’s claimed O&M expenses. PECO M.B. at 24-25.

The ALJ recommended approval of the proposal to adjust CWC consistent with any adjustment to the Company’s claimed O&M expenses because no Party disputed the methodology that the Company used in calculating its CWC and no Party challenged the Company’s proposed revenue lag, expense lag, or net lag (revenue lag minus expense lag). Accordingly, the ALJ recommended that the Company’s CWC claim be reduced by $54,001 consistent with the various adjustments proffered by I&E and the OCA. R.D. at 49-50.

We concur with the ALJ that adjusting the CWC consistent with any adjustment to the Company’s claimed O&M expenses is reasonable. As will be discussed in more detail in Section VII.R of this Opinion and Order, *infra,* regarding the Company’s expense claims, the CWC component of PECO’s rate base will be reduced by $136,580, which reflects, in part, our adjustment to O&M expenses of $19,972,406. In making this adjustment, we have applied the same methodology utilized by PECO and the ALJ and agreed upon by I&E and the OCA.

## Uncontested Issues

As shown on PECO Exhibit MJT-1, Schedules C-11 and C-13, the Company originally based its materials and supplies and gas storage inventory claims on a sum of thirteen-month averages, using data from the thirteen-month period June 2019 through June 2020. Likewise, PECO based its customer deposits and CAC claims on the thirteen-month averages of customer deposits and CAC, using data from the thirteen‑month period June 2019 through June 2020. *See* PECO Exh. MJT-1, Schs. C-7 and C-9.

I&E posited that materials and supplies, gas in storage, customer deposits, and CAC claims in the FPFTY be determined using an updated thirteen-month average ended September 30, 2020, in order to include the most up-to-date data available, as shown on I&E Exhibit 3, Schedule 1. I&E M.B. at 21.

In rebuttal testimony, PECO indicated that it did not object to I&E’s recommended adjustments to its materials and supplies, gas storage inventory, customer deposits, and CAC claims, in order to reflect data for the thirteen-months ended September 30, 2020. PECO St. 3-R at 2-3. Accordingly, PECO reflected these adjustments to its materials and supplies, gas storage inventory, customer deposits, and CAC claims calculated on Schedules C-11, C-13, C-7, and C-9 of PECO Exhibit MJT-1 Revised, respectively.

Additionally, I&E recommended that the Company provide the Commission’s Bureau of Technical Utility Services (TUS) and I&E with an update to PECO Exhibits MJT-1 and MJT-2, Schedule C-2, no later than October 31, 2021, which should include actual capital expenditures, plant additions, and retirements by month from July 1, 2020 through June 30, 2021. I&E M.B. at 21. I&E also recommended an additional update be provided comparing projected additions and retirements with actual additions and retirements through June 30, 2022, no later than October 1, 2022. *Id.*

As there were no disagreements with the aforementioned proposals and revisions, the ALJ recommended that they be approved by the Commission. R.D. at 50‑51. Given that no Party has filed Exceptions, we find the ALJ’s recommendation to be reasonable. Accordingly, we shall adopt the ALJ’s recommendation on this matter without further comment.

# Revenues and Revenue Requirement

## Revenue Requirement

### Positions of the Parties

PECO’s final proposed revenue requirement was approximately $655,990,364, representing a proposed revenue increase of $65,976,052 over *pro forma* revenues at present rates of $590,014,312.[[47]](#footnote-48) This represented a reduction of approximately $2.7 million to the Company’s initial revenue increase request of $68.7 million. PECO M.B. at Appendix A, Table I.[[48]](#footnote-49)

I&E recommended a revenue requirement of $616,358,000 for PECO. I&E noted that this recommended revenue requirement represented an increase of approximately $26,344,000 to the claimed present rate revenues of $590,014,312. Further, I&E’s recommended revenue increase of $26.3 million represented a $42.4 million reduction to PECO’s initial request of a $68.7 million increase and a 4.46% overall increase in revenue. I&E M.B. at 12.

As noted above, the OCA took the position that the Company should not receive *any* increase in revenues. Accordingly, the OCA proposed a final revenue requirement of $578,540,000, representing a revenue reduction of approximately $11,474,000 to the Company’s claimed present rate revenues. OCA M.B. at Appendix A, Table I.

### Recommended Decision

The ALJ recommended an overall revenue requirement of $613,906,529 for PECO based on the various adjustments he adopted in his Recommended Decision, resulting in an overall distribution revenue increase of $23,892,217. R.D. at 1, 419, Appendix Table 1.

### Disposition

Based upon our findings regarding certain inputs to PECO’s rate base, *supra,* and to PECO’s expenses, cost of common equity, and overall rate of return, discussed, *infra*,we shall approve an overall revenue requirement of $619,132,795, which will result in an overall distribution revenue increase of $29,118,484, on an annual basis.

## Forfeited Discounts

### Positions of the Parties

I&E proposed an adjustment to increase PECO’s *pro forma* level of forfeited discounts (*i.e.,* late payment charge revenues) by approximately $358,000, or from $926,000 to $1,284,000 under proposed rates for the FPFTY ending June 30, 2022, based on the use of a three-year average of the historic ratio of forfeited discounts with total revenues. The $1,284,000 represented 0.195% of $658,591,000 of proposed Gas Service Revenues for the year ending June 30, 2022. I&E further recommended that the forfeited discount amount should be decreased if the Commission grants less than a full increase and recommended that the Company include revenue under proposed rates from forfeited discounts equal to 0.195% of Gas Service Revenues upon determination of the total revenue granted by the Commission. I&E M.B. at 21-22.

PECO countered that forfeited discounts should be projected for the FPFTY based on their relationship to past due accounts receivable, and not to total revenues. Therefore, PECO calculated forfeited discount revenue for the FPFTY by first calculating the average forfeited discount revenue for the three years ended December 31, 2019, as a percentage of average past due accounts receivable balances for the same period. In addition, PECO reduced its FPFTY level of forfeited discount revenue to account for a permanent waiver of late fees on past due balances for customers enrolled in the Company’s CAP. PECO M.B. at 26-27.

PECO argued that it prepared a linear trend analysis to compare the relationship of forfeited discounts to past due accounts receivable and total revenues wherein it plotted indexed monthly values for revenue, past due accounts receivable, and forfeited discounts for the period from January 2012 through December 2019. PECO explained that it determined that this period was appropriate to address short-term variations, as well as the anomalous impact of the COVID-19 pandemic. PECO claimed that based on this analysis, it concluded that forfeited discounts have a much stronger relationship with past due accounts receivable than with overall revenues. PECO St. 2-R at 8-9.

I&E rebutted that the Company’s explanation of how it calculated its projected forfeited discount revenue illustrates why that projection is understated. In this regard, I&E submitted that the time period PECO chose for its analysis does not include a year in which the Company increased its rates and that its explanation of its methodology does not indicate that the increase in rates from the present base rate proceeding was factored into the analysis. Therefore, in I&E’s view, it is not possible to determine the level of accounts receivable PECO will experience as a result of the base rate increase; nor can an accurate projection of forfeited discounts be projected based on the Company’s methodology. I&E further opined that it is reasonable to expect that forfeited discounts revenues will increase when a utility’s base rates are increased as a result of a base rate proceeding. Accordingly, I&E stressed its position that a three-year average of the historic relationship of forfeited discounts and total revenue applied to the projected revenue at proposed rates remains the most reasonable method of projecting forfeited discounts because it smooths out year to year variations. I&E M.B. at 22-23.

PECO rejoined that it accounted for the impact of its proposed rate increase on its *pro forma* level of forfeited discounts by including a forfeited discount rate in the gross revenue conversion factor used to determine the Company’s revenue requirement. In addition, PECO submitted that its analysis properly excluded calendar year 2020 data in light of the effects of the pandemic on forfeited discounts. Thus, PECO contended that I&E’s proposal to calculate *pro forma* forfeited discounts based on a three-year average of the historic relationship with total revenues should be rejected. PECO M.B. at 27; PECO R.B. at 17-18.

### Recommended Decision

The ALJ found PECO’s position, outlining its methodology for calculating forfeited discounted revenue, *supra,* was persuasive. The ALJ stated that because PECO pointed out that forfeited discounts are imposed based on past due balances of accounts receivables, he agreed that PECO’s approach is reasonable and appropriately reflects the payment characteristics of PECO’s current customer base. Additionally, the ALJ found that PECO’s linear trend analysis over the period from 2012 through 2019 demonstrated that forfeited discounts have a much stronger relationship with past due accounts receivables than with overall revenues. Therefore, the ALJ recommended that PECO’s position be adopted. R.D. at 54-56.

### Disposition

No Party filed Exceptions to the ALJ’s recommendation. We find that the ALJ’s recommendation is reasonable and based on sound record evidence. Accordingly, we shall adopt the ALJ’s recommendation that approves PECO’s proposed methodology for calculating forfeited discounts revenues based on their relationship to past due accounts receivable.

# Expenses

## Payroll and Payroll Related Expense

### Positions of the Parties

PECO provided that its requested payroll allowance for the FPFTY of $42,209,000 was developed based upon its authorized and budgeted employee complement for the FPFTY of 639 full-time equivalent (FTE) positions. PECO explained that it annualized budgeted payroll expenses to reflect wage increases to be granted during the FPFTY. PECO adjusted its FPFTY budgeted data to normalize a one‑time cash payment to union employees made in connection with the ratification of PECO’s current collective bargaining agreements. PECO M.B. at 28 (citing PECO St. 3 at 34-35; PECO Exh. MJT-1 Revised, Sch. D-6).

#### The OCA’s Proposed Adjustment

The OCA proposed an adjustment to reduce payroll expenses by $2,447,000, or from $42,209,000 to $39,762,000, by: (1) adjusting the employee headcount and (2) eliminating past costs for a one-time bonus paid in exchange for ratification of the union contract on or before December 31, 2014. The OCA witness, Mr. Morgan, recommended an employee headcount of 604 positions, representing the most recent actual number of employees, reasoning that the Company did not adequately support the increase in the number of positions for the FPFTY. Mr. Morgan testified that the Company showed that there were 585 employees at the beginning of the HTY and 602 employees at the end of the HTY. Mr. Morgan noted that the Company provided that the 37 new positions the Company projects to reach the complement of 639 included 30 positions hired during the HTY and 7 positions which were for allocated[[49]](#footnote-50) employees. Accordingly, Mr. Morgan stated that the Company failed to provide the proper support for the projected increase in the number of positions that occurred during the FTY. Mr. Morgan elaborated that he had not seen any support, including management authorization, for the projected increase in the number of employees. He explained that there is no documentation that the new positions were authorized. Therefore, he reasoned that the costs related to the additional positions should not be allowed. OCA M.B. at 44‑45 (citing OCA St. 2 at 23-24).

Mr. Morgan recommended removing the normalization of the one-time cash payment for ratification of the union contract because it is a prior period cost, and recovery would constitute retroactive ratemaking and violate normal ratemaking principles. OCA M.B. at 46 (citing OCA St. 2-R at 25).

#### I&E Proposed Vacancy Rate Adjustment

I&E recommended a reduction of $858,715 based on employees’ unfilled (vacant) positions (that are budgeted in the FPFTY claim), calculated based on PECO’s historic average annual vacancy rate of 2.1% as experienced in the fiscal years ending June 30, 2018, 2019, and 2020. I&E stated that the Company’s claim, based on the assumption that it will maintain 100% full staffing levels as budgeted in the FPFTY throughout the whole year, is unrealistic since there will always be a certain number of normal vacancies due to retirements, resignations, transfers, layoffs, etc. on a day-to-day operational basis. I&E submitted that these vacancies are unpredictable and there will always be search and placement time involved in filling vacancies. I&E M.B. at 24 (citing I&E St. 1 at 12-15).

#### Employee Benefits Expense and Payroll Taxes

I&E recommended a reduction of $120,397 to the Company’s claim for employee benefits based on the reduction to payroll expense for the vacancy adjustment. I&E M.B. at 26 (citing I&E St. 1 at 16).

The OCA recommended an adjustment of $315,000 to the employee benefits expense. R.D. at 121 (citing OCA St. 2, Sch. LKM‑12).

### Recommended Decision

The ALJ agreed with the OCA’s adjustment of $2,447,000 to PECO’s payroll account based on an employee headcount for the FPFTY, finding that PECO’s headcount was not adequately supported. According to the ALJ, PECO fell substantially short of its anticipated headcount for 2020, such that its projected headcount for the FPFTY is speculative. The ALJ determined that adopting the OCA’s adjustment will lead to a reasonable and just rate, as ratepayers will not be paying for the costs of employees who have not been hired. The ALJ also recommended a corresponding adjustment to the Company’s Projected Employee Benefits expense by $315,000 to reflect 604 employees rather than 639. R.D. at 121.

The ALJ also explained that the past costs for the one-time bonus should be eliminated as these payments were made in 2015 and were not connected to any future requirement of the employees. Additionally, the ALJ stated that the Company’s attempts to recover these costs would violate the rule against retroactive ratemaking. R.D. at 121‑122.

### PECO Exception No. 3 and Replies

In its Exception No. 3, PECO contends the ALJ erred by adopting the OCA’s proposed adjustments to PECO’s payroll expense. PECO explains that its payroll expense, employee benefits and payroll taxes are based upon 639 FTE employees that PECO plans to have on its payroll for the FPFTY. PECO states that the 639-employee count includes 602 FTE employees on the Company’s payroll for the HTY ended June 30, 2020, and 37 employees that PECO plans to add by the end of the FPFTY to staff its gas operations. PECO Exc. at 16 (citing PECO St. 2-R at 10-11).

PECO also argues that although the OCA recommended the proposed adjustments to reflect an employee count of 604 FTEs, which was PECO’s actual headcount on September 30, 2020, this recommendation is contrary to the evidence. PECO provides that its actual headcount had already reached 612 employees by December 31, 2020. PECO states that it has rescheduled its Gas Mechanics School that was canceled in 2020 due to the COVID-19 pandemic. PECO explains that the Gas Mechanics School represents the Company’s hiring pool for gas operations personnel. PECO insists that it expects to have 639 FTE employees on its payroll by June 30, 2022, and likely, before that date. PECO Exc. at 17-18.

In its Replies, I&E argues that the OCA’s adjustment was correct. I&E provides that PECO experienced normal employee vacancies when the actual filled positions are compared to the budgeted monthly positions during the last three fiscal years. I&E also argues that PECO’s assertion that the 639 budgeted positions in the FPFTY do not include vacant positions is not reliable or acceptable because the Company’s FPFTY payroll expense claim is calculated based on the total budgeted 639 positions to be maintained/filled throughout the FPFTY. I&E also points out that PECO’s FPFTY budgeted positions were calculated based on 602 filled positions as of June 30, 2020, which is subject to change every month due to unpredictable normal vacancies. I&E R. Exc. at 5-6 (citing R.D. at 82).

In its Replies, the OCA submits that the ALJ’s adjustment to the Company’s Payroll Expense was proper and reasonable because the Company’s projected headcount of 639 was not supported by its historic data or by the Company’s actual hiring experience. The OCA notes that the Company failed to provide job descriptions and proof of authorization for the projected thirty-seven additional positions. OCA R. Exc. at 6-7 (citing OCA M.B. at 45-46, R.D. at 100-101). The OCA argues that the Company’s claim that it had reached a headcount of 612 by the end of 2020 should not be accepted as an accurate indication of progress towards the FPFTY projected headcount or PECO’s actual hiring experience because that number includes allocated employees, while its projected headcount of 639 employees by the end of the FPFTY does not. OCA R. Exc. at 7 (citing OCA St. 2 at 16; OCA M.B. at 45-46; R.D. at 100-101).

### Disposition

PECO provided that its claim for payroll expense, employee benefits and payroll taxes is based upon the 639 FTEs that PECO plans to have on its payroll for the FPFTY. PECO stated that it has scheduled its Gas Mechanics School for September 2021 and expects to hire at least twenty new employees from this class. However, while the Gas Mechanics School is scheduled, we note that there is no guarantee that it will occur or that PECO will find twenty or more graduates suitable for hire from this class. Therefore, we agree with the OCA that PECO failed to provide job descriptions and proof of authorization for the projected additional thirty-seven positions. We also note that while PECO provided evidence of progress toward the 639 total complement by including seven allocated positions in its 612 employee headcount as of December 31, 2020, we find the ALJ’s recommendation to adopt the OCA’s downward adjustment of $2,447,000, or from $42,209,000 to $39,762,000, to reflect an employee complement of 602 reasonable. We also agree with the ALJ’s recommendation to reduce the employee benefits expense by $315,000 to reflect the change in employee headcount. We find the elimination of the past costs for the one‑time bonus paid in 2015 to be reasonable. Accordingly, PECO’s Exception No. 3 is denied.

## Contracting and Material Expenses

### Positions of the Parties

PECO provided that it is seeking recovery of contracting and materials expenses of $42,955,000 in the FPFTY. PECO explained that there are three principal drivers in the Company’s increase in contracting and materials expense over the HTY booked amounts budgeted for the FTY and FPFTY: (1) gas mapping system enhancements and gas mapping projects in the FTY; (2) planned activities to reduce PECO’s non-emergent leak backlog; and (3) increased security expenses for PECO crews working in high-crime areas during the FTY. PECO M.B. at 31.

I&E recommended reducing the Company’s claim by approximately $10 million based on an average of the last three years’ expense. I&E M.B. at 27. I&E provided that in PECO’s discovery responses the Company stated that the increase in its FTY expense claim was due to lower than expected spending in the HTY caused by the impact of COVID-19 pandemic-related restrictions. I&E M.B. at 27 (citing I&E St. 1‑SR; I&E Exh. 1, Sch. 9 at 2). I&E explained that the Company mentioned additional planned activities for the FTY that increase the FTY claim, but the Company did not provide the projected FTY and FPFTY spending for each of the planned additional activities, such as a breakdown of contracting and materials expenses by category, and the basis of projection for these expenses to be incurred in the FTY and FPFTY. I&E further submitted that in the absence of a detailed explanation and support for the significant increase of 51.09% from the HTY to the FTY expense claim, neither the FTY nor the FPFTY expense claim is reasonable, prudent, or reliable because the FTY increase is reflected in the FPFTY claim. I&E M.B. at 27-28 (citing PECO St. 2-R at 19; I&E St. 1-SR at 34).

I&E noted that PECO has experienced budgeted underspent expense levels in the prior three fiscal years. Specifically, PECO’s actual contracting and materials expenses were underspent by 11.42% in 2017-18, 2.76% in 2018-2019, and 24.46% in 2019-20, as compared to the budgeted expense in the respective fiscal years. I&E stated that it is speculative to assume that the impact of COVID-19 pandemic related restrictions will diminish completely in the FTY and FPFTY and the Company will be able to spend the entire budgeted amount in those periods. I&E M.B. at 28 (citing I&E St. 1 at 39; I&E St. 1-SR at 34).

The OCA provided that the Company increased the FPFTY amount for Contracting and Materials Expense by approximately $400,000 over the HTY amount in the aggregate. OCA M.B. at 48 (citing PECO St. 3, Exh. MJT-1, Sch. D-4 at 55-56). The OCA witness Mr. Morgan testified that the Company did not offer a specific reason for the increase, but rather attributed it to “inflation adjustments.” OCA M.B. at 48 (citing OCA St. 1 at 39 (quoting the Company’s response)). The OCA reasoned that the specifics of the inflation adjustments are unknown and should not be accepted by the Commission. OCA M.B. at 49 (citing OCA St. 2 at 39-40). Therefore, the OCA recommended that the most recent actual three-year average level of contracting expenses should be used, and the Contracting and Materials expense be reduced by $367,000. OCA M.B. at 50 (citing OCA St. 2, Sch. LKM-23).

### Recommended Decision

The ALJ agreed with I&E’s recommendation to reduce the Company’s claim by $10,015,000 based on an average of PECO’s last three years of contracting and materials expenses. The ALJ reasoned that it would be speculative at best to assume that the pandemic will not have any impact on the Company’s projects in the FTY and FPFTY and that the Company will be able to spend its entire budgeted amount for those periods. R.D. at 122.

### PECO Exception No. 4 and Replies

In its Exception No. 4, PECO provides that it employed a rigorous budgeting process to determine its FTY and FPFTY O&M expenditures (including contracting and materials expense) and has recovered from initial COVID-19 pandemic related construction delays that had affected its operations and maintenance projects for part of 2020. PECO Exc. at 21-22 (citing PECO St. 2 at 10-12; PECO St. 2-R at 2; Tr. at 249‑51). PECO contends that there is no valid basis to assume that the pandemic will have any impact on the Company’s projects in the FTY and FPFTY. PECO Exc. at 22.

PECO avers that it originally intended to file its base rate case in March 2020 with a HTY ended December 31, 2019. However, PECO delayed its filing by six months due to the COVID-19 pandemic for the benefit of customers. PECO Exc. at 22 (citing Tr. at 250-51). PECO explains that due to this delay, the Company refreshed the budget that was already approved by senior management and used the most up-to-date information to accommodate the use of a fiscal year ending in June (*i.e*., an HTY ended June 30, 2020). PECO submits that the updated budget reflected PECO’s most current information regarding customer load, capital expenses, O&M expenses, depreciation and amortization expense, and interest and tax expense. Since the update occurred approximately four months into the COVID-19 emergency, PECO contends that the update reflected impacts resulting from the pandemic. PECO Exc. at 22 (citing PECO St. 2-R at 2-3; Tr. at 249-51).

PECO states that it provided detailed testimony regarding the specific projects driving the increases in FTY and FPFTY contracting and materials expense. The Company expects to incur approximately $8 million in incremental spending over prior years in both the FTY and FPFTY. PECO Exc. at 23 (citing PECO M.B. at 31-32, PECO Exh. MJT-1 Revised, Sch. D-4; PECO St. 2-R at 17-19; Tr. at 252-53). PECO avers that the ALJ’s recommendation did not address this evidence. PECO Exc. at 23.

PECO states that its witness, Mr. Bradley testified that the Company is “back to normal” and has procedures in place for its employees and contractors so that construction projects are not expected to be delayed. PECO Exc. at 23-24 (citing Tr. at 218). PECO explains that it underspent its contracting and materials expense in recent years, but that the 2018-2019 underspending was de minimis (2.76%) and the HTY (24.6%) underspending was due to the COVID-19 pandemic impacts in the early months of the pandemic, which are not expected to impact contracting and materials expenses in the future. PECO Exc. at 24 (citing Tr. at 251-53).

In its Replies, I&E provides that the ALJ correctly reasoned, as noted by I&E, that the Company’s actual contracting and materials expense was underspent in 2017, 2018, and 2019. I&E maintains that although the Company asserts that its reduced contracting and materials expenses in 2020 were the result of work stoppages due to the COVID-19 pandemic, ALJ Pell agreed with I&E that it would be speculative at best to assume that the pandemic will not have any impact on the Company’s projects in the FTY and FPFTY and that the Company will be able to spend its entire budgeted amount for those periods. I&E R. Exc. at 7 (citing R.D. at 122).

In its Replies, the OCA submits that the Company was underspending on contracting and materials expenses well before the COVID-19 pandemic, and the Company’s use of an inflation factor in determining an increase in this expense area is inappropriate. OCA R. Exc. at 8 (citing OCA M.B. at 48-49; R.D. at 122). The OCA states that the Company’s significantly-increased contracting and materials expense claim is unreasonable and unjustified, and the Commission should accept I&E’s reasonable three‑year average calculation. OCA R. Exc. at 8.

### Disposition

We agree with the OCA that the Company did not provide the specifics of the inflation adjustment it used to project contracting and materials expenses for the FTY and FPFTY. While PECO contends that the COVID-19 pandemic will not affect its construction program, we agree with the ALJ that the impacts of the pandemic on PECO’s construction program are not certain. We find the ALJ’s recommendation to utilize the three-year average of construction and materials expenses as a basis to reduce the Company’s claim for this expense by $10,015,000, or from $42,955,000 to $32,940,000, to be reasonable and substantiated by the record evidence. Accordingly, PECO’s Exception No. 4 is denied.

## Outside Services (Including EBSC Charges)

### Positions of the Parties

PECO’s claim for Outside Services expenses is $22 million in the FPFTY and includes EBSC charges for services such as information technology, finance, human resources, and legal, etc. PECO M.B. at 33.

PECO provided that Attachment III-A-22(a) to PECO’s initial filing shows that the Company’s HTY actual outside services expense was $21,640,000. PECO projected a slight decrease in FTY outside services expenses to $21,093,000 with a slight increase to $22,135,000 in the FPFTY. According to PECO, this represents an increase of approximately 4.9% over the FTY, but only an approximately 2.25% increase over the HTY, which is lower than the Company’s historical three-year average for outside services expense. PECO M.B. at 34 (citing RJS-2R at 16-17).

While PECO stated its outside services claim is approximately $22 million, as provided in PECO Exh. RJS-1, I&E used $16,572,000 (FERC Account 923) as its starting point for the outside services claim as provided in PECO Exh. MJT-1, Schedule D-4 at 56. I&E recommended an allowance of $13,437,856, or a reduction of $3,134,144 ($16,572,000 - $13,437,856), to the Company’s claim for outside services net of the “cost to achieve”[[50]](#footnote-51) adjustment of $370,000. I&E M.B. at 29 (citing I&E St. 1 at 20; I&E St. 1‑SR at 17).

I&E explained that the Company argues that because the FPFTY claim for total EBSC charges is $22,000,000 and the FTY claim of $21,000,000 is lower than the historic three-year average; the FPFTY claim for EBSC is consistent with the historic three-year average. I&E also noted that PECO clarifies that the FPFTY outside services expense claim of $16,572,000 (FERC Account 923) represents a combination of: (a) EBSC contracting charges (a subset of total EBSC charges); and (b) PECO contracting charges, allocated to FERC Account 923. I&E M.B. at 29-30 (citing PECO St. 2-R at 15‑17).

I&E stated that PECO has been experiencing a declining trend in both the EBSC costs and the contracting service costs for the three years prior to the FTY. I&E stated that the FPFTY EBSC claim of $15,290,000 is higher by 15.53% over the historic three-year average of $13,234,000. The FPFTY contracting service claim of $726,000 is higher by 15.79% over the historic three-year average of $627,000. I&E M.B. at 30 (citing I&E St. 1-SR at 15-16, Table at 16).

I&E took the position that adjusting the HTY actual outside services for inflation based on the Consumer Price Index (CPI) factors of 2.75% and 2.03% to determine the FTY and FPFTY allowance is fair and reasonable despite the decline in actual outside services expense by 3.17% in 2018-2019 and 15.40% in 2019‑2020. I&E M.B. at 31 (citing I&E St. 1 at 20-22; I&E St. 1-SR at 17).

The OCA witness Mr. Morgan recommended an adjustment to EBSC charges because he disagreed with the use of inflation escalations as the basis in increase to costs. Mr. Morgan testified that the inflation adjustment should not have been used as the EBSC costs are subject to similar budget preparation guidelines as those used by PECO. According to the OCA, while it was possible to obtain proper budget forecast information, the Company chose to use the shortcut of an inflation escalation. OCA M.B. at 52 (citing OCA St. 2-SR at 21). The OCA recommended the use of the most recent three-year EBSC expense which results in a reduction of $997,000. OCA M.B. at 52-53 (citing OCA St. 2 at 36-37, Sch. LKM-20).

### Recommended Decision

The ALJ agreed with I&E that the Company’s claimed increase in outside services expenses is overstated and unsupported. The ALJ found that I&E witness Mr. D.C. Patel’s testimony that the Company had been experiencing a declining trend in both the EBSC costs and the contracting service costs for the three years prior to the FTY was particularly persuasive. The ALJ also agreed with I&E’s argument that the use of inflation factors to determine a *pro forma* expense allowance is acceptable if the inflation factors used are specified and the determined amounts are supported by calculations. The ALJ concluded that did not happen here and recommended that the Commission adopt I&E’s proposed allowance of $13,437,856 for outside services. R.D. at 123-24 (citing *Pa. PUC v. Citizens’ Elec. Co. of Lewisburg PA*, Docket No. R-2019-3008212 (Order entered April 27, 2020)).

### PECO Exception No. 5 and Replies

In its Exception No. 5, PECO provides that it is seeking recovery of approximately $22,135,000 in outside services expenses in the FPFTY. PECO states that its HTY actual outside services expense was $21,648,000 and the Company’s FTY claim was $21,093,000. PECO reiterates that the Company’s FPFTY claim represents an increase of approximately 4.9% over the FTY, but only an approximately 2.25% increase over the HTY. PECO submits that its FPFTY claim is also lower than the Company’s historical three-year average for outside services expense. PECO Exc. at 24-25 (citing PECO M.B. at 34; PECO Exh. RJS-2 at 16-17).

PECO refutes I&E’s contention, as echoed by the ALJ, that the Company has been experiencing a declining trend in costs from EBSC and other contracting service costs and that the Company failed to support its proposed increase in outside services expense from HTY to the FTY. PECO Exc. at 25 (citing I&E M.B. at 29-31; R.D. at 122-23). PECO avers that the ALJ ignored PECO’s testimony that I&E is utilizing incorrect numbers to determine its recommended adjustment and is incorrectly deriving its conclusions based on the portion of outside service costs in FERC Account 923 only while ignoring the portions of outside service costs in other FERC accounts. PECO argues that applying I&E’s proposed methodology to the correct numbers would yield an even greater claim for outside services expense than the Company is seeking. PECO R. Exc. at 25.

According to PECO, I&E witness Mr. Patel should have utilized the GAAP-based projections set forth in PECO Exh. RJS-1 and Attachment III-A-22(a), which were included in the Company’s initial filing. PECO R. Exc. at 26 (citing PECO M.B. at 34; PECO Exh. RJS-2 at 16-17). PECO continues that when Mr. Patel’s CPI factors are applied to the HTY data set forth in Attachment III-A-22(a), a greater FPFTY amount is generated than requested by the Company. PECO R. Exc. at 26.

PECO submits that considering the Company’s proposal as set forth in PECO Exh. RJS-1 and Attachment III-A-22(a) shows that PECO’s claim for an approximately 2.25% increase from the HTY to the FPFTY is reasonable. PECO asserts that, as I&E concedes, the use of inflationary factors to determine *pro forma* expense allowance is consistent with Commission policy. PECO R .Exc. at 26.

In its Replies, I&E provides that the ALJ correctly agreed with I&E’s argument that the use of inflation factors to determine a *pro forma* expense allowance is acceptable if the inflation factors used are specified and the determined amounts are supported by calculations. I&E R. Exc. at 8 (citing R.D. at 123-24). I&E insists that the Company’s increase of 26.55% in the FTY over the HTY actual expense and additional 4.57% increase for the FPFTY are unsupported. I&E R. Exc. at 8 (citing R.D. at 122).

### Disposition

I&E recommended an allowance of $13,437,856 (a reduction of $3,134,144) to the Company’s claim for outside services net of the cost to achieve adjustment of $370,000. I&E used CPI factors of 2.75% and 2.03% to determine the FTY and FPFTY allowance by adjusting the HTY actual outside services for inflation. Along with the ALJ, we agree with I&E’s argument that the Company’s increase of 26.55% in the FTY over HTY actual expense and an additional 4.57% increase for the FPFTY are unsupported. We further agree with the ALJ and I&E that the Company did not provide the inflation factors or calculations it used to calculate the outside services claim. Accordingly, PECO’s Exception No. 5 is denied.

## Other Post-Employment Benefits Expenses

### Positions of the Parties

PECO offered that it provides medical-related benefits to eligible retirees through its parent company, Exelon’s OPEB plan. PECO claimed $1,050,000 of OPEB expense in the FPFTY, adding that this is a significant increase in OPEB expense when compared to prior years. The Company explained that beginning in 2015, PECO began providing a defined contribution to eligible retirees for use in purchasing Medicare coverage. PECO M.B. at 36 (citing PECO St. 2-R at 25-27); PECO R.B. at 24. PECO elaborated that this change in the Company’s retirement plan resulted in a “re‑measurement” of its OPEB obligation, which led to a prior service credit in other comprehensive income. *Id.* (citing PECO St. 2-R at 27).

The Company noted that the prior service credit was amortized over the average remaining service period of the active plan participants (approximately seven years), and in June 2021, the amortization period will expire, resulting in an increase to its FPFTY OPEB expense. Further, PECO noted that the expiration of the prior service credit in June 2021 is a known and measurable event, as confirmed by the Company’s independent third-party actuary, resulting in an increase to OPEB expense in the FPFTY. Moreover, PECO asserted that the testimony of its witness, Mr. Stefani, regarding the creation and amortization period of the prior service credit, as well as the actuarial reports provided by the independent third-party, comprise substantial evidence to support the Company’s OPEB claim. PECO R.B. at 24-25 (citing PECO M.B. at 37; PECO St. 2-R at 25-28; PECO Exhs. RJS-1RJ at 15, RJS-2RJ at 15, and RJS-3RJ at 3).

I&E recommended an allowance of $270,000, or a reduction of $780,000, for the Company’s OPEB expense, based on continuing the FTY claim as the FPFTY allowance, because PECO’s projected increases in its FTY and FPFTY claims are based on unsupported assumptions and are, therefore, not reasonable or reliable. I&E argued that its recommendation is reasonable and appropriate in the absence of detailed information from the Company regarding the service credit adjustments reflected in the OPEB costs of the last three fiscal years and the adjustments made to the FTY and FPFTY OPEB claims. I&E R.B. at 21-22 (citing I&E M.B. at 32-33); I&E St. 1-SR at 38-39.

The OCA contended that the Commission should adopt the recommendation of its witness, Mr. Morgan, who adjusted the Company’s OPEB expense to reflect the most-recent three-year average of actual and projected OPEB costs, resulting in a downward adjustment of $486,000 to PECO’s OPEB expense claim. The OCA explained that in order to capture PECO’s predicted increase in OPEB expense due to the prior service credit expiration, Mr. Morgan averaged the Company’s actual and projected OPEB expense for the years 2020-2022. The OCA noted that, regarding the Company’s focus on the expiration of the prior service credits, fluctuation of OPEB expense is based on many assumptions that could affect the level of OPEB expense and, therefore, a normalization adjustment is recommended. OCA R.B. at 28-29 (citing OCA St. 2-SR, Sch. LKM-3 at 1; OCA St. 2 at 26-27).

### Recommended Decision

The ALJ recommended that the Commission adopt the OCA’s proposed reduction of $486,000 to the Company’s OPEB claim. The ALJ agreed with the OCA’s approach in this instance that, in order to properly capture the Company’s predicted rise in OPEB expense due to the expiration of the prior service credit in 2021, the actual and projected OPEB expenses for the years 2020-2022 should be averaged, which will reflect a more accurate and normalized level of OPEB expenses. The ALJ noted that OPEB expenses can fluctuate from year to year and, therefore, the normalization adjustment recommended by the OCA is reasonable. R.D. at 124.

### PECO Exception No. 6 and Replies

In its Exception No. 6, PECO argues that the ALJ erred in adopting the OCA’s proposal to normalize PECO’s OPEB expense over a three-year period. PECO repeats its argument that the prior service credit, which emerged due to a change in its medical plan, is currently being amortized over the average remaining service period of the active plan participants, but the expiration of the service credit at the end of the FTY will cause OPEB expense to increase from the FTY to the FPFTY. PECO maintains that it wants to recover the increase in OPEB expense that is attributable to the loss of that amortization. PECO also submits that the ALJ’s rationale, to adopt the OCA’s proposed normalization in order to capture the predicted rise in OPEB expense resulting from the expiration of the prior service credit, is in conflict with the purpose of normalization, which is to identify and remove non-annual events. PECO elaborates that normalizing OPEB expense over a three-year period when two of those years include the application of prior service credits set to expire after the end of the FTY will result in an unfair downward recovery. PECO Exc. at 26-28 (citing R.D. at 124; PECO St. 2‑R at 25-28; James H. Cawley & Norman J. Kennard, *A Guide to Utility Ratemaking* at 85 (2018 ed.)).

In its Replies, the OCA counters that PECO’s concerns regarding OPEB expense were resolved in the OCA’s recommendation because the three-year normalization period uses actual and estimated OPEB costs from 2020-2022 and, therefore, properly captures the anticipated increase in OPEB expense in 2021 while also reflecting a normalized level of OPEB expense, which can fluctuate from year to year for a variety of reasons. OCA R. Exc. at 8-9 (citing R.D. at 124; OCA St. 2-SR, Sch. LKM‑13; OCA M.B. at 53-54).

### Disposition

We agree with the ALJ’s recommendation that the OCA’s proposed adjustment to OPEB expense, in which actual and projected OPEB expense for the years 2020-2022 are averaged, will reflect a level of OPEB expense that is more accurate and reasonable. We are persuaded by the OCA’s argument that its proposed adjustment calculation, which utilizes the Company’s actual and estimated OPEB costs from 2020‑2022, will include the projected increase in OPEB expenses that will result from the expiration of the prior service credit amortization. We also agree with the OCA’s argument that OPEB expense has a propensity for fluctuation from year to year. Therefore, we shall deny PECO’s Exception No. 6 and adopt the ALJ’s recommendation to reduce the OPEB expense claim by $486,000, or from $1,050,000 to $564,000.

## Costs to Achieve Exelon/PHI Merger

### Positions of the Parties

PECO proposed amortizing, over a three-year period, recovery of $1,111,000 in costs incurred from savings that the Company and its customers realized as a result of the 2016 merger of PECO’s parent company, Exelon, with Pepco Holdings, Inc. PECO asserted that the merger-related expenses were unanticipated, extraordinary, and non-recurring, and that PECO’s customers have experienced, and will continue to experience, cost savings from the merger. PECO R.B. at 26-27 (citing PECO M.B. at 37‑38; PECO St. 2-R at 12-14).

I&E and the OCA recommended that the Commission disallow all of the claimed merger-related expenses, asserting that recovery of such costs would result in retroactive ratemaking absent prior Commission permission and the Company’s customers have not experienced a rate reduction as a result of the merger. I&E R.B. at 22-23; OCA M.B. at 54-55; OCA R.B. at 29-30. I&E further contended that the merger-related costs were incurred prior to the HTY and the merger-related savings were realized in prior years. I&E R.B. at 23 (citing I&E M.B. at 34). The OCA also argued that utilities undergo mergers often, and therefore, merger-related costs are not unanticipated, extraordinary, or nonrecurring. OCA R.B. at 29-30.

### Recommended Decision

The ALJ recommended that PECO’s proposal to recover $1,111,000 for recovery of costs to achieve merger expenses be rejected in its entirety. The ALJ agreed with I&E and the OCA’s arguments that: (1) the claim for recovery of merger-related costs would result in retroactive ratemaking in the absence of the Commission’s prior permission to defer such costs for ratemaking purposes; (2) the merger costs were incurred prior to the HTY and the offsetting merger related savings were realized in prior years; and (3) PECO has retained the savings generated from the merger and, as a result of the merger, PECO’s customers have not experienced a reduction in rates. R.D. at 125.

### Disposition

No Party filed Exceptions on this issue. Finding the ALJ’s recommendation to be reasonable and supported by substantial evidence in the record, we shall adopt it without further comment.

## Regulatory Commission Expenses/General Assessments

### Positions of the Parties

PECO provided that the OCA witness Mr. Morgan proposed an adjustment to reduce PECO’s claim for regulatory commission expenses to the HTY level of general assessments for the Commission, the OCA and the OSBA, based on the premise that PECO did not explain in detail the nature of the projected increase of $462,000 in the FPFTY. PECO M.B. at 39 (citing OCA St. 2 at 38; OCA Sch. LKM-22). PECO witness Mr. Stefani explained that the Company’s actual 2020-2021 (FTY) general assessments totaling $2,022,423, which is an increase of 16.6% over the HTY level of expense, substantiates the Company’s FPFTY claim of $2,197,000. PECO argued that its inflation adjustment was reasonable, as using the actual 16.6% would result in a higher claim than the Company requested. PECO M.B. at 39-40 (citing PECO St. 2-R at 20; PECO Exh. RJS-2-R).

### Recommended Decision

The ALJ agreed with PECO’s position that the Company’s actual FTY increase of $288,000 (16%) over the HTY level of expense substantiates the Company’s FPFTY claim of $2,197,000.[[51]](#footnote-52) The ALJ found the Company’s argument that to use the 16% increase in the FPFTY would result in an even greater claimed expense to be persuasive, as well. The ALJ reasoned that using an inflation factor in this case is appropriate. R.D. at 125-26.

### OCA Exception No. 3 and Replies

In its Exception No. 3, the OCA disagrees with the ALJ’s assessment that PECO’s regulatory commission expense will increase by 16.6% between the FTY and FPFTY because it is speculative and not supported by evidence. OCA Exc. at 11 (citing R.D. at 125-26). The OCA provides that pursuant to Section 510 of the Code, the general assessment for Commission operations can fluctuate from year to year depending on the Commission’s budget and how that budget is allocated across each group of utilities. OCA Exc. at 11 (citing 66 Pa. C.S. § 510). The OCA explained that its witness, Mr. Morgan, adjusted the Company’s claim to remove an inflation adjustment. The OCA remains of the opinion that an adjustment to reflect the HTY level of regulatory commission expense to reduce O&M expenses by $462,000 should be made. OCA Exc. At 11 (citing OCA St. 2, Sch. LKM-22).

In its Replies, PECO provides that the OCA’s exception on this issue focuses on its general disagreement with adjustments based on inflation escalations. PECO argues that the use of inflation factors in PECO’s budgeting process is appropriate where there are not specifically known changes in costs or activity levels. PECO R. Exc.at 8. PECO notes that the OCA also speculates that PECO’s expense could fluctuate up or down in the FPFTY depending on how general assessments are allocated to utilities. PECO R. Exc. at 8 (citing OCA Exc. at 11). PECO argues that the OCA did not present any evidence that would suggest that PECO’s general assessments in the FPFTY would decrease all the way to the HTY level. PECO R. Exc. at 8-9.

### Disposition

We agree with the ALJ’s recommendation to accept PECO’s inflation adjustment for this expense. The OCA recommendation to reduce the claim to the HTY amount is unreasonable. We concur with the ALJ that the use of the inflation adjustment in this instance is reasonable. Therefore, we shall adopt the ALJ’s recommendation approving the Company’s claim of $2,197,000 for Regulatory Commission Expenses and general assessments. The OCA’s Exception No. 3 is denied.

## Research and Development Expenses

### Positions of the Parties

PECO stated that the Company’s FPFTY claim for Research and Development (R&D) expense of $280,000 was based on sound budgeting techniques. PECO noted that the OCA witness Mr. Morgan proposed to reduce the claim by $180,000 by using the three-year average of R&D expense. PECO M.B. at 40 (citing OCA St. 2 at 37; OCA Sch. LKM-21). PECO provided that its historic R&D expense level for the years ended June 30, 2018 and 2019 was abnormally low because a significant amount of the R&D budget was redeployed to offset higher priority needs to manage gas operating expenses, such as emergent gas leak events. PECO M.B. at 40 (citing St. 2-R at 20).

The OCA noted that the Company’s requested amount of $280,000 is abnormally high compared to prior years. According to the OCA, the Company’s R&D expense ranged from $59,000 in 2018 to $253,000 in 2020. Mr. Morgan testified that the Company did not provide any information or data that would explain the increase. OCA M.B. at 56 (citing OCA St. 2, Sch. LKM-21; OCA St. 2 at 37).

### Recommended Decision

The ALJ agreed with the OCA that the Company did not provide support or reasoning for its proposed increase to R&D expenses from previous years. The ALJ also disagreed with the Company’s argument that using the three-year average would introduce an anomaly as the Company repurposed R&D funds for other higher priority needs such as emergent gas leaks. The ALJ reasoned that the Company’s use of R&D funding for other purposes leads to a reasonable conclusion that the entire amount is not justified. R.D. at 126.

### Disposition

None of the Parties filed Exceptions on this issue. We agree with the ALJ’s recommendation to adopt the OCA’s proposal to reduce the Company’s Research and Development expense by $138,000, or from $280,000 to $142,000, based upon the Company’s three‑year average spending. Accordingly, we shall adopt the ALJ’s recommendation on this matter.

## Employee Activity Costs

### Positions of the Parties

PECO proposed a claim of $139,402 for certain employee activities including the Company’s annual picnic and other special events in which PECO provides employee recognition. PECO M.B. at 41 (citing PECO St. 2-R at 21).

I&E recommended an allowance of $58,469, or a reduction of $80,933, to the Company’s claim for employee activity costs. I&E recommended the disallowance of the Company’s employee picnic and celebration expenses of $80,933, reasoning that these expenses are not necessary for the provision of safe and reliable gas service to ratepayers. I&E M.B. at 37 (citing I&E St. 1 at 26).

The OCA witness Mr. Morgan recommended adjusting the expense by $71,000 to reflect the HTY spending level because of the uncertainty of the COVID-19 pandemic and the ability of the Company’s employees to assemble. OCA M.B. at 57 (citing OCA St. 2 at 40).

### Recommended Decision

The ALJ recommended the adoption of the OCA’s proposal to reduce the Company’s claim for Employee Activity Costs by $71,000. The ALJ agreed with the OCA that in light of the COVID-19 pandemic, the Company’s $71,000 increase over the HTY spending level is highly speculative. R.D. at 127.

### Disposition

None of the Parties filed Exceptions on this issue. We agree with the ALJ’s recommendation to adopt the OCA’s proposal to reduce the Employee Activity Costs expense by $71,000, or from $139,402 to $68,402, based upon the in-person nature of the employee activities and the potential for long-lasting effects of the pandemic. Accordingly, we shall adopt the ALJ’s recommendation on this matter.

## Travel, Meals, and Entertainment

### Positions of the Parties

PECO proposed a claim of $1,032,000 for Travel, Meals, and Entertainment expense. PECO provided that both I&E and the OCA proposed adjustments to the Company’s claim. I&E proposed to apply inflation factors to PECO’s HTY expense to arrive at its allowance of $862,153, representing a reduction of $169,847. PECO M.B. at 42 (citing I&E St. 1 at 41-42; I&E St. 1-SR at 35-37). The OCA proposed to disallow all but PECO’s HTY level of expense, resulting in a downward adjustment of $178,000. PECO M.B. at 42 (citing OCA St 2 at 41; OCA sch. LKM-25).

### Recommended Decision

The ALJ agreed with the OCA’s adjustment that reduces the Company’s claim for Travel, Meals and Entertainment expense by $178,000. The ALJ agreed with the OCA that rather than base the level of expense on a forecast determined from 2018 and 2019 activity, this expense should be adjusted to reflect the HTY level of expense. R.D. at 128.

### Disposition

None of the Parties filed Exceptions on this issue. We agree with the ALJ’s recommendation to adopt the OCA’s proposal to reduce the Travel, Meals and Entertainment expense by $178,000, or from $1,032,000 to $854,000. We find the Company’s argument that the decline in business travel will be alleviated during the FPFTY to be speculative. Accordingly, we shall adopt the ALJ’s recommendation on this matter.

## Membership Dues

### Positions of the Parties

PECO claimed $646,899 in the FTY and $655,897 in the FPFTY for membership dues expense. According to PECO, I&E witness Mr. Patel recommended a reduction of $67,762 in the FPFTY, contending that the Company failed to properly support its claim and recommended that the Commission reduce the Company’s claim by applying inflation factors of 2.75% and 2.03% to the Company’s HTY membership dues to determine the FTY and FPFTY expenses. PECO M.B. at 42-43 (citing I&E St. 1 at 27-29; I&E St. 1-R at 22-25). PECO provided that its actual membership dues have fluctuated over the prior three years and I&E’s adjustment would reduce PECO’s claim below the historic average of actual membership dues (approximately $612,000 over the three years ended June 30, 2020). PECO M.B. at 43 (citing PECO St. 2-R at 23).

### Recommended Decision

The ALJ agreed with I&E that the increases proposed by the Company are speculative and unreliable because they are not consistent with acceptable inflation rates. The ALJ recommended that the Commission adopt I&E’s proposal to reduce the Company’s claim for Membership Dues expense by $67,762. R.D. at 128.

### Disposition

None of the Parties filed Exceptions on this issue. We agree with the ALJ’s recommendation to adopt I&E’s proposal to reduce the Membership Dues expense by $67,762, or from $655,897 to $588,135. Accordingly, we shall adopt the ALJ’s recommendation on this matter.

## Injuries and Damages

### Positions of the Parties

PECO stated that its FPFTY claim for injuries and damages expense of $638,000 is derived from a third-party actuarial report obtained by the Company and shared with the Parties. According to PECO, the OCA witness, Mr. Morgan, proposed to normalize the Company’s claim for injuries and damages expense based on the Company’s historical three-year average resulting in a $464,000 downward adjustment. PECO M.B. at 43 (citing OCA St. 2 at 30; OCA St. 2-SR at 23-24, Sch. LKM-16). PECO took the position that utilizing the three-year average would be unreasonable as it would include a negative $9,000 expense for the twelve months ended June 30, 2019 due to an actuarial update to the Company’s workers’ compensation, bodily injury, and property damage reserve. The prior year’s actual expense for the twelve months ended June 30, 2018 was $301,000, and the following year’s actual expense for the twelve months ended June 30, 2020 was $231,000. PECO M.B. at 43-44 (citing PECO St. 2-R at 24).

The OCA witness Mr. Morgan testified that “the amount included in the cost of service for Injuries and Damages is significantly higher than previous years.” OCA M.B. at 60 (citing OCA St. 2 at 30). The OCA provided that no single year is representative of the normal level of Injuries and Damages because this expense fluctuates from year to year. Mr. Morgan recommended normalizing the expense based on the most recent three years of actual expenses “to avoid an over-recovery of costs.” *Id.*

### Recommended Decision

The ALJ agreed with the OCA that normalization of the Injuries and Damages expense is the appropriate methodology for calculating this expense for the FPFTY. The ALJ reasoned that while the one-year negative expense will have an impact on the average, the average is the “best approach to smooth out the effects of this expense that occurs at regular intervals but in irregular amounts.” R.D. at 129.

### PECO Exception No. 7 and Replies

In its Exception No. 7, PECO provides that the OCA proposed to normalize the Company’s claim for Injuries and Damages expense based on the Company’s historical three-year average, which would result in a $464,000 downward adjustment. PECO Exc. at 28 (citing OCA M.B. at 59-61). PECO submits that the negative $9,000 amount for the twelve months ended June 30, 2019 was an aberration and the result of an actuarial update to the workers’ compensation, bodily injury and property damage reserve for that period. PECO Exc. at 28-29 (citing PECO M.B. at 43-44). PECO contends that the negative amount for 2019 is the type of aberration that normalization attempts to avoid being reflected in rates, as it would unreasonably skew the Company’s three-year average downward. PECO Exc. at 29 (citing PECO M.B. at 43-44; PECO St. 2-R at 24).

In its Replies, the OCA provides that the ratemaking technique of normalization is “used to smooth out the effects of an expense item that occurs at regular intervals, but in irregular amounts, and is a proper adjustment to make the test year expense representative of normal operations.” OCA R. Exc. at 10 (citing *Pa. PUC v. Total Environmental Solutions, Inc.*, 2008 Pa. PUC LEXIS 42 at \*98). The OCA notes that its witness, Mr. Morgan, testified that PECO’s claim was significantly higher than previous years, and that no single year is representative of the normal level of Injuries and Damages because this expense fluctuates from year to year. OCA R. Exc. at 10 (citing OCA M.B. at 60; OCA R.B. at 36, OCA St. 2 at 30). The OCA reasons that while the Company argues that the negative $9,000 expenses was an abnormality, it provides no evidence that suggests that abnormalities such as this one will not happen again, which is why normalizing this expense is the most appropriate method of calculating the expense. OCA R. Exc. at 10.

### Disposition

We find that the claimed expense of $638,000 derived from a third-party actuarial report is significantly higher than the previous years’ amounts, even if one ignores the negative $9,000 actuarial adjustment in 2019. We agree with the OCA that the Company has not justified why the claimed expense is so much greater than recent years’ expense. We concur with the ALJ that it is reasonable to accept the OCA’s downward adjustment of $464,000 to the Injuries and Damages expense, resulting in a reduction from $638,000 to $174,000. Accordingly, PECO Exception No. 7 is denied and the ALJ’s recommendation on this matter is adopted.

## Property Taxes

### Positions of the Parties

PECO provided that its claim for property tax expense was based on the Company’s most recent actual property tax bills from 136 municipalities, with an adjustment to apply a 2.5% inflation factor. PECO M.B. at 44 (citing PECO St. 2-R at 24-25). According to PECO, the OCA witness Mr. Morgan adjusted the Company’s claim downward by eliminating the application of the 2.5% inflation factor, which would result in a downward adjustment of $112,000. PECO argued that it is reasonable to assume that the Company’s property tax will increase consistent with the inflation adjustment. PECO explained that the entire budgeted amount for property taxes is comprised of two components: Public Utility Realty Tax (PURTA) and real estate tax. PECO noted that its budgeted amounts for PURTA do not reflect an inflation rate since they were derived directly from the 2019 Pennsylvania PURTA Notice of Determination. PECO M.B. at 44 - 45 (citing PECO St. 2-R at 24-25; PECO Ex. RJS-3-R). PECO maintained that its application of a 2.5% inflation factor was reasonable and consistent with Commission practice and Mr. Morgan’s adjustment should be rejected. PECO submitted that eliminating the 2.5% inflation factor solely from the real estate tax portion of the Company’s claim for property taxes (to which it was applied by the Company) would reduce the Company’s claim by $61,395 rather than the $112,000 reduction proposed by the OCA. PECO M.B. at 45.

### Recommended Decision

The ALJ found the Company’s use of the 2.5% inflation factor to calculate its Property tax expense reasonable. The ALJ recommended that the Commission accept the Company’s as-claimed Property Tax expense. R.D. at 130.

### OCA Exception No. 3 and Replies

In its Exception No. 3, the OCA maintains its position, as provided above in the discussion regarding the Regulatory Commission Expenses/General Assessments, that adjustments based on inflation escalations “are not actually known and measurable.” OCA Exc. at 10 (citing OCA M.B. at 55-56; OCA R.B. at 30-32). The OCA submits that its witness, Mr. Morgan, recommended that the “costs should be based upon evidence or documentation that supports the Company’s adjustments.” OCA Exc. at 10 (citing OCA M.B. at 62, OCA St. 2 at 42). The OCA continues to recommend an adjustment to remove the effect of the inflation escalation on the real estate tax component of the property tax expense, which would reduce the Company’s taxes other than income by $61,395. OCA Exc. at 10-11 (citing OCA R.B., App. A, Table II).

In its Replies, PECO explains that the OCA tries to characterize PECO’s property tax claim as an instance of a blanket inflation adjustment applied to numerous expense claims. PECO notes that the case OCA cited to in its argument at page 10 of its Exceptions involved a utility applying an inflation adjustment to seventeen expense items. PECO R. Exc. at 9 (citing OCA Exc. at 10; *Pa. PUC v. Nat’l Fuel Gas Dist. Corp.*, 1994 Pa. PUC LEXIS 135, \*137-38). PECO contends that the proposed 2.5% increase is a targeted adjustment for a specific expense. PECO argues that inflation adjustments have been approved where specific expense items are expected to increase in the future, the increase cannot be precisely determined, and the inflation increase is a reasonable proxy. PECO R. Exc. at 9 (citing *Pa. PUC v. Pennsylvania Gas and Water Co.*, 1993 WL 856537, \*31).

### Disposition

We find that the use of an inflation adjustment in this instance is a reasonable approach to estimate property taxes. It is not a blanket use of an inflation adjustment but rather a targeted approach that yields a reasonable proxy for an amount that must be determined. We agree with the ALJ’s recommendation to accept PECO’s claim for Property Taxes. As we stated *supra* in the Disposition for Regulatory Commission Expenses/General Assessments, the OCA Exception No. 3 is denied. Accordingly, we shall adopt the ALJ’s recommendation on this matter.

## Energy Efficiency and Conservation Program Costs

### Positions of the Parties

PECO provided that it requested $4.5 million in annual funding for its gas EE&C programs. According to PECO, this funding request would increase the annual budget of the gas EE&C program and allow PECO to expand program offerings to residential customers and income-eligible customers, pursue innovative pilot projects, and support new marketing and outreach to increase customer participation in the program. PECO M.B. at 45 (citing PECO St. 9 at 6-10; PECO St. 9-R at 4-6). PECO revised its analysis to correct certain calculation errors identified by the OCA witness Mr. Geoffrey C. Crandall. PECO submitted that the revised analysis found that the proposed program had a total resource cost (TRC) of 1.02 and is cost effective. PECO M.B. at 45 (citing PECO St. 9-R at 2-3).

I&E recommended a reduction of $1,772,500 to the expanded EE&C program cost. I&E M.B. at 43 (citing I&E St. 1 at 34). I&E noted the limited success rate of PECO’s current rebate programs and low participation in available programs. I&E stated that PECO has experienced significant unspent EE&C funding at an average of 43.24% of annual customer funding during the last three fiscal years, which was required to be refunded back to the customers. I&E M.B. at 44 (citing I&E St. 1 at 34‑35). I&E submitted that although PECO has operated its EE&C program since 2010‑2011, the program has averaged customer participation of only 3,501 customers out of approximately 534,000 customers over the last three years. I&E M.B. at 44 (citing I&E St. 1-SR at 30, citing PECO St. 1 at 2). I&E contended that since natural gas prices are at historic lows, usage reductions will not translate into significant annual savings for those customers who implement energy conservation measures, and those measures will require long payback periods. I&E M.B. at 45 (citing I&E St. 1-SR at 29-34).

The OCA recommended that the Commission should deny the Company’s proposed expansion of its residential EE&C programs. The OCA noted that over the past several years the Company has underspent its existing budget for EE&C programs by a significant margin. According to the OCA, the TRC analysis provided by the Company demonstrates that the Company’s proposed portfolio is only marginally cost-effective. OCA M.B. at 62. The OCA stated that the Commission should adopt the OCA’s recommendation of maintaining the existing budget and a portfolio proposed by the OCA witness Mr. Crandall. OCA M.B. at 62-63. The OCA’s recommendation reduces the Company’s claim by $2.492 million. OCA M.B. at 63 (citing OCA St. 2 at 41; OCA St. 2-SR, Sch. LKM-26, Line 3).

CAUSE-PA stated that it is generally supportive of EE&C initiatives but notes that the low-income program component of PECO’s EE&C Plan – the Safe and Efficient Heating Program (SEHP) – requires adjustment to ensure equitable and proportionate distribution of program benefits to economically vulnerable households. CAUSE-PA noted that the SEHP is available to low-income homeowners with income at or below 100% of the federal poverty level (FPL) and will replace a limited number of furnaces over twenty-five years old and boilers over thirty years old. CAUSE-PA explained that the program will be administered by a Conservation Service Provider (CSP) and will be funded at $1 million. CAUSE-PA M.B. at 37 (citing CAUSE-PA St. 1 at 45-46).

CAUSE-PA expressed concern about the lack of proportional EE&C programming for low-income consumers, who help to finance the programs through rates. CAUSE-PA offered that while PECO’s voluntary EE&C program is not strictly subject to the program standard as required by Act 129, PECO’s voluntary, rate-payer supported EE&C programs must still be just, reasonable, and in the public interest. CAUSE-PA M.B. at 38 (citing 66 Pa. C.S. § 2806.1, *et seq.*). CAUSE-PA contended that the Commission should require PECO to include additional opportunities within its general residential program for low-income consumers to access energy efficient equipment and programming without an upfront cost. CAUSE-PA M.B. at 38‑39 (citing CAUSE-PA St. 1 at 48).

CAUSE-PA offered that the eligibility standards for PECO’s SEHP are unreasonably restrictive in that it is available only to homeowners with income at or below 100% FPL. CAUSE-PA proposed that PECO expand eligibility to the SEHP to include tenants and those with income between 101-150% FPL. CAUSE-PA M.B. at 39.

CAUSE-PA asserted that PECO has not set forth any information regarding how its SEHP will be coordinated with PECO’s other low-income programming. CAUSE-PA recommended the Commission require PECO to work with stakeholders and interested parties to develop a specific plan for coordinating its voluntary natural gas EE&C with other EE&C programs, including but not limited to LIURP, Act 129, and the Weatherization Assistance Program (WAP). CAUSE-PA M.B. at 39.

### Recommended Decision

The ALJ agreed with I&E’s recommendation to reduce the Company’s claimed EE&C costs by $1,772,500, or from $4.5 million to $2,727,500, based on the Company’s limited historical success rate of its current rebate programs. The ALJ reasoned that the Company’s projected increase in customer participation in the FPFTY is speculative, unreasonable, and not supported by historic participation levels. R.D. at 130-31.

### Exceptions and Replies

#### OCA Exception No. 4 and Replies

In its Exception No. 4, the OCA provides that I&E’s adjustment would grant the Company a small increase ($719,500) to its EE&C budget which is not supported.[[52]](#footnote-53) The OCA contends that the Commission should adopt the recommendation of OCA to maintain PECO’s existing budget of $2.008 million. OCA Exc. at 13 (citing OCA M.B. at 28-29). The OCA argues that the Commission should require the Company to re-allocate its existing EE&C budget among a mix of existing and new programs in accordance with the recommendation of the OCA witness Mr. Crandall. OCA Exc. at 13 (citing OCA M.B. at 155; OCA St. 6 at 30).

According to the OCA, the Company’s proposed EE&C portfolio would have a TRC value of anywhere slightly below or slightly above one. The OCA submits that Mr. Crandall’s recommended portfolio has a TRC value well above one. OCA Exc. at 13 (citing OCA St. 6-SR at 9). Mr. Crandall’s portfolio would include a mix of residential rebate programs for efficient furnaces and smart thermostats, among others, and the Low-Income Safe and Efficient Heating Program (SEHP) as initially proposed by the Company. OCA Exc. at 13 (citing OCA M.B. at 155, OCA St. 6 at 30).

The OCA avers that its witness Mr. Crandall noted that the Company did not perform evaluation, measurement and verification (EMV) studies for its existing programs, making it difficult to assess the effectiveness of the Company’s existing programs. OCA Exc. at 14 (citing OCA St. 6 at 3). According to the OCA, the Company agreed that it would perform the EMV studies and submit them during its next rate case filing for evaluation. OCA Exc. at 14 (citing OCA St. 6 at 37-38; PECO St. 9-R at 9-10). The OCA avers that the Commission should require the Company to perform these analyses and submit them during its next rate case proceeding. OCA Exc. at 14.

Additionally, the OCA provides that PECO proposed to continue its current practice of reconciling unspent residential EE&C funds and returning those unspent funds to customers through its universal service fund charge. The OCA avers that the Company acknowledges that its existing commercial EE&C programs had no such reconciliation mechanism. Mr. Crandall recommends that PECO use a reconciliation mechanism for commercial customers. OCA Exc. at 14 (citing OCA St. 6 at 35-36). The OCA avers that the Company agreed to implement this reconciliation mechanism. OCA Exc. at 14 (citing PECO St. 9-R at 10). The OCA submits that the ALJ erred by not adopting this recommendation and the Commission should adopt this reconciliation mechanism for the Company’s commercial EE&C programs.

In its Replies, PECO notes that the ALJ adopted I&E’s proposal to reduce PECO’s claimed costs by $1,772,500 in light of historic EE&C spending, resulting in an annual EE&C budget of $2,727,500. PECO R. Exc. at 17 (citing R.D. at 130-31). According to PECO, the ALJ did not make any findings about the content of PECO’s proposed programs, or the programmatic recommendations of the OCA and CAUSE-PA. The ALJ stated that PECO “should accommodate any and all new program costs within its existing budget.” PECO R. Exc. at 17 (citing R.D. at 130).

While PECO did not take exception to the ALJ’s EE&C budget recommendation, PECO opposes the additional budget reduction recommended by the OCA. PECO explains that if the Commission does not approve any increase to its budget, PECO could proceed to offer its expanded suite of rebates within budget limitations but could not support the SEHP (which has a proposed annual budget of $1 million) or pilot programs (which have a proposed annual budget of $125,000). PECO explains further that if the Commission approves the ALJ’s budget recommendation, PECO could implement the SEHP it proposed, but only with a reduced annual budget. PECO R. Exc. at 17-18.

PECO asserts that under any budget outcome, the Commission should reject the programmatic changes recommended by the OCA and CAUSE-PA. PECO avers that its portfolio provides an appropriately broad range of EE&C opportunities while remaining cost-effective. PECO argues that the OCA’s proposal would unnecessarily limit customer opportunities and that CAUSE-PA’s recommendations would drive up portfolio costs with no commensurate increase in available funding. PECO R. Exc. at 18 (citing PECO M.B. at 87-89; PECO R.B. at 56-59).

In its Replies, I&E agrees with the ALJ’s recommendation to reduce the Company’s EE&C budget claim by $1,772,500. I&E R. Exc. at 16-17.

#### CAUSE-PA Exception No. 4 and Replies

In its Exception No. 4, CAUSE-PA provides that the ALJ adopted I&E’s recommendation to reduce PECO’s claimed EE&C cost by $1,772,500, but the ALJ failed to indicate which portion of the proposed programming would be scaled back to reflect this decrease in funding. In addition, CAUSE-PA notes that the ALJ did not address CAUSE-PA’s recommendation regarding PECO’s EE&C plan that would help address identified deficiencies in PECO’s EE&C program reach for low-income consumers. CAUSE-PA Exc. at 19-20.

CAUSE-PA argues that ordering PECO to use the $1,772,500 to remediate the deficiencies in PECO’s rebate program and address low-income access to its EE&C programs is a better solution than disallowing the funding. If the funds are disallowed, CAUSE-PA maintains that PECO should still be ordered to implement its SEHP as modified by CAUSE-PA’s reforms to ensure that low-income customers are able to benefit from the EE&C programs equitably. CAUSE-PA Exc. at 20 (citing CAUSE-PA M.B. at 40).

CAUSE-PA notes that its witness Mr. Miller pointed out that despite making up an estimated 20% of PECO’s residential customers, low-income customers make up just 1% of those projected to be served through PECO’s EE&C Plan. CAUSE-PA claims that low-income savings are projected at only 0.72% of savings achieved through the program for the general residential class. CAUSE-PA Exc. at 21 (citing CAUSE-PA St. 1 at 46).

CAUSE-PA put forward several program updates for PECO to improve access for low-income customers, including:

* Allow all PECO customers with income at or below 150% of the Federal Poverty Level (FPL) to participate in its low-income EE&C program, including both homeowners and tenants.
* Include additional opportunities within PECO’s general residential program for low-income consumers to access energy efficient equipment without any customer contribution.
* Require PECO to host a collaborative meting to develop a specific plan for coordinating voluntary EE&C programs with other related programs available to PECO’s low-income customers.

CAUSE-PA Exc. at 21 (citing CAUSE-PA St. 1 at 47-48).

CAUSE-PA submits that the ALJ summarized CAUSE-PA’s recommendations but did not address the recommendations in the disposition. CAUSE‑PA Exc. at 21 (citing R.D. at 263-65). CAUSE-PA notes that the ALJ found that the Company should not be permitted to increase its annual funding for EE&C programs because past customer participation levels have not met projections and program expenditures have been significantly less than the budgeted amounts. CAUSE‑PA Exc. at 21 (citing R.D. at 130-31). CAUSE-PA puts forward that Mr. Miller’s recommendations to improve access for low-income households by removing cost barriers to EE&C participation would help alleviate these problems, had they not been overlooked. CAUSE-PA Exc. at 21.

CAUSE-PA explains that PECO’s SEHP is designed to target low-income homeowners with income at or below 100% FPL and will replace a limited number of furnaces over 25 years old and boilers over 30 years old. CAUSE-PA Exc. at 22 (citing CAUSE-PA St. 1 at 45). Mr. Miller was supportive of the program and provided that these direct installations will help reduce heating costs for households with old and inefficient heating and hot water systems. CAUSE-PA Exc. at 22 (citing CAUSE-PA M.B. at 37). CAUSE-PA submits that these measures are not generally available to low-income households through other programming, which only provides services when a system is inoperable. CAUSE-PA Exc. at 22 (citing CAUSE-PA M.B. at 38).

In its Replies provided *supra*, PECO addressed both the OCA and CAUSE‑PA’s recommendations for changes to PECO’s EE&C programs.

In its Replies, I&E provides that the ALJ’s statement that the Company should accommodate any and all new program costs within its existing budget presumably includes any and all CAUSE-PA recommendations. I&E R. Exc. at 24 (citing R.D. at 130).

In its Replies, the OCA reiterates its position that the Company should not be permitted to receive an increase to its annual funding amount as allowed by the modest increase granted by the adjustment of I&E. OCA R. Exc. at 18 (citing OCA Exc. at 11-14). The OCA contends that the Commission should reject CAUSE‑PA’s request to grant PECO its proposed EE&C budget increase. The OCA maintains that PECO should be able to accommodate the requests of CAUSE-PA within its existing budget. The OCA provides that it supports the Low-Income SEHP and notes that its witness Mr. Crandall recommends approval of the Company’s proposed Low-Income SEHP within its existing budget. OCA Replies at 18 (citing OCA St. 6 at 33-34).

### Disposition

We agree with the ALJ’s recommendation to adopt I&E’s reduction to the EE&C expense. The ALJ concluded the reduction was reasonable due to the historic low levels of participation in the EE&C programs and PECO’s underspending of the EE&C budget. We agree. We note that the ALJ’s reduction allows for a modest increase of $719,500 in PECO’s EE&C expense from its previous budget amount. ($2,727,500 (allowance) - $2,008,000 (existing budget) = $719,500). OCA Exc. at 12, n.12. We will not remove this increase as the OCA recommended.

The OCA recommended that PECO adopt programmatic changes, including a reallocation of PECO’s existing EE&C budget among a mix of existing and new programs in accordance with the recommendations of the OCA witness Mr. Crandall. The OCA argued that Mr. Crandall’s recommended portfolio contains a mix of existing and new programs that would be more cost-effective and has a TRC value above one. PECO has provided that the OCA proposed eliminating certain measures and sharply reducing the available budgets for others. We agree with PECO that OCA’s proposal could unnecessarily limit customer opportunities.

Regarding CAUSE-PA’s recommended programmatic changes to PECO’s EE&C programs, we agree with CAUSE-PA that there is potential for PECO to make its savings targets reach more low-income households. CAUSE-PA provides that PECO projects to serve approximately 27,664 consumers through its EE&C programs, but only 289 (1%) of those will be low-income customers. CAUSE-PA notes that projected savings achieved for low-income customers are disproportionally low, just 3,529 MCF out of the 492,983 MCF savings projected for the residential class, amounting to just 0.72% of the overall EE&C program savings. CAUSE-PA Exc. at 22 (citing CAUSE-PA St. 1 at 46). PECO has stated that,

[i]f the Commission does not approve any increase to its budget, PECO could proceed to offer its expanded suite of rebates within budget limitations but could not support the SEHP (which has a proposed annual budget of $1 million) or pilot programs (which have a proposed annual budget of $125,000). If the Commission approves the ALJ’s budget recommendation, PECO could implement the SEHP as proposed by the Company, but only with a reduced annual budget.

PECO R. Exc. at 17-18. The ALJ’s recommendation has allowed for an increase of $719,500 over the existing budget. We note that PECO has agreed to hold a collaborative meeting to discuss the coordination of the Company’s EE&C program with other services for low-income customers. PECO St. 9-R at 9. We encourage PECO to carefully review its EE&C programs overall and to apply this funding to low-income programs such as the SEHP with the goal of increasing equitable low-income household participation.

Based on the forgoing discussion, the OCA’s Exception No. 4 and CAUSE‑PA’s Exception No. 4 are denied. Accordingly, we shall adopt the ALJ’s recommendation on this matter consistent with the discussion above.

## Rate Cost Expenses Normalization

### Positions of the Parties

PECO proposed an allowance for rate case expense of $1.6 million to be amortized over three years. PECO noted that its projected need for rate relief in three years will be driven by the capital requirements of the Company’s planned infrastructure improvement programs. PECO witness Mr. Stefani testified that PECO needs to invest approximately $1.2 billion in new and replacement gas utility plant between July 1, 2020 and June 30, 2024. PECO M.B. at 47 (citing PECO St. 2 at 3). PECO stated that with that level of investment and even marginal year-over-year increases in O&M expense, it is not reasonable to assume that PECO could delay a subsequent base rate filing for five years. PECO M.B. at 47 (citing PECO St. 3-R at 22).

I&E recommended a five-year normalization period for PECO’s rate case expense, based on PECO’s historic rate case filing frequency, and stated that PECO’s claimed three-year period is speculative in nature. I&E M.B. at 46-47 (citing I&E St. 1 at 8-11).

The OCA recommended that the Commission reduce the rate case expense by $208,000. The OCA argued that the normalization period should be five years to reflect PECO’s rate case filing history more accurately. The OCA noted that PECO’s last rate case filing was approximately ten years ago. The OCA provided that the Company’s rate case expense claim of $1.5 million is based on the inclusion of the fees for legal services and consultants to prepare and adjudicate the present case. OCA M.B. at 63 (citing OCA St. 2 at 30). The OCA’s witness Mr. Morgan also suggested that the five‑year normalization period can better reflect the potential savings the Company may gain from holding virtual proceedings in decreased travel and document reproduction. OCA M.B. at 64 (citing OCA St. 2 at 31).

### Recommended Decision

The ALJ agreed with I&E and the OCA that the Company’s rate case expense should be normalized over five years. The ALJ noted that in the recent *Columbia Gas* case, the Commission indicated that “the normalization period should align with the historic data rather than the Company’s assertion” as to when it is likely to file its next base rate case. The ALJ provided that the appropriate length of time for normalization for the Company’s rate case is five years. R.D. at 131.

### PECO Exception No. 8 and Replies

In its Exception No. 8, PECO avers that the three-year amortization period is based on the Company’s expectations that it will need to file a base rate case in three years due to PECO’s planned investment of $1.2 billion in new and replacement gas plant between July 1, 2020 and June 30, 2024. PECO Exc. at 29-30. PECO maintains that it has provided evidence of substantial planned investments which, along with O&M expenses, would require the Company to file a rate case within three years. PECO Exc. at 30 (citing PECO R.B. at 47). PECO submits that the Commission has previously affirmed that it is appropriate to consider evidence regarding the need for rate relief, such as ongoing capital improvements, in determining the appropriate normalization period for rate case expense. PECO Exc. at 30 (citing *UGI Electric*).

In its Replies, I&E maintains that the Company’s rate case expense should be normalized over a five-year period. I&E puts forward that the ALJ properly noted, in the recent *Columbia Gas* case, the Commission indicated that “the normalization period should align with the historic data rather than the Company’s assertion” as to when it is likely to file its next base rate case. I&E R. Exc. at 9 (citing R.D. at 131; *Columbia Gas* at 78-79). I&E asserts that the ALJ properly concluded, based on PECO’s filing history, that the appropriate length of time for normalization for the Company’s rate case expense is five years. I&E R. Exc. at 9 (citing R.D. at 131).

In its Replies, the OCA provides that the Commission has consistently held that rate case expenses are normal operating expenses, and normalization should, therefore, be based on the historical frequency of the utility’s rate filings. OCA R. Exc. at 11. According to the OCA, in recent cases, the Commission reiterates that the normalization period is determined by “examining the utility’s actual historical rate filings, not upon the utility’s intentions.” OCA R. Exc. at 11 (citing *P**a. PUC v. City of Lancaster*, Docket No. R-2010-2179103 (Order entered July 14, 2011) (*Lancaster 2011*); *P**a. PUC v. Metropolitan Edison Co.*, Docket No. R-00061366 (Order entered January 11, 2007); *P**a. PUC v. City of Dubois – Bureau of Water*, Docket No. R‑2016‑2554150 (Order entered May 18, 2017), at 65 (*City of Dubois*)).

### Disposition

We agree with the ALJ that, based on the historic filing frequency of the Company, a five-year normalization period is appropriate for the rate case expense. While the Company asserts that it will need to file within three years, we cannot rely on the Company’s assertion, as there is no guarantee the Company will make the capital investments it projects. As the Commission found in the recent *Columbia Gas* case, a normalization period based on the actual historic filing frequency is more reliable than future speculation or the stated intention to file a rate case. *See Columbia Gas* at 78‑79. For these reasons, PECO Exception No. 8 is denied, and we shall adopt the ALJ’s recommendation on this matter.

## Regulatory Initiatives

### Positions of the Parties

PECO claimed $47,000 to amortize over three years the O&M and depreciation expenses that the Company incurred to establish a Gas Procurement Charge (GPC) and Merchant Function Charge (MFC) pursuant to the Commission-approved settlement of PECO’s natural gas unbundling rate proceeding at Docket No. P‑2012‑2328614 (Gas Unbundling Settlement). PECO M.B. at 48 (citing PECO St. 3 at 40; PECO St. 3-R at 4, 24; PECO Exh. MJT-1 Revised, Sch. D-14).

I&E recommended an updated allowance of $28,200 to the regulatory initiative cost claim based on a five-year amortization period, representing a reduction of $18,000 to the Company’s claim. I&E M.B. at 48 (citing I&E St. 1-SR at 27).

The OCA recommended that the Company not be allowed to recover O&M expenses related to the implementation of the GPC and MFC, as these costs were not allowed to be deferred under the terms of the settlement reached in the Gas Unbundling Settlement. According to the OCA, the settlement only allows recovery of the IT-related capital costs. OCA M.B. at 67 (citing OCA St. 2 at 32). The OCA recommended a downward adjustment of $40,000. OCA M.B. at 47 (citing OCA St. 2-R, Sch. LKM-18).

### Recommended Decision

The ALJ agreed with I&E’s recommendation that a five-year amortization is appropriate and is consistent with I&E’s five-year normalization for rate case expense. R.D. at 132.

### Disposition

No Party filed Exceptions on this issue. We find that the ALJ’s recommendation is reasonable and supported by substantial evidence on the record. However, we note that Table II of the ALJ’s rate tables in the Appendix attached to the Recommended Decision, setting forth the ALJ’s recommended adjustments, inadvertently indicates an upward adjustment of $18,000 to the Company’s claim. Consistent with the above, the adjustment should instead represent a downward adjustment of $18,000 to the Company’s claim. Table II of the Commission Tables Calculating Allowed Revenue Increase that accompanies this Opinion and Order appropriately reflects this downward adjustment, which will have a downward effect on the final revenue requirement for PECO in this proceeding. Therefore, we shall adopt the ALJ’s recommendation consistent with this discussion.

## Manufactured Gas Plant Remediation Expenses

### Positions of the Parties

PECO stated that it had undertaken efforts to remediate former manufactured gas plant (MGP) sites in its service territory consistent with standards established by the Pennsylvania Department of Environmental Protection (PADEP). PECO plans to achieve regulatory closure with PADEP for twenty-four of the twenty-six presently identified MGP sites by the end of 2023. PECO M.B. at 49 (citing PECO St. 1 at 13-14). PECO claimed $804,000 to amortize over a period of nine years the $7.237 million that the Company will not have recovered through current rates for its MGP remediation liability by June 30, 2021. PECO M.B. at 49-50 (citing PECO St. 3 at 39-40; PECO Exh. MJT-1 Revised, Sch. D-13).

The OCA provided that the Company claims that it has eight remaining sites with an overall estimated liability of $21.5 million to remediate, $7.237 million of which it has not yet recovered. The OCA offered that the $14.3 million the Company has pre-collected represents an over-collection of ratepayer funds that is being held by the Company. OCA M.B. at 68 (citing OCA St. 2 at 28).

The OCA recommends that the Commission require the Company to recover the remaining remediation cost over a fourteen-year period which is consistent with the settlement in Docket No., R-2010-2161592 rather than the nine-year period the Company requested, resulting in an annual recovery of $517,000 and a downward adjustment of $287,000 to the Company’s O&M expenses. OCA M.B. at 68-70 (citing OCA St. 2 at 29-30, Sch. LKM-15). The OCA also recommended that the Company be required to impute carrying costs on the over-collected MGP remediation cost that is held by the Company. OCA M.B. at 68 (citing OCA St. 2 at 30).

The OCA stated that the Company agreed to impute carrying costs on the over-collected MGP remediation cost that is held by the Company and the Commission should require the Company to do so. OCA M.B. at 70 (citing PECO St. 3-R at 26).

### Recommended Decision

The ALJ agreed with the OCA that the MGP Remediation Expense should be recovered over a fourteen-year period as opposed to the Company’s requested nine-year period. The ALJ provided that the Settlement at Docket No. R-2010-2161592 is consistent with the fourteen-year period and it is reasonable to extend the recovery of the remaining remediation costs over the fourteen-year period. The ALJ found the Company’s approach of paying interest on the monthly balance of MGP funds that are not yet spent on remediation activities at the residential mortgage lending rate specified by the Secretary of the Pennsylvania Department of Banking and Securities after July 1, 2021, when new rates will take effect, to be reasonable. R.D. at 133.

### Disposition

No Party filed Exceptions on this issue. We are of the opinion that the ALJ’s recommendation on this issue is just and reasonable. Accordingly, we shall adopt the ALJ’s recommendation that requires the Company to recover the remaining remediation cost over a fourteen-year period, resulting in an annual recovery of $517,000 and a downward adjustment of $287,000 to the Company’s claim.

## Depreciation Expense

### Positions of the Parties

PECO has claimed an annual depreciation expense allowance of $86,146,000 for the FPFTY based on depreciation calculations prepared by Ms. Fulginiti. *See* PECO Exh. MJT-1 Revised, Sch. D-1. Although no Party disputed the reasonableness of the Company’s proposed depreciation rates, the OCA and I&E have recommended adjustments to its claimed depreciation expense. *See* OCA St. 2 at 41; I&E St. 3 at 12-14. PECO maintains that these adjustments, however, are concomitant to their proposed adjustments to accrued depreciation related to plant additions and, therefore, should be rejected for the reasons discussed related to rate base, *infra*. PECO MB at 51.

Consistent with its recommended plant in service adjustment, the OCA recommended a derivative adjustment that lowers the Company’s claimed FPFTY depreciation expense by $7,827,000. *See* OCA M.B. at 70; *see also* OCA St. 2, Sch. LKM-27.

Similarly, I&E recommended that the Company’s FPFTY depreciation expense claim be reduced by approximately $804,000, consistent with its recommendation to remove a portion of the Natural Gas Reliability project plant addition *infra*. I&E St. 3-SR at 8.

### Recommended Decision

After making the necessary derivative adjustments to the Company’s accumulated depreciation to reflect his recommended reduction of $46,820,803 to PECO’s claimed FPFTY rate base, the ALJ recommended that the Commission adopt I&E’s associated adjustment that reduces the Company’s proposed depreciation expenses by $804,000.[[53]](#footnote-54) R.D. at 47, 134.

### PECO Exception No. 10 and Replies

In its Exception No. 10, PECO argues that the Commission should reject the ALJ’s recommended adjustment to depreciation expense for the reasons set forth in its Exception No. 1. PECO Exc. at 32.

In Replies, I&E submits that the ALJ’s recommended adjustment to the Company’s proposed plant in service is proper and his corresponding adjustment to the depreciation expense is proper as well. I&E R. Exc. at 11.

### Disposition

As discussed above, we have modified the ALJ’s recommendation and rejected I&E’s proposed adjustment to remove a portion of the Natural Gas Reliability project plant addition from the Company’s FPFTY plant in service claim. Consistent with this finding, we shall also decline to make a concomitant adjustment to the Company’s proposed annual depreciation expense. Accordingly, we shall modify the ALJ’s recommendation and grant PECO’s Exception No. 10.

## Cash Working Capital

### Positions of the Parties

CWC represents the funds needed to pay O&M expenses and taxes that, on average, are incurred in advance of the utility’s receipt of revenues. PECO calculated its cash working capital requirement using the lead-lag method. R.D. at 49-50 (citing PECO St. 3 at 16-22; PECO Exh. MJT-1 (Revised), Sch. C-4). No party disputed the methodology that the Company employed or challenged its proposed revenue lag, expense lag or net lag (revenue lag minus expense lag). However, because O&M expenses are an input to the calculation of cash working capital, adjustments to working capital will be made in accordance with total O&M operating adjustments adopted in this proceeding. R.D. at 50.

I&E recommended an allowance of $3,135,234, representing a reduction of $301,766 ($3,437,000 - $3,135,234) to the Company’s final CWC claim. However, I&E noted that its recommendation is not a final recommendation. In this regard, I&E explained that all adjustments to the Company’s claims must be continually brought together in the ALJ’s Recommended Decision and again in the Commission’s Final Order. I&E continued that this process, known as “iteration,” effectively prevents the determination of a precise calculation until all adjustments have been made to the Company’s claims. I&E MB at 50.

### Recommended Decision

The ALJ did not specify a final recommended CWC, noting I&E’s recommendation and explanation, *supra.*  R.D. at 99. However, in the rate tables set forth in the Appendix accompanying the Recommended Decision, Table II: Summary of Adjustments shows a total downward adjustment to the Company’s O&M expenses of $19,934,806. Additionally, Table VI: Cash Working Capital-O&M Expense shows a downward adjustment to the O&M Expense component of the cash working capital of $91,783. Finally, Table II shows a net overall downward adjustment to cash working capital of $54,001.

### Disposition

Based on the above discussion of the adjustments to PECO’s individual expense claims, we have approved a total downward adjustment to the Company’s O&M expenses of $19,972,406. The cash working capital components related to interest and dividends, taxes, and O&M expense result in a net overall reduction of $136,580 to the Company’s cash working capital.[[54]](#footnote-55)

# Taxes

## Payroll Tax Expense

### Positions of the Parties

PECO claimed a payroll tax expense of $3,776,000. This amount was determined using budgeted amounts for the FPFTY, with *pro forma* adjustments to payroll taxes to reflect the impact of the FPFTY salary and wage adjustments. PECO St. 2‑R at 9-11, PECO Exhibit MJT-1, Sch. D-16.

I&E recommended an allowance of $3,699,145 for payroll taxes, or a reduction of $76,855 ($3,776,000 - $3,699,145) to the Company’s claim. I&E’s recommendation for its reduction to payroll taxes was made to reflect the tax effects associated with its proposed reduction to Payroll Expense, *supra*. I&E M.B. at 50-51.

Due to its proposed reduction to Payroll Expense, the OCA stated there is a corresponding effect on payroll taxes since payroll taxes are calculated as a percentage of payroll. The OCA recommended a reduction to payroll taxes of $187,000. OCA M.B. at 71-72.

### Recommended Decision

The ALJ noted that in considering PECO’s proposed payroll expense, *supra,* he accepted the OCA’s proposed downward adjustment of $2,447,000. The ALJ concurred with the OCA that, due to the aforementioned reduction to Payroll Expense, there is a corresponding effect on payroll taxes since payroll taxes are calculated as a percentage of payroll. Accordingly, the ALJ agreed with the OCA that the Company’s claimed payroll taxes should be reduced by $187,000. RD at 137.

### PECO Exception No. 3 and Replies

In its Exception No. 3, PECO claims the ALJ improperly adopted the OCA’s proposed adjustments to Payroll Expense, employee benefits and payroll taxes. PECO Exc. at 16-20.

In its Replies to PECO’s Exception No. 3, *supra,* I&E disagrees with PECO’s claim and states the ALJ correctly recommended adopting the OCA’s adjustments. I&E R. Exc. at 5.

In its Replies to PECO’s Exception No. 3, the OCA states the ALJ properly reduced Payroll Expenses. OCA R. Exc. at 6.

### Disposition

At the outset, we note that the position we have adopted in the Payroll Expense section of this Opinion and Order has a flow-through impact on the Company’s payroll taxes. Consistent with our finding, *supra,* that PECO’s Exception No. 3 should be denied, we shall adopt the ALJ’s recommendation that the Company’s claimed payroll taxes should be reduced by $187,000, or from $3,776,000 to $3,589,000.

## Property Tax Expense

### Positions of the Parties

PECO stated its property tax expense projections were determined by applying a 2.5% inflation adjustment to the Company’s most recent actual property tax bills. PECO M.B. at 44-45; PECO R.B. at 31-32. However, the OCA claimed property taxes should be adjusted downward by $61,395, consistent with its adjustment to remove the Company’s inflation adjustment on property tax expense. OCA R.B at 44, App. A, Table II.

### Recommended Decision

The ALJ addressed property tax expenses under the Expenses section of the Recommended Decision. The ALJ recommended accepting PECO’s claimed property tax expense. Therefore, the ALJ did not recommend any changes to the Company’s claimed property taxes. R.D. at 137-38.

### OCA Exception No. 3 and Replies

As previously noted, in its Exception No. 3, the OCA avers that the ALJ erred in recommending the Company’s inflation factor adjustments for PECO’s claimed property tax expense. The OCA maintains its position that adjustments based on inflation escalations are not actually known and measurable. Therefore, the OCA continues to recommend an adjustment to remove the effect of the inflation escalation on the real estate tax component of the property tax expense, which would reduce the Company’s taxes other than income by $61,395. OCA Exc. at 10-11.

In its Replies to Exceptions, PECO asserts that the ALJ properly recommended approving the Company’s claim for property tax expense that reflects a 2.5% inflation factor adjustment for its most recent actual property tax bills. PECO R. Exc. at 9.

### Disposition

We note that the position we adopted in the Property Tax Expense section of this Opinion and Order has a flow-through impact on PECO’s taxes. We agree with the ALJ’s recommendation to accept PECO’s claim for Property Taxes. Consistent with our finding, *supra*,in the Disposition for Property Tax Expense, the OCA’s Exception No. 3 is denied.

## Income Taxes

### Positions of the Parties

PECO noted that there are no contested issues regarding income taxes. PECO explained that the OCA’s proposed adjustment to eliminate the Company’s rate base claim for incremental FPFTY plant additions would have the concomitant effect of increasing income taxes and decreasing the rate base deduction for deferred income taxes. PECO M.B. at 51-52. The OCA agreed with the Company and reflected the concomitant adjustments. OCA M.B. at 72.

### Recommended Decision

The ALJ noted PECO’s claims for Federal and State income taxes are set forth in PECO Exhibit MJT-1 Revised, Schedule D-18. Additionally, the ALJ stated no party disputes the manner in which the Company calculated its Federal and State income taxes. RD at 134. The ALJ made no specific recommendation as to PECO’s claims for Federal and State income taxes.

### Disposition

No Exceptions were filed objecting to the ALJ’s recommendation on this issue. We find that the manner in which the Company calculated its Federal and State income taxes is just and reasonable and supported by ample record evidence. Accordingly, we shall adopt PECO’s calculation method.

# Fair Rate of Return

## Proxy Groups

To estimate a utility’s cost of equity,[[55]](#footnote-56) a proxy 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, therefore, is a more reliable measure. I&E St. 2 at 7.

### Positions of the Parties

PECO used a proxy group of nine gas companies, which it referred to as the “Gas Group.” PECO began with the group of ten gas companies contained in The Value Line Investment Survey (*Value Line*). The Company decided to exclude UGI Corporation (UGI) in formulating its proxy group due to its dissimilarities in financial risk to the companies in the Gas Group. Namely, PECO noted UGI’s diversified businesses that include natural gas, propane, two international liquid propane gas (LPG) segments, electric generation and distribution, and energy services. PECO explained that it used the same nine companies the Commission used as its barometer group for the DSIC in its Quarterly Earnings Reports. *See Bureau of Technical Utility Services Report on the Quarterly Earnings of Jurisdictional Companies for the Year ended September 30, 2020*, Docket No. M‑2020‑3023406, Attachment G (January 14, 2021) (Quarterly Earnings Report). PECO M.B. at 60-61.

I&E’s proxy group consisted of seven companies. In selecting 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 currently involved in an announced merger or the target of an announced acquisition;
5. The company must have four 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 St. 2 at 6-7, 9. I&E stated that it designed its proxy group to select companies that are most like the gas distribution company subject in this proceeding. *Id.* at 7.

I&E noted that beyond its rationale for excluding UGI, PECO did not provide a list of criteria it used to determine its Gas Group other than that the Gas Group is made up of the companies that TUS uses to calculate the cost of equity in its Quarterly Earnings Report. I&E also explained that while both its own proxy group and the Company’s Gas Group contain seven of the same companies, PECO’s Gas Group includes two companies that I&E does not use. Those two companies are New Jersey Resources Corp. (New Jersey Resources) and Southwest Gas Holdings, Inc. (Southwest Gas Holdings) which I&E did not consider because neither of them met I&E’s criterion that fifty percent or more of the company’s revenues must be generated from the regulated gas utility industry. According to I&E, if fewer than fifty percent of revenues come from the regulated gas business sector, a company is not comparable to the subject utility as it does not provide a similar level of regulated business. Therefore, I&E took the position that these two companies should be removed from the Company’s proxy group. I&E St. 2 at 10.

The OCA’s proxy group included each of the companies in PECO’s proxy group, with one exception. The OCA explained that while PECO did not include UGI in its Gas Group, the OCA did. The OCA noted that both it and the Company included Chesapeake Utilities in their respective proxy groups. According to the OCA, Chesapeake Utilities operates a diverse set of businesses that includes natural gas distribution, natural gas transmission, electric distribution operations, propane distribution, and other lines of business. The OCA stated that UGI operates a similarly diverse set of businesses. According to the OCA, it is not appropriate to exclude one diversified company from consideration in a proxy group, while including another. OCA M.B. at 83-84.

The OCA explained that it also separately examined the existing capital structure and cost of equity indicated for PECO’s ultimate corporate parent Exelon, which is traded on the New York Stock Exchange (NYSE), is followed by Value Line Investment Survey, and is classified as an electric utility. According to the OCA, Exelon is the company with the most direct link to PECO’s Gas Division, tempered by recognition of the different returns and capital need for electric utilities and natural gas utilities. OCA M.B. at 84.

The OCA disagreed with I&E’s proxy group. According to the OCA, removing certain companies within a proxy group of similar companies, as I&E has done, is inherently subjective. In addition, the OCA argued that removing companies from a group that is already small can result in data integrity issues. Therefore, the OCA took the position that unless a company is currently going through bankruptcy or a merger/acquisition transaction, it should be included within a proxy group for transparency purposes.[[56]](#footnote-57) OCA M.B. at 124; OCA St. 3-R at 7-8.

Additionally, the OCA acknowledged that the Commission adopted I&E’s similar proxy group in *Columbia Gas*, based upon the recommendation of ALJ Katrina L. Dunderdale in that proceeding. Nonetheless, the OCA submitted that the Commission should determine what proxy group and base of financial information provides the best basis to determine an appropriate cost of equity for PECO based upon the record developed in this present proceeding and current information. OCA M.B. at 124.

In response to I&E’s criticism of its Gas Group, PECO argued that it is not appropriate to eliminate companies from a proxy group based on the percentage of revenues devoted to utility operations because the margins on other business segments within proxy group companies are generally dissimilar to the utility business. Additionally, in response to the OCA’s criticism of its Gas Group, PECO restated its position that UGI should not be included in a gas proxy group because it is more diversified outside of the natural gas distribution business than the other companies that are properly included in the proxy group. PECO also submitted that no weight should be given to the OCA’s separate analysis of Exelon. In this regard, PECO argued that reference to a utility’s parent corporation is inappropriate and inconsistent with Commission policy, which is to use a proxy group analysis to set the return on equity when the utility’s own stock is not traded. PECO M.B. at 73-74.

Table 1, below, provides a summary of the companies each party proposed to be used in their respective gas proxy groups:

**Table 1: Summary of the Proposed Gas Proxy Groups in this Proceeding**



PECO M.B. at 60; I&E St. 2 at 9; OCA St. 3 at 40.[[57]](#footnote-58)

### Recommended Decision

The ALJ recommended that the Commission use I&E’s gas proxy group in setting the appropriate cost of equity for the Company. The ALJ found I&E’s proxy group was the most comparable to PECO. The ALJ agreed with I&E’s usage of the percentage of revenue as a criterion and echoed I&E that if fewer than fifty percent of a company’s revenues is from the regulated gas business, the company is not comparable to the subject utility because it does not provide a similar level of regulated business. R.D. at 183-84.

### Exceptions and Replies

In its Exception No. 5B, the OCA excepts to the ALJ’s recommendation that I&E’s proxy group be adopted in setting a cost of equity for the Company. According to the OCA, I&E’s proxy group is inadequate when compared to the OCA’s proxy group. In this regard, the OCA restates its position that I&E’s witness Mr. Christopher Keller’s evaluation of a small proxy group, which is comprised of only seven companies, is too small and prone to data integrity issues that may lead to an excessive cost of equity. In contrast, the OCA argues that its witness Mr. O’Donnell evaluated a larger group of companies than either the Company or I&E that provided more data points and a more robust analysis to support the OCA’s cost of equity recommendation of 8.75% for PECO, *infra*. Therefore, the OCA claims that the Commission should adopt the OCA’s proxy group because it is based on the evaluation of data for the ten companies included in the *Value Line* Gas Group as opposed to seven companies in I&E’s proxy group. OCA Exc. at 18-19.

In its Replies to Exceptions, PECO argues that the ALJ properly rejected the OCA’s proxy group in light of its inclusion of UGI, which does not have similar financial risks compared to the rest of the companies in the proxy group. PECO reiterates its position that UGI is more diversified outside of the gas distribution business than the other companies in the Gas Group and reports financial results for six separate business segments, in addition to the natural gas utility business. PECO R. Exc. at 11.

In its Replies to Exceptions, I&E submits that ALJ Pell correctly recommended using I&E’s proxy group based on his finding that I&E’s proxy group is most comparable to the Company in developing an appropriate cost of equity. I&E R. Exc. at 18.

### 4. Disposition

Based on our review of the record, we shall adopt ALJ Pell’s recommendation that I&E’s proxy group should be utilized in setting the appropriate rate of return for PECO. At the outset, we note that I&E has proffered the same proxy group in the instant proceeding that we recently found was appropriate for the company at issue in *Columbia Gas. See Columbia Gas* at 104-05, 107.Additionally, we acknowledge the validity of the OCA’s argument that we must determine which proxy group and base of financial information provides the best basis to determine an appropriate cost of equity for PECO based upon the record developed in this proceeding and current information. However, we are not persuaded by the OCA’s contention that a different proxy group should be utilized in setting the appropriate rate of return for PECO. Rather, we reach the same conclusion as we did in *Columbia Gas,* based on the specific record evidence in this proceeding, that I&E’s proxy group of companies is the proxy group proffered in this proceeding that most closely resembles PECO.

In its Exception No. 5B, the OCA argues that its proxy group should be used in place of I&E’s because I&E’s proxy group is too small and prone to data integrity issues, leading to an excessive cost of equity. OCA Exc. at 18. We disagree. We note that I&E properly excluded three companies from its proxy group that the OCA chose to include in its proxy group. First, we concur with I&E’s reasoning as to why it did not include New Jersey Resources and Southwest Gas Holdings in its proxy group. By extension, we also find that I&E’s method of using the percentage of revenues devoted to utility operations is preferable to PECO’s proposed method of using the percentage of gas utility assets to total assets in screening companies to include in a proxy group.[[58]](#footnote-59) The record indicates that assets are accounted for at the original cost minus depreciation, which means that the value of an asset depends on its age. Therefore, it is possible for the regulated utility segment of a company to predominately have assets that are depreciated. Although a utility may have assets that are significantly depreciated, it does not always indicate the level of business a company does. In addition, there are differences between businesses in the amount of capital needed. A utility with all new equipment may need a large amount of assets to produce a small level of cash flow while another business may need only a small amount of assets to produce a large level of cash flow. For these reasons, PECO’s method may not always be a reliable way of determining whether a business is primarily a regulated utility. *See* I&E St. 2-SR at 6.

In contrast, as I&E and the ALJ pointed out, a company’s revenues represent the percentage of cash flow it receives from each business line related to providing a good or service. Therefore, if less than fifty percent of revenues come from the regulated gas sector, the company is not comparable to the subject utility as it does not provide a similar level of regulated business. *See* I&E St. 2-SR at 7. Accordingly, we find that both New Jersey Resources and Southwest Gas Holdings are too dissimilar to PECO for purposes of being used this proceeding’s gas proxy group.

Next, we find that UGI is also properly excluded from the proxy group. On this point, we highlight PECO’s position in which it contended that the record indicates that non-utility operations comprise 87% of UGI’s revenues, 48% of its net income, and 73% of assets for UGI Corporation. As a result, PECO argued, and we agree, that when compared to the other companies in the proxy group, UGI is not a comparable company, because its risk is higher than that of PECO. *See* PECO St. 5-R at 18.

Additionally, we find that performing a separate evaluation on Exelon as a measure of the cost of equity for PECO is inappropriate and unnecessary. It has been our policy to use a proxy group analysis to set the return on equity when the utility’s own stock is not traded. We utilized this approach in the past because it produces a return that is available on other enterprises of comparable risk. *See* PECO St. 5-R at 18; *Columbia Gas* at 111. Thus, we find that the OCA has not provided any argument in this proceeding that would persuade us to depart from this approach and to examine Exelon separately.

Consistent with the above, we shall deny the proxy group arguments set forth in the OCA’s Exception No. 5B and adopt I&E’s proposed proxy group.

## Capital Structure Ratios

A utility’s capital structure represents how the company has financed its rate base with different sources of funds. The primary funding sources are long-term debt and common equity. A capital structure may also include preferred stock and/or short-term debt. I&E St. 2 at 10-11. Determining the appropriate capital structure is crucial in developing the weighted cost of capital, which, in turn, determines the overall rate of return in the revenue requirement equation.

### Positions of the Parties

PECO proposed a capital structure of 53.38% common equity and 46.62% long-term debt, which represents its projected capital structure as of the end of the FPFTY ending June 30, 2022. According to the Company, if an operating public utility raises its own debt directly in the capital markets, as PECO does, the operating public utility’s own capital structure ratios should be used to determine its overall rate of return. Thus, PECO explained that it based its FPFTY capital structure upon its actual capital structure as of June 30, 2020, and made adjustments to reflect events that will occur during the FTY and FPFTY and impact the cost of debt, including: (1) the Company’s plans to issue new long-term debt in March of 2021, September of 2021, and March of 2022; (2) a debt maturity that will occur in September of 2021; (3) planned future equity financings; (4) the build-up of retained earnings; and (5) the redemption of high-cost long-term debt and preferred stock. PECO M.B. at 55.

PECO argued that the Commission has determined in previous proceedings that a utility’s actual structure should be utilized unless there is a finding that it is atypical or too heavily weighted to either the debt or equity side. PECO M.B. at 57 (citing *Pa. PUC. v. PPL Electric Utilities Corporation*,Docket No. R-2012-2290597 *et al*. (Order entered December 28, 2012) (*2012 PPL Order*)). According to PECO, this policy was recently affirmed in *Columbia Gas.* PECO further submitted that because its common equity ratio falls within the ranges of the common equity ratios in the proxy groups employed by both the OCA and I&E, it is appropriate to use the Company’s actual capital structure for ratemaking purposes. PECO M.B. at 56-58; PECO R.B. at 37‑38.

I&E recommended that the Commission adopt PECO’s proposed capital structure. According to I&E, the Company’s claimed capital structure falls within the range of the I&E proxy group’s 2019 capital structures, which is the most recent information available at the time of I&E’s analysis. I&E further noted that the 2019 range consists of long-term debt ratios ranging from 33.18% to 53.48% and equity ratios ranging from 32.78% to 59.01%, with a five-year average of 40.29% for long-term debt and 47.60% for common equity. I&E M.B. at 53-54.

In contrast, the OCA submitted that the Company’s end of FPFTY capitalization ratios set forth in its proposed capital structure are not “actual,” but are projections which should be scrutinized to assure that consumers are not paying an excessive level of return on an equity ratio which is not realized. According to the OCA, most projections tend to set common equity at too high a value given the inherent subjectivity and erratic nature of where the common equity ratios may actually fall out in future years. The OCA argued that this is particularly relevant given the current economic climate wherein the COVID-19 pandemic has increased the uncertainty associated with projected future common equity ratios. The OCA alleged that PECO’s proposed common equity ratio of 53.38% represents a level of equity that is too high and will impose excessively higher costs on PECO’s ratepayers, as dollars to provide an equity level of return must be adjusted for taxes. Therefore, the OCA took the position that using a hypothetical capital structure with a lower level of equity ratio is more appropriate to set just and reasonable rates and to protect the Company’s ratepayers. OCA M.B. at 78-81; OCA R.B. at 47-50.

Accordingly, the OCA proposed a capital structure of 50% common equity and 50% long-term debt to set rates for PECO. The OCA explained that its witness Mr. O’Donnell identified a common equity ratio of 50% to be appropriate based upon a review of: (1) the common equity ratio of the companies in the OCA’s proxy group (50.70%) and PECO’s parent company Exelon (50.40%); (2) the common equity ratio granted by utility regulators across the United States in 2019 (51.75%); and (3) the common equity ratio granted by utility regulators across the United States over the past fifteen years. The OCA asserted that state regulators have been very consistent with their rulings in natural gas rate case cases over the past fifteen years. The OCA continued that from 2005 through 2019, common equity ratios approved by state regulators have ranged from 47.24% to 52.49%, with an average of 49.91%. Thus, the OCA maintained that the average common equity ratio granted by state regulators much more closely approximates a ratio of 50.00% as opposed to PECO’s request of 53.38%. OCA M.B. at 81; OCA St. 3 at 41.

### Recommended Decision

The ALJ recommended that PECO’s proposed capital structure of 53.38% common equity and 46.62% long-term debt be adopted. According to the ALJ, PECO demonstrated that as an operating public utility that issues its own debt directly in the capital markets, the Company’s actual capital structure ratios should be used. The ALJ noted that the legal standard in Pennsylvania for deciding whether to use a party’s proposed hypothetical capital structure in setting rates is that if a utility’s capital structure is within the range of a similarly situated barometer group of companies, rates are set based on the utility’s actual capital structure. The ALJ concurred with PECO’s argument that the Commission previously found this to be true in the *2012 PPL Order* and that it reaffirmed this standard in *Columbia Gas.* Additionally, the ALJ found particularly persuasive I&E’s support of the Company’s capital structure when it noted that the Company’s claimed capital structure falls within the range of the I&E proxy group’s 2019 capital structures, which I&E indicated is the most recent information available at the time of its analysis. R.D. at 211-13.

### OCA Exception No. 5A and Replies

In its Exception No. 5A, the OCA remains of the opinion that a hypothetical capital structure consisting of 50% common equity and 50% long-term debt is better suited to set just and reasonable rates for PECO. First, the OCA submits that the ALJ relied on unsound policy in the context of legal standards in citing to the *2012 PPL Order* and to *Columbia Gas* to reach his conclusion that if a company’s proposed capital structure is within the range of a proxy group, the Commission will refrain from exercising its discretion to alter this claimed capital structure. Instead, the OCA argues that the ALJ should have focused on whether PECO has met its burden of proof with substantial evidence pursuant to Section 315(a) of the Code, 66 Pa. C.S. § 315(a)*.* According to the OCA, PECO did not refute the concern of the OCA’s witness Mr. O’Donnell that utility forecasts of common equity ratios are subjective and tend to be overstated. OCA M.B. at 15-16.

Next, the OCA claims that it set forth specific evidence in support of its position to reject PECO’s claimed capital structure ratios. In this regard, the OCA submits that the Company’s risk profile does not justify PECO’s request for a higher equity ratio. In the OCA’s view, the decrease in the Federal Funds rate signals a decrease in the cost of capital for companies like PECO. In addition, the OCA restates its position that the current economic climate and the COVID-19 pandemic has increased the uncertainty associated with projected future common equity ratios. Further, the OCA submits that because returns on common equity, paid in the form of dividends, are not tax deductible, common equity financing, on a pre-tax basis alone, is “about 21% or more expensive than debt financing.” OCA Exc. at 16-17.

Based on the above, the OCA reiterates its position that in setting forth the appropriate capital structure, it is more compelling to consider: (1) the actual capital structure ratios approved by other regulatory commissions in setting just and reasonable rates for other utilities; (2) the average common equity ratio for the OCA’s proxy group; and (3) the common equity ratio of PECO’s parent company, Exelon. OCA Exc. at 17.

In its Replies to Exceptions, PECO retorts that the OCA’s capital structure recommendation is unreasonable and unsupported. PECO contends that the ALJ properly cited to the *2012 PPL Order* in which the Commission found that the legal standard in Pennsylvania for deciding whether to use a party’s proposed hypothetical structure in setting rates is that if a utility’s capital structure is within the range of a similarly situated proxy group of companies, rates are set based on the utility’s actual capital structure. According to PECO, the ALJ correctly found no reason to depart from this standard because PECO’s capital structure falls within the ranges of the common equity ratios in the OCA and I&E proxy groups. Further, PECO submits that while the OCA claims that it is more compelling to examine the OCA’s own criteria for setting a capital structure, all this information shows is that PECO’s common equity ratio is not equivalent to certain average calculations provided by the OCA, and not that the Company’s capital structure falls outside of the range of similarly situated proxy group companies. PECO R. Exc. at 10.

In its Replies to Exceptions, I&E submits that ALJ Pell correctly recommended that the Commission accept the capital structure proposed by the Company. I&E highlights the ALJ’s finding that the Company demonstrated that as an operating public utility that issues its own debt directly in the capital markets, PECO’s own capital structure ratios should be used to determine its overall rate of return. According to I&E, the ALJ correctly referenced I&E’s argument in support of the Company’s capital structure, in that the Company’s claimed capital structure falls within the range of the I&E proxy group’s 2019 capital structures. I&E R. Exc. at 17-18.

### Disposition

On consideration of the record evidence in this proceeding, we are persuaded by the position of PECO and, therefore, we shall adopt the ALJ’s recommendation to use the Company’s actual capital structure. Initially, we note that the actual capital structure represents the Company’s decision, in which it has full discretion, on how to capitalize its rate base. This actual capitalization forms the basis upon which PECO attracts capital. *See 2012 PPL Order* at 68; *Columbia Gas* at 116. PPL’s long‑term debt cost rate of 3.84%, discussed, *infra,* which all Parties have accepted for ratemaking purposes, fully reflects the capitalization determined by the Company to be appropriate. As the ALJ and PECO each pointed out, we reaffirmed in *Columbia Gas* that the legal standard in Pennsylvania for deciding whether to use a party’s proposed hypothetical capital structure in setting rates, *i.e.*, if a utility’s actual capital structure is within the range of a similarly situated proxy group of companies, rates are set based on the utility’s actual capital structure. *Columbia Gas* at 116. More specifically, we reaffirmed this standard, which we articulated in the *2012 PPL Order,* as follows:

Absent a finding by the Commission that a utility’s actual capital structure is atypical or too heavily weighted on either the debt or equity side, we would not normally exercise our discretion with regard to implementing a hypothetical capital structure.

*Id.* at 116-17 (citing *2012 PPL Order* at 68).

We find no merit in the OCA’s argument in its Exceptions that ALJ Pell relied on unsound policy in citing to the legal standards set forth in the *2012 PPL Order* and reaffirmed in *Columbia Gas.* Rather, we note that aside from its argument that it achieves a lower revenue requirement, the OCA did not substantiate its position regarding the selection of a hypothetical capital structure of 50% common equity and 50% debt. Additionally, the OCA set forth a hypothetical debt ratio without using a hypothetical cost of debt related to the natural gas rate case rulings that it referenced, *supra*. We further note that given that there is a direct relationship between the cost of debt and the amount of financial risk shown by the debt ratio, the OCA’s proposal, if adopted, would result in a mismatch of debt ratio and debt cost such that PECO’s resulting return on equity would not correspond with the actual financial risk of the Company. *See* PECO St. 5-R at 8.

Additionally, the OCA provided the list of companies in Table 2, below (Table 6 in OCA’s St. 3), to illustrate the 2019 common equity ratios in the proxy group it submitted on the record in this proceeding:

**Table 2: Summary of 2019 Common Equity Ratios in OCA’s Gas Proxy Group**

|  |  |
| --- | --- |
| **Company** | **2019 Ratio** |
| Atmos | 62.00% |
| Chesapeake | 56.10% |
| New Jersey Res | 50.20% |
| Nisource | 36.90% |
| NWNG | 51.80% |
| ONE Gas | 62.30% |
| South Jersey | 40.80% |
| Southwest Gas | 52.10% |
| Spire | 55.00% |
| UGI Corp | 39.80% |
| **Average** | **50.70%** |
|  |  |
| Exelon Corp | 50.40% |

*See* OCA St. 3 at 40, Table 6. The OCA submitted the information in this table to bolster its argument that PECO’s proposed common equity ratio is higher than the average of equity ratios for a similar group of natural gas companies. However, we find that the data in the table instead lends support to PECO’s argument that its proposed actual common equity ratio falls well within the range of the common equity ratios of similar natural gas companies. In this regard, the OCA’s data in Table 2, above, demonstrates that PECO’s proposed common equity ratio of 53.38 % is below that of four of the companies in the OCA’s proposed proxy group (*i.e.,* Atmos, Chesapeake, OneGas, and Spire), whose common equity ratios range from 55.00% to 62.30%. *See* PECO St. 5-R at 6; *Columbia Gas* at 117.

Next, as noted above, we have determined that the proxy group of seven companies proffered by I&E is the appropriate proxy group to use in developing a return on common equity for PECO in this proceeding. We likewise find that I&E’s proxy group further underscores that PECO’s proposed actual capital structure is not atypical and is within the range of reasonableness. The record indicates that PECO’s claimed capital structure falls within the range of the 2019 capital structures for the companies in I&E’s proxy group, which we have determined to be the most like PECO. The 2019 range consists of long-term debt ratios ranging from 33.18% to 53.48% and equity ratios ranging from 32.78% to 59.01%, with a five-year average of 40.29% for long-term debt and 47.60% for common equity. *See* I&E St. 2 at 12.

Moreover, we find no basis in the OCA’s argument that the common equity ratio of PECO’s parent company Exelon should be considered in arriving at the appropriate capital structure ratio. In our view, the use of Exelon’s capital structure would result in a mismatch between the applied capital structure and PECO’s actual financial risk. We note that because Exelon is a holding company, its capital structure reflects the financial risk associated with the ownership of multiple utilities, a large generation company, and significant unregulated competitive businesses. For this reason, we find that it is not appropriate to compare an operating utility’s capital structure to the capital structure of its parent holding company that holds these diverse utility and non‑utility operations. *See* PECO St. 5-R at 8-9.

In light of the above, we find that PECO’s proposed actual capital structure is not atypical and is within a range of reasonableness. In addition, we conclude that the ALJ’s and PECO’s reliance on *Columbia Gas* to set rates in this proceeding on PECO’s actual capital structure is on point and underscores our findings based on the specific record developed in this proceeding that PECO’s actual capital structure is within the range of capital structures of the similarly situated proxy group of companies proposed by I&E.

Accordingly, we find no basis on which to impose the OCA’s hypothetical capital structure on the Company. Therefore, we shall deny the OCA’s Exception No. 5A and adopt the ALJ’s recommendation to use PECO’s proposed actual capital structure of 53.38% common equity and 46.62% long-term debt in this proceeding.

## Cost of Debt

### Positions of the Parties

PECO initially proposed a cost of long-term debt of 3.97% for the FPFTY, based on data ending June 2020. PECO M.B. at 58. However, in its Rebuttal Testimony, PECO provided an updated cost of long-term debt of 3.84% for the FPFTY based on data as of December of 2020. PECO St. 5-R at 9-10; PECO Exh. PRM-1 (Revised), Sch. 6 at 3. PECO explained that in reaching its proposed cost of long-term debt, it computed the weighted average embedded cost rates of the Company’s long-term debt as of the end of the HTY, FTY and FPFTY, respectively, and then accounted for the Company’s early redemption of high-cost debt and for the future debt issuances of the Company in 2021 and 2022. PECO M.B. at 58.

I&E agreed with PECO that the Company’s updated claimed long-term debt cost rate of 3.84% should be utilized. I&E noted that given PECO’s proposed capital structure ratios, *supra,* PECO’s proposal results in a weighted cost of debt of 1.79%. I&E further noted that this represents a decrease of 0.06% (1.85% - 1.79%) to the Company’s original claim. In I&E’s view, PECO’s claimed cost rate of long-term debt is reasonable and representative of the natural gas industry. I&E M.B. at 53.

The OCA explained that it opposed the Company’s initial proposed cost of long-term debt. However, the OCA submitted that PECO’s updated proposed cost of long-term debt of 3.84% properly reflects the current and expected low cost of capital environment. OCA M.B. at 81-82.

### Recommended Decision

The ALJ observed that no Party disagreed with PECO’s proposal to use its actual cost of long-term debt of 3.84%. Therefore, the ALJ recommended that the Company’s proposal be adopted. R.D. at 213.

### Disposition

No Party filed Exceptions on this issue with regard to the ALJ’s recommendation. Finding the ALJ’s recommendation to be reasonable, we shall adopt it without further comment. Accordingly, we shall approve a long-term debt cost rate of 3.84% for PECO in this proceeding.

## Cost of Common Equity

In the instant proceeding, PECO, I&E, the OCA, and the OSBA presented their positions on a reasonable ROE. As will be addressed in more detail, *infra,* the Parties’ positions were generally developed through comparison groups’ market data, costing models, reflection or rejection of risk and leverage adjustments, and a management performance adjustment, Table 3, below summarizes the cost of common equity claims made and the methodologies[[59]](#footnote-60) used by the Parties in this proceeding:

**Table 3: Summary of Parties’ Cost of Equity Proposals and Methodologies**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Party** | **DCF** | **CAPM** | **RP** | **CE** | **ROE** |
| **PECO** | 13.46% | 12.67% | 10.00% | 12.00% | 10.95% |
| **I&E** | 10.24% | 9.08% |  |  | 10.24% |
| **OCA** | 7.75%-10.00% | 5.50%-7.75% |  | 9.25%-10.25% | 8.75% |
| **OSBA** |  |  |  |  | 8.75% |

### Methods for Determining the Cost of Common Equity

#### Discounted Cash Flow Method (DCF)

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.

##### Positions of the Parties

PECO’s DCF model consists of a dividend yield plus a growth rate plus a leverage adjustment. PECO proposed a cost of common equity under the DCF method of 13.46%, which is calculated as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Dividend + | Growth + | Leverage = | DCF Cost Rate |
|  |  |  |  |  |
| Original | 3.28% | 7.50% | 1.96% | **12.74%** |
|  |  |  |  |  |
| Updated | 3.79% | 7.50% | 2.17% | **13.46%** |

The Company’s original dividend yield calculation used the three-month average dividend yields for the Gas Group and adjusted those yields for expected growth in the dividend to produce the dividend yield of 3.28%. PECO Exh. PRM-1, Sch. 7. PECO’s updated calculation used data for the period May 2019 – June 2020 to calculate a dividend yield following the market reaction to the COVID-19 pandemic. This data showed that if updated information were used, the adjusted dividend yield would rise to 3.79%. PECO Exh. PRM-1(updated), Sch. 7.

PECO principally relied upon five-year forecasts of earnings per share growth, as earnings growth appropriately measures the growth in price over time. The Company used four separate sources of projected earnings growth: IBES/First Call, Zacks, and Value Line. From this data, and applying judgment, PECO recommended a growth rate of 7.50%. PECO M.B. at 62.

The Company also argued that a leverage adjustment should be added to its DCF cost rate. PECO explained that a leverage adjustment is designed to adjust the DCF cost rate for the different percentage of debt in the capital structure calculated at market values of equity and long-term debt (the values used by investors) as compared to the percentage of debt in the capital structure at book value (the values used in the ratemaking process) to account for the greater financial risk created by a higher debt ratio when that cost rate is applied to a book value capitalization in utility proceedings. The Company argued that an unadjusted DCF greatly understates the cost of common equity because the proportion of market value common equity in the Gas Group’s capitalization was significantly higher than its proportion measure at book value. Accordingly, PECO proposed to add a leverage adjustment of 196 basis points (*i.e.*,1.96%) to its DCF cost of common equity calculation. PECO M.B. at 63-64.

At the outset, I&E claimed the DCF method is in accordance with the Commission’s historical use of the DCF as the primary methodology to determine a utility’s cost of equity. I&E noted its recommendation is consistent with the methodology historically used by the Commission in base rate proceedings and was most recently acknowledged in *Columbia Gas*. Through the methodologies outlined in its testimony, I&E calculated that the DCF methodology produces a cost of common equity of 10.24%. I&E M.B. at 54-55.

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. 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. I&E’s dividend yield calculation placed equal emphasis on the most recent spot and the 52-week average dividend yields, resulting in an average dividend yield of 3.38%. I&E St. 2 at 21.

I&E used earnings growth forecasts to calculate its expected growth rate. I&E’s earnings forecasts are developed from projected growth rates using five-year estimates from established forecasting entities for its proxy group of companies, yielding an average five-year growth forecast of 6.86%. I&E St. 2 at 23.

I&E submitted that PECO’s proposed leverage adjustment should be rejected because investors base their decisions on book value debt and equity ratios for regulated utilities, and not on market values, rendering any adjustment unnecessary. I&E also submitted that recent Commission precedent supports rejecting a utility’s request for a leverage adjustment. I&E St. 2 at 41-42.

The OCA proposed a DCF cost of equity range of between 7.75% and 10.00%. The OCA utilized a DCF analysis and employed the following formula, which was also used by I&E: k=D/P + g, where “k,” “D,” “P,” and “g” are as defined in I&E’s DCF analysis, *supra*. OCA M.B. at 84-87; OCA St. 3 at 56-57.

The OCA calculated the dividend yield by averaging the dividend yield expected to be paid over the next twelve months for each comparable company, as reported by *Value Line*. The OCA provided that an appropriate dividend yield must be developed utilizing forecasted annualized dividend yields based on three separate time periods (*i.e.*, 13-weeks, 4-weeks, and 1-week) provided by *Value Line*. The OCA obtained an average dividend yield for the proxy group for each of the three time periods: 3.7%, 3.5%, and 3.6%, respectively. OCA M.B. at 87-88. OCA St. 3 at 59.

The OCA stated it used two methods to identify a measure of the growth in dividends that investors expect. The first method is referred to as the plowback ratio method. Under this approach, if a company is earning a rate of return, or “r,” on the company’s common equity, and it retains a percentage of these earnings, or “b,” then each year of the earnings per share (EPS) are expected to grow by “b x r.” OCA St. 3 at 46. The second method the OCA used to estimate the expected growth rate was to analyze the 10-year and 5-year historical compound annual rates of change for EPS, dividends per share (DPS), and book value per share (BPS) as reported by *Value Line* for each of the relevant corporations. OCA M.B. at 88-90. OCA St. 3 at 60-61.

Like I&E, the OCA submitted that PECO’s proposed leverage adjustment should be rejected. The OCA reasoned that an upward adjustment to a proper DCF based cost of equity estimate is unnecessary and unreasonable. OCA M.B. at 116-17.

#### Capital Asset Pricing Model (CAPM)

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

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

k = Rf + β(Rm – Rf)

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

##### Positions of the Parties

PECO determined the CAPM cost of equity as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | Rf + | β + | (Rm – Rf)+ | Size= | CAPM Cost Rate |
|  |  |  |  |  |  |
| Original | 1.75% + | 1.05 + | 9.10% + | 1.02% = | **12.33%** |
|  |  |  |  |  |  |
| Updated | 2.00% + | 1.10 + | 8.77% + | 1.02% = | **12.67%** |

PECO initially determined the risk-free rate to be 1.75% based on current and forecasted long-term Treasury Bond yields. In the Company’s update, based on revised projections, the risk-free rate increased to 2.00%. PECO also calculated a 9.10% premium for the risk/market premium component of the CAPM analysis, based upon the average historical data and forecasted returns. PECO updated the risk premium, decreasing it to 8.77%. The Company used a leverage adjusted beta of 1.05, to reflect the financial risk associated with the rate setting capital structure that is measured at book value. In PECO’s update, there was an increase in the leverage adjusted beta to 1.10. Additionally, PECO included a 1.02% size adjustment to its CAPM analysis. Therefore, PECO calculated a CAPM cost of common equity of 12.67% for its gas group. PECO M.B. at 64-66; PECO St. 5-R at 10-11.

In calculating the CAPM cost of common equity, I&E chose the risk-free rate of return (Rf) of 1.23% from the projected yield on ten-year Treasury bonds as the most stable risk-free measure. I&E explained that its decision to use ten-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 0.85. To arrive at a representative expected return on the overall stock market, I&E stated that it 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 its CAPM analysis is 10.46%, which yields a cost of equity result of 9.08%. According to I&E, the 9.08% cost of equity from its CAPM should only be used as a point of comparison to its 10.24% DCF cost of capital. I&E M.B. at 54-55; I&E St. 2 at 24-28.

In response to PECO’s CAPM analysis, I&E submitted that the Company used the same leverage adjustment for inflating its CAPM betas from 0.84 to 1.05 that was used for its DCF calculation. I&E asserted that such enhancements are unwarranted for beta in a CAPM analysis for the same reasons that enhancements are unwarranted for in DCF results. In addition, I&E disagreed with PECO’s 102-basis point size adjustment applied to its CAPM analysis. I&E St. 2 at 42-45.

The OCA performed a CAPM analysis to provide the Commission with additional information. However, the OCA expressed its reservations regarding the usefulness of the CAPM approach. Specifically, the OCA asserted that the application of the CAPM in an inaccurate manner, such as when forecasted risk premiums or forecasted interest rates are employed, can lead to erroneous results. In its CAPM analyses, the OCA used a one-year historical period of thirty-year Treasury Bond yields to calculate a risk-free rate of 1.61%, a beta of 0.89, and an equity risk premium range from 4.25% to 6.25%. Using this data, the OCA concluded the proper CAPM return on equity is in the range of 5.00% to 7.75%. OCA M.B. 91-93; OCA St. 3 at 78-87.

#### Risk Premium (RP) Model and Comparable Earnings (CE) Model

Under the Risk Premium approach, the cost of equity capital is determined by corporate bond yields plus a premium to account for the fact that common equity is exposed to greater investment risk than debt capital. The RP method determines the cost of equity by summing the expected public utility bond yield and the return of equities over bond returns (*i.e*., the “equity premium”) over a historical period, as adjusted to reflect lower risk of utilities compared to the common equity of all corporations. PECO M.B. at 66; PECO St. 5 at 38.

The CE method estimates a fair return on equity by comparing returns realized by non-regulated companies to the returns that a public utility with similar risk characteristics would need to realize in order to compete for capital. According to PECO, because regulation is a substitute for competitively determined prices, the returns realized by non-regulated firms with comparable risks to a public utility provide useful insight into investor expectations for public utility returns. The firms selected for the CE method should be companies whose prices are not subject to cost-based price ceilings (*i.e.*, non‑regulated firms) so that circularity is avoided. The CE method utilizes the concept of opportunity cost, wherein investors will likely dedicate their capital to the investment offering the highest return with similar risk to alternative investments. PECO M.B. at 66-67; PECO St. 5 at 48.

##### Positions of the Parties

The Company determined the RP cost of common equity to be 10.50%, updated to 10.00%, as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | Interest Rate + | Risk Premium = | RP Cost Rate |
|  |  |  |  |
| Original | 3.50% + | 6.75% = | **10.25%** |
|  |  |  |  |
| Updated | 3.25% + | 6.75% = | **10.00%** |

PECO explained that the interest rate in its calculation is an estimated interest rate for A‑rated public utility bonds, while the risk premium in its calculation is the average of historical risk premiums over long-term corporate bonds.

PECO also performed a comparable earnings analysis based on the principle set forth by the United States Supreme Court that a utility should be afforded an opportunity to earn a return on its property equal to that being earned on investments in other businesses with corresponding risks and uncertainties. *See Bluefield, supra*. The Company’s analysis identified non-regulated companies with comparable risk and produced a cost rate of 12.90% (updated to 12.0%). PECO M.B. at 66-68; PECO St. 5 at 48.

I&E submitted that neither the RP method nor the CE method should be used in determining an appropriate cost of equity in a base rate proceeding. I&E pointed out that the RP method is a simplified version of the CAPM model. However, I&E noted that while the CAPM directly measures the systematic risk of the company through the use of beta, the RP method does not measure the specific risk of the company. As to the CE method, I&E charged that it is not market-based and relies upon historic accounting data. Further, I&E contended that under the CE method, the most problematic issue is determining what constitutes comparable companies. I&E St. 2 at 18-19.

The OCA conducted two different CE analyses. The first examines returns on book value equity for the comparable group. The second examines allowed natural gas utility returns over an extended period of time to evaluate the trend in returns for companies of similar risk. However, the OCA stated the Comparable Earnings Analysis is inferior to the DCF model and should be given much less weight in the determination of the ROE recommended in this case. For its first Comparable Earnings Analysis, the OCA used historic and forecasted earned returns on book value equity resulting in average earned returns on equity ranging from 8.9% to 10.4%. The OCA’s second Comparable Earnings Analysis takes the average authorized return on equity for natural gas utilities by state regulators across the United States from 2005 to 2019. The OCA averred the average allowed return on equity over this period is 9.95%. OCA M.B. at 93‑94; OCA St. 3 at 75-76.

The OCA claimed that the Commission should give little, if any weight to PECO’s RP and CAPM analyses. The OCA argued that PECO’s RP and CAPM analyses are flawed by the Company’s choice of inputs and inclusion of a size adjustment. Further, the OCA noted the RP and CAPM are both essentially risk premium models, where the CAPM is more company specific due to its use of beta to measure systemic risk. The OCA averred that the Company’s CE analysis did not address the cost of equity for PECO and focused on companies that are not public utility companies. OCA M.B. at 118-22.

Therefore, I&E and the OCA recommended using the DCF method as the primary method to determine the cost of common equity and using the CAPM method as a comparison to the DCF results. Both I&E and the OCA pointed out that the DCF method has historically been the Commission’s preferred method of setting common equity cost rates. I&E M.B. at 54-55; OCA M.B. at 82-83.

#### Recommended Decision

The ALJ agreed with I&E’s proposal to calculate the recommended return on equity pursuant to the DCF methodology, using the CAPM as an alternate means to verify the reasonableness of the return on equity. The ALJ recommended the Commission approve the use of the DCF method as the primary method to determine the cost of common equity and to use the results of the CAPM as a comparison to the DCF results, consistent with the methodology commonly endorsed by the Commission in base rate proceedings. R.D. at 215.

#### Exceptions and Replies

In its Exception No. 5B, the OCA contends that the ALJ erred by recommending I&E’s DCF methodology. The OCA argues that I&E incorrectly relied on forecasted earnings growth rates instead of considering historical growth rates. Additionally, the OCA argues I&E’s CAPM analysis is flawed based on how it calculated the overall market return. OCA Exc. at 19-20.

In its Replies to Exceptions, PECO maintains using historic growth rates is inconsistent with the DCF methodology, does not properly reflect investor expectations, and is inconsistent with the leading literature on the DCF methodology. Next, PECO addresses the OCA’s contention that I&E’s CAPM calculation is flawed. PECO asserts that the OCA incorrectly used the geometric mean rather than the arithmetic mean, in its historic analysis of the total market returns. PECO R. Exc. at 11.

#### Disposition

Upon our consideration of the record evidence, wefind that I&E’s DCF calculation correctly used forecasted earnings growth rates instead of considering historical growth rates. The record indicates that growth rate forecasts are made by analysts who already factor historical data into their forecasts of earnings per share growth. Although past performance can yield valuable information, relying on it for a DCF analysis results in placing too much weight on past performance. Thus, the best measure of growth for use in the DCF model are forecasted earnings growth rates. *See* PECO St. 5-R at 25-28; I&E St. 2-R at 17.

Likewise, we agree with I&E’s CAPM analysis using the arithmetic mean, and not the geometric mean. The record indicates that the theoretical foundation of the CAPM requires that the arithmetic mean be used because it conforms to the single period specification of the model and it provides a representation of all probable outcomes and has a measurable variance. *See* PECO St*.* 5-R at 36-37; *See also UGI Electric* at 99-100.

We further note that the use of I&E’s DCF and CAPM methodologies was recently confirmed in *Columbia Gas*. *See Columbia Gas* at 131. Like the ALJ, we find no reason to deviate from the use of these methods in the instant case. Therefore, we shall deny the DCF and CAPM arguments set forth in the OCA’s Exception No. 5B and adopt the ALJ’s recommendation.

### Business Risks and Management Performance

#### Positions of the Parties

PECO included a twenty-five-basis point management effectiveness upward adjustment to its ROE claim. PECO M.B. at 68-71.

I&E, the OCA, and the OSBA each opposed any allowance for management effectiveness. I&E M.B. at 56-58; OCA M.B. at 95-111; OCA R.B. at 57‑63; OSBA M.B. at 7.

PECO 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. PECO insisted that it has made numerous improvements in its service, such that it should be eligible for an enhancement to its ROE because of its strong performance in the area of management effectiveness. More specifically, PECO argued that it has, *inter alia*: (1) engaged in substantial efforts to eliminate potential environmental concerns at its former MGP sites, such that once remediated, the cites may be used for various beneficial land-use purposes; (2) successfully managed its natural gas distribution system in a safe and responsible manner in order to ensure pipeline reliability by meeting all requirements of the pipeline safety regulations; and (3) implemented a number of important initiatives and technological improvements focused on safety and reliability. PECO also asserted that it has successfully managed and controlled its operating expenses since its last base rate case in 2010 to deliver savings to customers, with a compound annual growth rate in O&M expense since 2010 of 1.9%, or 1.3% if increases in its “gas mapping and locate expenses” since 2010 are removed. In addition, PECO argued that it has engaged in various initiatives to improve its customer service. PECO highlighted that the PECO customer experience, as measured by J.D. Power, has improved from a score of 726 to 748, resulting in PECO’s customer service ranking among comparative utility companies increasing from 7th out of 12 in 2017 to 4th out of 12 in 2019. PECO M.B. at 68-71; PECO R.B. at 48-50.

I&E countered that the Company’s proposed management effectiveness adjustment should be disallowed. I&E reasoned that neither PECO nor any other utility should be awarded additional basis points to their ROE for simply doing what they are required to do to provide adequate, efficient, safe, and reasonable service under Section 1501 of the Code, 66 Pa. C.S. § 1501. In I&E’s view, awarding the Company management effectiveness points will result only in the customer paying more money to receive the level of service that the Company is obligated to provide. I&E stressed that even a modest increase in the cost of equity by an additional twenty‑five basis points translates to an additional $3,285,458 cost that would flow through to the ratepayers. Therefore, I&E submitted that true management effectiveness is realized when a utility earns a higher return through its efficient use of resources and cost cutting measures, resulting in greater net income being available to shareholders. According to I&E, ensuring that cost saving measures flow through to ratepayers is especially important now as many have recently experienced reduced household income as a result of job loss or reduction in hours due to the global pandemic. I&E M.B. at 56-58. Further, I&E submitted that in *Columbia Gas*,the Commission affirmed ALJ Dunderdale’s denial of a management performance adjustment based on similar grounds, in consideration of the current pandemic. *Id.* at 57 (citing *Columbia Gas* at 134).

Similar to I&E, the OCA argued that the Company’s management performance is not sufficient to justify the imposition of additional costs on PECO’s ratepayers even under normal conditions, let alone during a pandemic. The OCA echoed I&E that the Commission should reject PECO’s request for a management effectiveness adjustment for the same reasons it did so in denying Columbia’s request in *Columbia Gas.* The OCA also submitted that many of the Company’s claimed examples of superior management performance are merely activities that were necessary for the Company to comply with specific legal requirements, such as Section 1501, Commission Orders approving settlements, or Commission regulatory standards. In addition, the OCA claimed that PECO’s performance in the area of customer service is neither superior nor exemplary. According to the OCA, the change in its J.D. Power score that PECO highlighted is not a meaningful indicator of management effectiveness when the Commission has its own performance metrics and evaluations. Moreover, the OCA pointed to the testimony of its witness Mr. Colton that customer satisfaction, collections data, and customer service outcomes data revealed that PECO’s performance trended towards the middle or bottom level of performance. OCA M.B. at 95-111; OCA R.B. at 57-63.

The OSBA took the position that PECO should not receive any upward adjustment in its ROE for management effectiveness. According to the OSBA, such an adjustment is inappropriate during the COVID-19 pandemic. The OSBA echoes I&E and the OCA that ALJ Dunderdale rejected a similar proposal in *Columbia* Gas based on this same reasoning. OSBA M.B. at 4-5, 7.

#### Recommended Decision

ALJ Pell concurred with the position of I&E, the OCA, and the OSBA that PECO should not be awarded an additional twenty-five basis points for “superior management performance.” The ALJ highlighted the I&E’s position that awarding the Company management effectiveness points would cost the customer money for PECO to provide adequate, efficient, safe, and reasonable service that is required by the Code and the Commission’s Regulations. The ALJ also found persuasive I&E’s argument that even a modest increase in the cost of equity by an additional twenty-five basis points results in ratepayers paying an additional $3,285,458. According to the ALJ, any savings from effective operating and maintenance cost measures should instead flow through to ratepayers and investors. Therefore, the ALJ recommended that no upward management effectiveness adjustment be made to the Company’s cost of equity. R.D. at 216.

#### PECO Exception No. 11 and Replies

In its Exception No. 11, PECO takes issue with the ALJ’s finding that he was particularly persuaded by I&E’s arguments against the Company’s requested management effectiveness adjustment. PECO submits that I&E’s witness stated only that PECO’s performance was “adequate” and that the ALJ similarly made no findings regarding PECO’s actual performance. According to PECO, this approach runs contrary to Section 523 of the Code, *supra,* by assuming that all service is “adequate” and, therefore, undeserving of any additional recognition. PECO stresses that Section 523 explicitly requires consideration of the adequacy of service. In addition, PECO notes that the Commission has previously considered and rejected broad arguments that no management performance recognition should be provided for the performance of a utility’s statutory obligations and has instead awarded an increase in equity. PECO insists that when the record in this proceeding is examined, it is clear that the Company has met its burden of demonstrating that it has provided superior management effectiveness through increased quality and reliability of service, commitment to energy efficiency, use of cost-effective new technologies, its vigilance in protecting the safety of its workers, and its strong promotion of community and economic development. PECO Exc. at 32-34.

PECO also submits that the ALJ erred by giving no consideration to the Company’s actions in response to the COVID-19 pandemic. PECO notes that it delayed the filing of its rate case by six months. According to PECO, this decision was recognized by each of the Parties to this proceeding. PECO also claims that it undertook several customer initiatives in light of COVID-19. Namely, PECO states that it provided extensive assistance to customers, temporary modifications to the eligibility requirements for the Company’s hardship fund, and several temporary universal service measures that remain pending before the Commission. PECO Exc. at 35 (citing *Petition of PECO Energy Company for Public Meeting August 6, 2020 Expedited Approval of Temporary Universal Service Measures to Address COVID-19 Related Economic Hardship and Provide Additional Opportunities for Electric Usage Reduction*, Docket No. P‑2020‑3020555). PECO stresses that the Commission has recognized management effectiveness through increases in a company’s cost of equity, even in economically challenging times such as the 2008 recession. PECO Exc. at 32 (citing *Pa. PUC v. Aqua Pa., Inc.*, Docket No. R-00072711 (Order entered July 31, 2008)). Therefore, PECO remains of the opinion that it should receive an upward adjustment of twenty-five basis points to its ROE for management performance. PECO Exc. at 35.

In its Replies to Exceptions, I&E submits that the ALJ properly denied the Company’s request for an upward adjustment of twenty-five basis points for management effectiveness. I&E agrees with the ALJ that any savings from effective operating and maintenance cost measures should flow through to ratepayers and investors. Therefore I&E opines that PECO’s Exception No. 11 should be denied. I&E R. Exc. at 12.

In its Replies to Exceptions, the OCA contends that the Commission’s determination of just and reasonable rates should not include any additional basis points in equity return for management performance, consistent with the recommendation of the ALJ. The OCA reasons that the ALJ’s recommendation is actually consistent with Section 523(a), 66 Pa C.S. § 523(a). The OCA continues that under Section 523(a), the Commission is to 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.” In the OCA’s view, the ALJ considered, as other relevant evidence, the potential $3.2 million impact of the Company’s claim on ratepayers for the Company to provide service that is mandated under Section 1501 of the Code. In addition, the OCA submits that PECO references the COVID-19 pandemic only to claim its response thereto was an example of superior management performance. However, the OCA argues that the adverse impact of the COVID-19 pandemic on consumers lends support to the ALJ’s recommendation to deny the Company’s claimed upward adjustment to ROE. OCA R Exc. at 12-13.

#### 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 Replies to Exceptions of the Parties, we are in agreement with the ALJ’s recommendation that an upward adjustment for management performance is not appropriate in this proceeding. We are of the opinion that such an upward adjustment is contrary to the public interest. As discussed above, we have adopted the ALJ’s recommendation that I&E’s proposed proxy group and use of the DCF method be used in setting a cost of equity for PECO. Having also adopted the Company’s proposed cost of debt and actual capital structure, this results in a 10.24% cost of equity that is, in our view, already on the higher side of what is just and reasonable. As such, we conclude that no additional upward adjustment is warranted.

We also agree with the OCA’s argument in its reply to PECO’s Exception No. 11 that ALJ Pell properly recommended denial of the Company’s claim consistent with both Section 523(a) of the Codeand the record developed in this proceeding. Namely, like the ALJ, we are persuaded by I&E’s argument that even a modest increase in the cost of equity by an additional twenty-five basis points results in ratepayers paying an additional $3,285,458 in order to receive the level of service that is already required by Section 1501 of the Code. We join the ALJ in echoing I&E’s position that ensuring that cost saving measures flow to ratepayers is especially important in light of the COVID-19 pandemic. Accordingly, we shall deny PECO’s Exception No. 11 and adopt the ALJ’s recommendation on this matter.

### Rate of Return on Common Equity

#### 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. PECO relied on each of these methodologies in presenting its recommended rate of return on common equity of 10.95%. This figure is inclusive of the 0.25% management performance upward adjustment that PECO requested. PECO M.B. at 60.

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

As a result of its DCF analysis, I&E recommended a cost of common equity of 10.24%. I&E M.B. at 55.

The OCA recommended a cost of common equity of 8.75% under a traditional ratemaking approach, primarily based on the DCF model. OCA M.B. at 94.

The OSBA noted that in the instant proceeding, the Company requests a 10.95% ROE when the current 10-Year T-Note yields 0.90%. OSBA M.B. at 5. According to the OSBA, this implies a 10.05% (*i.e.,* 1005 basis points) risk premium over the ten-year T‑Note rate. The OSBA submitted that the average risk cost of equity capital is 8.0% and implies that PECO should receive an ROE below 8.0%. OSBA M.B. at 4-5.

#### Recommended Decision

The ALJ rejected PECO’s proposed rate of return on common equity of 10.95%. Namely, the ALJ agreed with I&E’s proposal to calculate the recommended cost of equity pursuant to the DCF methodology and using the CAPM to verify the reasonableness of the DCF ROE. According to the ALJ, I&E’s analysis is consistent with the methodology commonly endorsed by the Commission and most recently accepted in *Columbia Gas*. Therefore, the ALJ recommend that the Commission adopt the 10.24% cost of equity as determined by I&E. R.D. at 215.

#### Exceptions and Replies

##### OCA Exception No. 5B and Replies

In its Exception No. 5B, the OCA disagreed with the ALJ’s cost of equity recommendation of 10.24%, based on I&E’s methodology recently approved in *Columbia Gas*. The OCA claims the ALJ erred by using a mechanical approach and failed to question whether the 10.24% cost of equity results in affordable rates when compared to the 9.86% cost of equity in *Columbia Gas.* In addition, the OCA argues that I&E’s cost of equity is not reflective of current market conditions. OCA Exc. at 18-20.

In its Replies to Exceptions, PECO submits that the Commission should reject the OCA’s cost of equity recommendation of 8.75%. PECO’s specific arguments in support of this position are set forth under the Proxy Groups and Methods for Determining the Cost of Common Equity, discussed, *supra.* PECO R. Exc. at 11-12.

In its Replies to Exceptions, I&E disagrees with the OCA’s Exception No. 5B. I&E states the ALJ correctly recommended the 10.24% cost of equity, calculated according to I&E’s DCF methodology, while using the CAPM as a check on the reasonableness of the return. I&E R. Exc. at 18.

##### OSBA Exception No. 1 and Replies

In its Exception No. 1, the OSBA argues that the ALJ erred by not addressing problems associated with relying on the DCF methodology. The OSBA restates its argument that the average risk cost of equity capital is 8.0% and implies that PECO should receive an ROE below 8.0%. Consequently, the OSBA submitted the only reasonable ROE proposal is no more than the OCA’s 8.75% cost of equity. OSBA Exc. at 2-3.

In its Replies to Exceptions, PECO submits that the OSBA’s proposed ROE should be rejected because, *inter alia*, the OSBA did not show how the alleged “premium” over Treasury bond yields provides any basis for calculating a proper cost of equity for the Company. PECO R. Exc. at 12.

#### d. Disposition

We have previously determined above that, consistent with Commission precedent, we shall use the DCF method as the primary method in establishing PECO’s cost of common equity. Further, we have adopted the ALJ’s recommendation to use I&E’s DCF methodology and to use I&E’s CAPM calculation as a check on the reasonableness of the DCF determined cost of equity. Therefore, we shall adopt the ALJ’s recommended 10.24% cost of equity. In our view, this is an appropriate cost of equity for PECO given the record developed in this proceeding. Accordingly, we shall deny: (1) the ROE arguments set forth in the OCA’s Exception No. 5B; and (2) the OSBA’s Exception No. 1.

## Overall Rate of Return

### Positions of the Parties

In this proceeding, PECO claimed that it should be permitted to earn a 7.64% overall rate of return. PECO’s proposed overall rate of return is comprised of a weighted average of a 3.84% rate of return on long-term debt, and a 10.95% rate of return on common equity, inclusive of a 25-basis point upward adjustment for management effectiveness. This is, in turn, based on a capital structure of 53.38% common equity and 46.62% long-term debt. PECO Exh. PRM-1 (updated) at 1.

I&E recommended that PECO should be afforded the opportunity to earn an overall rate of return of 7.26%. This recommended overall rate of return is comprised of a weighted average of a 3.84% rate of return on long-term debt and a 10.24% rate of return on common equity and is based off of the Company’s proposed capital structure. I&E M.B. at 9, 59.

The OCA proffered that the Commission should allow PECO the opportunity to earn a 6.30% overall rate of return on its rate base. The OCA’s recommendation is comprised of a weighted average of a 3.84% rate of return on long-term debt and an 8.75% rate of return on equity and is based on a hypothetical capital structure of 50% common equity and 50% long-term debt. OCA M.B. at 74.

Although the OSBA proposed a rate of return on common equity “of no more than 8.75 percent,” the OSBA did not provide tables specifying its proposed overall rate of return. OSBA M.B. at 5.

### Recommended Decision

The ALJ recommended that the Commission adopt I&E’s proposed overall rate of return of 7.26%. This is based upon the ALJ’s recommendations, *supra,* (1) approving the Company’s proposed capital structure of 53.38% common equity and 46.62% long-term debt; (2) approving the Company’s claimed cost rate of 3.84% for long‑term debt; (3) utilizing I&E’s methodology for determining a rate of return on common equity; and (4) denying the Company’s claimed 25-basis point upward adjustment for superior management performance. R.D. at 211-16.

### Exceptions and Replies

Only PECO and the OCA filed exceptions to the ALJ’s recommendations on a fair rate of return for the Company. PECO and the OCA’s Exceptions and Replies to Exceptions on the overall rate of return are based on their respective Exceptions and Replies to Exceptions regarding the ALJ’s recommended capital structure, proxy group, and the cost of common equity, *supra.*

### Disposition

For the reasons discussed above, we have adopted the ALJ’s recommendation as to the appropriate capital structure, cost of debt, and cost of common equity for PECO. Table 4 below summarizes our final determinations regarding PECO’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 PECO at 7.26%.[[60]](#footnote-61)

**Table 4: PECO Capital Structure - Authorized Overall Rate of Return**

|  |  |  |  |
| --- | --- | --- | --- |
| **Capital Type** | **Ratio** | **Cost Rate** | **Weighted Cost** |
| **Long-Term Debt** | 46.62% | 3.84% | 1.79% |
| **Equity** | 53.38% | 10.24% | 5.47% |
| **Total** | 100.00% |  | **7.26%** |

# Customer Programs and Miscellaneous Issues

## Recommendations Related to the COVID-19 Pandemic

### Positions of the Parties

Due to the economic crisis created by the COVID-19 pandemic, OCA witness Mr. Colton proposed an ERP to provide financial and collections relief to residential customers, particularly low-wage customers that may not have access to other forms of assistance. OCA M.B. at 127; OCA St. 5 at 27, Sch. RDC-1. The ERP proposal provides that the relief plan would conclude on December 31, 2021, and that the Parties in this proceeding would meet thirty days prior to the termination date to discuss a possible further extension of benefits. The ERP also includes cost recovery through a deferral mechanism so that current rates would not increase until the full extent of the pandemic and its economic consequences are known. OCA M.B. at 127; OCA St. 5 at 27, Sch. RDC-1, ¶ 4. The OCA submits that the Company already proposed a relief program for small business customers, and a relief plan should also be implemented for residential customers. OCA M.B. at 127; OCA St. 5 at 27.

Mr. Colton’s Schedule RDC-1 sets forth the details for the OCA’s proposed ERP. Customers would be eligible if they met the following criteria:

i. Any residential customer meeting the following qualifications will be eligible for the program: (i) The customer is a current customer in arrears; and (ii) The customer is not participating or eligible for [the Customer Assistance Program (CAP)]; and (iii) The customer provides the following:

1. proof of unemployment benefits filed/received for one or more household members on March 13, 2020; or

2. proof the customer, or a member of the customer’s household, is eligible for, or has received, the first federal COVID-19 relief check in the amount of $1,200.

OCA M.B. at 127-128; OCA St. 5, Sch. RDC-1, ¶ 1(c).

According to the OCA, the following benefits would be provided to eligible customers under the ERP:

b. Residential customer ERP benefits shall include:

i. Upon enrollment, suspension of collection efforts for any amounts due for service beginning as of the March 2020 billing cycle and continuing through the duration of the shutoff restrictions adopted pursuant to paragraph 1; and

ii. Upon enrollment, a customer shall be entitled to a one-time credit (up to $400) in an amount equal to 25% of the customer’s applicable balance as of the ERP Enrollment Termination Date (defined below).

iii. All ERP customers will be screened for CAP and [PECO’s Hardship Fund, the Matching Energy Assistance Fund (MEAF)] eligibility, and those who may be eligible will be encouraged to apply for the most appropriate program to address their needs.

iv. For customers determined to be ineligible for CAP, any remaining current applicable balance shall be subject to a long-term deferred payment arrangement (including the suspended amount). For purposes of establishing a deferred payment arrangement for applicable balances, the Company shall offer payment arrangement terms consistent with section 1405(b) or 24 months, whichever is longer, unless a shorter arrangement is affirmatively agreed to by the consumer. Longer payment arrangements may be offered to ERP participants at the discretion of the Company.

OCA M.B. at 128; OCA St. 5, Sch. RDC-1, ¶ 2(b).

CAUSE-PA witness Mr. Miller recommended various comprehensive, short-term policies and programs to help alleviate the impact of the pandemic on PECO’s residential customers, particularly on economically vulnerable low-income customers. Mr. Miller’s recommendations included the following:

* Increase funding for PECO’s Hardship Fund program by $2 million, through the use of pipeline penalty credits and refunds.
* Waive the current burdensome requirement that hardship fund recipients achieve a zero dollar balance as a condition to issuing a grant, even if the balance could be deferred for forgiveness through enrollment in CAP or otherwise addressed through a long term payment arrangement.
* Waive income certification requirements for enrollment in CAP until the state is no longer under a state of emergency.
* Provide arrearage forgiveness for arrears accrued while in CAP.

Waive late fees and reconnection fees for at least one year after a final order in this proceeding is issued.

CAUSE-PA M.B. at 16-17; CAUSE-PA St. 1 at 38-41. CAUSE-PA averred that each of these recommendations will help provide necessary assistance to those impacted by the pandemic and will help to ensure that low-and moderate-income families, including those who may find themselves in poverty for the first time, can maintain access to critical natural gas services to their homes. CAUSE-PA M.B. at 17.

PECO argued that the OCA and CAUSE-PA’s recommendations are not necessary, as the Company has been proactive in assisting its customers throughout the COVID-19 pandemic. PECO stated that its witness Ms. Kelly Colarelli described the offerings the Company has implemented that benefit all residential customers and those who participate in universal service programs. PECO M.B. at 80. PECO explained that since March 2020, PECO has offered all residential customers the opportunity to enter into a twenty-four-month payment agreement and has used many strategies to inform customers about this special payment agreement and facilitated enrollment through automated processes. *Id*. at 80-81. PECO noted that on December 17, 2020, the Commission approved PECO’s proposal to temporarily modify the eligibility requirements for the Company’s hardship fund, MEAF, to expand the number of customers who may qualify for assistance. *Id*. at 81 (citing *Petition of PECO Energy Company to temporarily amend its current 2016-2018 Universal Service and Energy Conservation Plan (2016 USECP Petition)*, Docket Nos. P-2020-3022124 and M‑2015‑2507139 (Secretarial Letter issued December 17, 2020)). The Company also filed a COVID-19 relief proposal on June 26, 2020, that included, among other things, a bill credit for CAP customers, temporary waivers of certain requirements for CAP enrollment and recertification, and a transfer of unspent Low-Income Usage Reduction Program (LIURP) funds to a summer cooling initiative. PECO M.B. at 81 (citing *Petition of PECO Energy Company for Expedited Approval of Temporary Universal Service Measures to Address COVID-19 Related Economic Hardship and Provide Additional Opportunities for Electric Usage Reduction* (*PECO June 2020 Petition*), Docket No. P-2020-3020555).[[61]](#footnote-62) Finally, consistent with Commission Orders at Docket No. M-2020-3019244, the Company implemented a variety of COVID-19 relief measures, including a moratorium on termination of service and waiver of connection fees and deposits for reconnection of service. PECO M.B. at 81; PECO St. 10-R at 3-4.

### Recommended Decision

The ALJ agreed with PECO that the consumer protection proposals of the OCA and CAUSE-PA were not necessary at this time and recommended that the Commission decline to approve the proposals. The ALJ found that the record demonstrated that PECO has been proactive in taking measures to help its customers during this pandemic. R.D. at 265. In reaching his conclusion, the ALJ cited to the Commission’s recent Order lifting the termination moratorium, stating that the Commission recognized that there have been improvements in Pennsylvania, as follows:

First, we acknowledge that even though Pennsylvania’s COVID-19 diagnoses and deaths are decreasing from previous tragic peaks reached in 2020 and January of this year, and vaccinations have begun, the pandemic is not yet over. However, the pandemic’s effect on the Commonwealth’s unemployment numbers has changed. Pennsylvania’s unemployment rate has improved from an astounding 16.2% in April 2020, to 10.2% in August 2020, to 7.1% in December 2020. This downward trajectory bodes well for Pennsylvania’s economy if this trend continues. February 2021 Pennsylvania statistics are not yet available, but the national unemployment rate for February at 6.2%, represents a continuing downward trend.

*Id*. (citing *Public Utility Service Termination Moratorium* (*March 2021 Moratorium Order*), Docket No. M-2020-3019244 (Order entered March 18, 2021) at 2).

Moreover, the ALJ noted the modifications/protections the Commission established in the *March 2021 Moratorium Order*. The ALJ concluded that while the Commission lifted the moratorium on service terminations, the Commission implemented several modifications/protections to existing collection policies that will apply to all electric, natural gas, water, wastewater, telecommunications, and steam utilities under the Commission’s jurisdiction until December 31, 2021. R.D. at 265 (citing *March 2021 Moratorium Order* at 4). The ALJ noted that these modifications/protections provide temporary extensions on payment arrangement terms for residential and small business customers. R.D. at 265-266.

### OCA Exception No. 6, CAUSE-PA Exception No. 1, and Replies

In its Exception No. 6, the OCA avers that the ALJ erred by denying the OCA’s proposed ERP. OCA Exc. at 20 (citing R.D. at 264-66). The OCA argues that PECO’s proposed consumer protections are limited and insufficient to address the impact of the COVID-19 pandemic on low-wage customers. The OCA states that the ALJ’s determination ignores the fact PECO’s current COVID-19 programs are primarily designed to assist low-income customers that qualify for universal service programs, while the ERP would extend beyond low-income customers who qualify for the existing universal service programs. The OCA explains that the ERP is designed to address customers who are not economically self-sufficient and have been hard-hit by the COVID-19 pandemic, but whose incomes exceed 150% of the FPL. *Id*. at 21. The OCA also explains that the ERP would provide a one-time credit, equal to 25% of the balance, or a maximum of $400, to eligible customers to help retire large arrearages and prevent termination. *Id*. (citing OCA St. 5, Sch. RDC-1, ¶ 2(b)).

The OCA also contends that while the payment arrangements provided for in the *March 2021* *M**oratorium Order* are important, these payment arrangements alone are not sufficient assistance. OCA Exc. at 21. The OCA asserts that its ERP proposal combines financial relief with a payment arrangement, and they operate together to address the needs of those customers that would otherwise fall in the gap between the customers that are eligible for low-income customer assistance programs and the customers that are economically self-sufficient. *Id*. at 21-22 (citing OCA St. 5 at 28). The ERP proposal would provide much-needed economic relief to customers that have demonstrated an impact from the COVID-19 pandemic and are otherwise having challenges paying their arrearages. The OCA submits that the *March 2021* *M**oratorium Order* does not prevent a public utility or the Commission from providing further relief for customers in a base rate proceeding. *Id*. at 22. The OCA avers that its proposed ERP should be approved because it would assist those near-poor, low-wage, low-income non‑CAP residential customers that are struggling due to the public health and economic crisis. *Id*. at 23.

In its Exception No. 1, CAUSE-PA argues that the ALJ erred in granting a rate increase during the COVID-19 pandemic without requiring changes to the Company’s policies and implementation of programs to mitigate the economic harm to low- and moderate-income customers. CAUSE-PA notes that its witness, Mr. Miller, recommended that PECO be required to implement the following emergency pandemic provisions: (1) increase funding for PECO’s Hardship Fund Program; (2) waive the requirement that grant recipients achieve zero balance, and require that grant recipients be provided with an affordable payment arrangement for any remaining balance after application of a hardship grant; (3) waive income certification requirements until businesses fully reopen and the state of emergency ends, and require PECO to work with stakeholders to develop a transition plan; (4) provide arrearage forgiveness for in-CAP arrears accrued during the pandemic; and (5) waive late fees and reconnection fees. CAUSE-PA Exc. at 4-6 (citing CAUSE-PA St. 1 at 38-41).

CAUSE-PA avers that the actions for which ALJ Pell credits PECO’s pandemic response are mostly existing obligations that have not expanded the availability of assistance to those in need and, in some cases, may detract from the availability of adequate assistance to those in need. CAUSE-PA Exc. at 6. For example, CAUSE-PA states that PECO has only offered customers twenty-four-month payment agreements, which CAUSE-PA believes are not affordable for low-income customers and are inferior to the payment arrangements offered by the Commission’s Bureau of Consumer Services, which allow for payment arrangements with terms of up to sixty months for low-income customers. *Id*. at 7 (citing 66 Pa. C.S.§ 1405(b)). CAUSE-PA also states that PECO’s process for connecting customers to payment arrangements is based on an automated Interactive Voice Response (IVR), and this process violates the statutory requirements in Chapter 14 that public utilities must provide information and referrals to appropriate universal service programs. Mr. Miller testified, “[i]f a payment arrangement is offered automatically through the IVR, there is no opportunity to assess the customer’s current economic circumstances” in order to match struggling customers with available assistance. CAUSE-PA Exc. at 7 (citing CAUSE-PA St. 1-SR at 5). CAUSE-PA further notes that PECO’s IVR payment arrangement process, which offers only an automated twenty-four-month payment arrangement to consumers calling for help with their bill, contradicts the Commission’s *March 2021 Moratorium Order*, which requires utilities to offer customers with incomes at or below 250% of the FPL with a sixty-month payment arrangement until December 31, 2021. CAUSE-PA Exc. at 7.

CAUSE-PA similarly criticizes PECO’s actions to increase eligibility for its Hardship Fund, MEAF, stating that this merely expanded the eligibility threshold but did not increase the budget available to servethose in need. CAUSE-PA avers that PECO’s entire MEAF budget is only $250,000 for both its natural gas and electric divisions**,** compared to the $122 million in arrears accrued by PECO’s residential consumers during the pandemic. CAUSE-PA contends that changes tothe eligibility criteria to spread this limited amount of funding across a greater number of customers is an inadequate response to address this crisis. CAUSE-PA continues that the only other step PECO has taken to address the pandemic was to file the *PECO June 2020 Petition* seeking approval to use funds already allocated to its universal service programming. CAUSE-PA contends that PECO has failed to take any further action in support of this petition. CAUSE-PA believes that the inadequacy of PECO’s pandemic response will expose tens of thousands of customers to the threat of termination and will ultimately result in an unprecedented increase in uncollectible expenses that will be borne by other residential consumers. CAUSE-PA Exc. at 8.

CAUSE-PA does not agree with the ALJ’s citation to the *March 2021* *Moratorium Order* as indicating that economic conditions in Pennsylvania are improving, noting that the evidence in this proceeding shows that low-income communities and communities of color have been hit the hardest by the economic crisis and are recovering more slowly. CAUSE-PA Exc. at 8 (citing CAUSE-PA St. 1 at 7-8). CAUSE-PA avers that the COVID-19 pandemic has had a severe detrimental impact on the economic climate in PECO’s service territory and on PECO’s customers’ abilities to afford service. CAUSE-PA states that even before the pandemic, a large portion of PECO’s customer base was unable to afford natural gas service, with nearly nineteen percent of PECO’s low-income consumers facing involuntary termination for nonpayment in 2019. CAUSE-PA asserts that COVID-19 program and policy mitigation is essential to ensure that consumers remain connected to natural gas services, especially if PECO’s rates increase, because this will further exacerbate unaffordability for low-income customers. CAUSE‑PA Exc. at 9.

In its Replies to Exceptions, PECO states that the ALJ correctly determined that any marginal benefit from CAUSE-PA and the OCA’s proposed initiatives are unnecessary because PECO took appropriate proactive relief measures and fully complied with the guidance and customer protections the Commission set forth in the *March 2021* *Moratorium Order*. PECO R. Exc. at 4-5. PECO states that since March 2020, it has offered all residential customers twenty-four-month payment agreements, used multiple means to inform customers of this opportunity, and facilitated enrollment through automated processes. *Id*. at 5. PECO also states that on December 17, 2020, the Commission approved a temporary modification of PECO’s MEAF eligibility so that more customers would qualify for assistance. *Id*. (citing *2016 USECP Petition*). PECO further states that it also implemented a variety of COVID-19 relief measures, including a temporary moratorium on terminating service and waiving connection fees and deposits for reconnection consistent with the Commission’s Orders at Docket No. M‑2020‑3019244. PECO R. Exc. at 5; s*ee also* PECO R. Exc. at 12-13. PECO believes it is appropriate to comply with the Commission’s COVID-19-related directives that were issued after considering the views of many stakeholders. *Id*. at 13.

### Disposition

Based on our review of the record in this proceeding, we conclude that the OCA and CAUSE-PA have not satisfied their burdens of proving that their COVID-19 relief programs should be adopted at this time. While these proposed programs have merit, PECO has presented testimony regarding the proactive measures it has taken to assist residential customers during the COVID-19 pandemic. PECO witness Mr. Bradley explained that since March 2020, the Company has provided all residential customers with the opportunity to enter into a 24-month payment agreement. As this payment agreement is being offered to all residential customers, some customers may receive a more beneficial agreement than would have been possible under Section 1405(b) of the Code, 66 Pa. C.S. § 1405(b), and neither PECO nor the Commission are precluded from offering a longer payment agreement to a customer based on income information. PECO has used various strategies, including emails targeted to customers with past due balances, letters, bill inserts, social media channels, and the Company’s website to inform customers about this special payment agreement. In addition to these strategies, PECO also implemented an automated enrollment process through which a customer could sign up for the payment agreement online or through IVR. PECO St. 1 at 20; PECO St. 10-R at 3.

PECO witness, Ms. Colarelli, testified regarding the Company’s proposed temporary measures within its universal service programs to provide additional relief to low-income customers during COVID-19. For example, on December 17, 2020, in the *2016 USECP Petition*, the Commission approved PECO’s proposal to temporarily modify the Company’s MEAF to expand the number of customers who may qualify for the program. PECO St. 10-R at 3. PECO also stated that it followed the directives in the Commission’s Orders at Docket No. M-2020-3019244, and implemented various COVID-19 relief measures, including a moratorium on termination of service and a waiver of connection fees and deposits for reconnection of service. *Id*. at 4.

We conclude that PECO’s actions in response to the COVID-19 pandemic, in combination with the modifications/protections set forth in the Commission’s *March 2021* *Moratorium Order*, are sufficient. While the *March 2021 Moratorium Order* was not entered until after the hearing and the Parties’ filing of briefs in this proceeding, PECO has indicated that it will follow this Order and we expect it to do so. Accordingly, PECO’s residential and small business customers will be offered extended repayment terms consistent with modifications/protections to existing collection policies delineated in the *March 2021 Moratorium Order*. For these reasons, we shall deny the Exceptions of the OCA and CAUSE-PA on this issue and adopt the ALJ’s recommendation.

## Universal Service Programs

### Positions of the Parties

CAUSE-PA averred that PECO’s CAP is not producing affordable rates for low-income customers for two reasons: (1) PECO’s current energy burden standards exceed the standards the Commission adopted in the CAP Policy Statement;[[62]](#footnote-63) and (2) PECO’s existing CAP program has failed to reach its own energy burden standards. CAUSE-PA M.B. at 22-23; CAUSE-PA St. 1 at 21-22. To address this unaffordability within CAP and to mitigate the impact of any approved rate increase on CAP customers, CAUSE-PA proposed several modifications to PECO’s CAP, including the following: (1) requiring PECO to adjust its applicable energy burden standards; (2) requiring PECO to immediately adjust the CAP fixed credit limit upon approval of any increase in rates; and (3) requiring PECO to develop a plan to increase CAP enrollment 50% by 2025. CAUSE-PA M.B. at 25; CAUSE-PA St. 1 at 23-24, 30-33).

CAUSE-PA also recommended several modifications to PECO’s LIURP program, including: (1) increasing the LIURP budget to a level comparable to similarly sized natural gas distribution companies (NGDCs); (2) establishing a $2,000 health and safety budget for LIURP jobs; (3) making the Company’s de facto heating pilot program a permanent part of its LIURP; (4) improving delivery of LIURP services to tenants and multifamily residents; and (5) establishing a policy that any unspent LIURP funds will automatically roll over and be added to the LIURP budget for the following year. *Id*. at 30-31.

PECO averred that CAUSE-PA’s proposals more properly would be considered as part of the ongoing proceeding concerning PECO’s proposed 2019-2024 Universal Service and Energy Conservation Plan (2019-2024 USECP) at Docket No. M‑2018-3005795.[[63]](#footnote-64) The Company explained that the 2019-2024 USECP contains the Company’s proposed universal service program terms, budgets, and customer outreach and education plans. The Company also explained that the 2019-2024 USECP significantly changes the format of PECO’s CAP from a Fixed Credit Option (FCO) to a Percentage of Income Payment Plan (PIPP), under which a CAP customer would receive a bill credit based upon his or her annual income and the applicable energy burden (EB) percentage. PECO proposed to adopt recommended EBs from the CAP Policy Statement for customers at 0-50% and 51-100% of the FPL and maintain PECO’s existing EBs for customers at 101-150% of the FPL. PECO M.B. at 82. PECO expects the PIPP to improve bill affordability for all CAP income groups in comparison to the current FCO. Given the time that will be required to transition to a PIPP, PECO also sought Commission approval to use the recommended EBs from the CAP Policy Statement as part of the FCO until the Company transitions from the FCO to its PIPP. *Id*. at 83; PECO St. 10-R at 8-9.

PECO noted that most of the issues raised in CAUSE‑PA’s CAP proposals are either pending before the Commission in other proceedings (adoption of new energy burdens, adjustment of the CAP credit after a rate increase, enhanced customer outreach) or already being implemented by the Company (waiving late fees and reconnection fees). PECO M.B. at 84-85. Similarly, PECO noted that the Company’s LIURP proposals, including overall program funding, spending limitations and high-usage thresholds are pending before the Commission in the 2019‑2024 USECP proceeding.

Likewise, the OCA averred that CAUSE-PA’s proposals relating to energy burdens are already being considered in two other proceedings, *Tenant Union Representative Network v. PECO Energy Company (TURN)*, Docket No. C‑2020‑3021557 (Initial Decision issued April 13, 2021)[[64]](#footnote-65) and the Company’s ongoing 2019-2024 USECP proceeding. The OCA opines that it is more appropriate to consider CAUSE-PA’s concerns regarding energy concerns in those proceedings.

The OCA also averred that CAUSE-PA’s CAP proposals should be addressed as part of the Company’s ongoing 2019-2024 USECP proceeding. OCA M.B. at 133; OCA R.B. at 70. Regarding energy burdens, the OCA stated that the Commission’s *Final CAP Policy Statement Order* anticipated that energy burdens would be addressed in USECPs, not in base rate proceedings. OCA M.B. at 134 (citing *Final CAP Policy Statement Order* at 2). The OCA submitted that reviewing energy burdens as part of a USECP will allow for consideration of the potential impacts to other elements of the USECP, such as the need for additional cost controls, and will also allow for an evaluation of energy burdens for both PECO gas and PECO electric. OCA M.B. at 137. With respect to CAUSE-PA’s CAP proposal, the OCA averred that the proposal would be a significant change to PECO’s CAP program and should be considered along with any other changes recommended to PECO’s CAP in the 2019-2024 USECP proceeding. *Id*. at 138; OCA St. 5-R at 11. OCA witness Mr. Colton testified that considering the proposal in the 2019-2024 USECP proceeding would allow CAUSE-PA to present additional programmatic and operational details that were not presented in this proceeding. OCA M.B. at 138-39; OCA St. 5-R at 11-12.

### Recommended Decision

The ALJ agreed with PECO and the OCA that CAUSE-PA’s proposals should be considered as part of the 2019-2024 USECP proceeding and recommended that the Commission decline to approve CAUSE-PA’s proposals at this time. R.D. at 267. In reaching this conclusion, the ALJ reasoned that if the universal service proposals were considered in isolation from the 2019-2024 USECP, all parties would be denied a complete view of how such proposals may impact other parts of the USECP. *Id*. at 266‑67. The ALJ cited to the Commission’s recent decision in *Columbia Gas* that energy burden and CAP credit calculation issues should not be considered separately from other parts of a company’s universal service program. *Id.* at 267.

### CAUSE-PA Exception No. 2 and Replies

In its Exception No. 2, CAUSE-PA avers that the ALJ erred in approving CAP rates that the Commission has determined are unreasonable and unaffordable, and these rates must be amended to ensure that PECO’s CAP rates are just, reasonable, and consistent with prior Commission Orders. CAUSE-PA Exc. at 10. CAUSE-PA sets forth four arguments in support of its position. First, CAUSE-PA states that the CAP rates approved in the Recommended Decision are unjust and unreasonable because the Commission’s *Final CAP Policy Statement Order* states that the current maximum energy burden ranges “do not reflect reasonable or affordable payments” for many low-income customers. *Id*. at 12 (citing *CAP Policy Statement Order* at 27). CAUSE-PA notes that the Commission is obligated under the Code to ensure that current and proposed rates are just and reasonable and to amend current rates when those rates are found to be unjust, unreasonable, or otherwise in violation of the law. CAUSE-PA Exc. at 12 (citing 66 Pa. C.S. §§ 1301, 1309(a)). CAUSE-PA submits that it makes no difference whether PECO’s CAP rates were previously approved by the Commission or whether those rates will be subject to review in a future or separate proceeding. CAUSE‑PA Exc. at 12-13. CAUSE-PA argues that the Commission must ensure that the rates charged to CAP customers are both just and reasonable in the context of this proceeding, and may not defer consideration of the reasonableness of CAP rates to another proceeding. *Id*. at 13. CAUSE-PA asserts that PECO’s CAP rates substantially exceed the maximum CAP energy burden standards set forth in the Commission’s revised CAP Policy Statement. *Id*. (citing *Final CAP Policy Statement Order* at 27). For these reasons, CAUSE-PA states that it would be categorically unjust and unreasonable to approve PECO’s CAP rates without adjusting PECO’s energy burden standards in compliance with the Commission’s revised energy burden standards. CAUSE-PA Exc. at 13-14.

Second, CAUSE-PA contends that the CAP rates the ALJ approved in the Recommended Decision contradict the Commission’s universal service obligations. *Id*. at 14. CAUSE-PA states that in addition to concluding that the current energy burden standards are unreasonable and unaffordable, the Commission has recently concluded that the Commission’s prior energy burden standards, currently in effect in PECO’s service territory, “fail to satisfy the statutory objectives of universal service and continue to lead to disproportionate termination numbers.” *Id*. (citing *Final CAP Policy Statement Order* at 30-31; 66 Pa. C.S. §§ 2202, 2203(8)). CAUSE-PA avers that the evidence in this proceeding demonstrates that PECO’s low-income customers, including CAP customers, have a markedly higher termination rate compared to average residential customers. CAUSE-PA also avers that these same customers carry a disproportionate level of debt due to the unaffordability of rates, which has worsened due to the ongoing economic crisis. CAUSE-PA Exc. at 14. Based on the record, CAUSE‑PA concludes that PECO’s CAP rates are not adequate to ensure that CAP customers can maintain service to their homes and, accordingly, PECO’s current CAP rates fail to satisfy the Commission’s statutory universal service obligations to ensure that universal service programs are adequate to assist low-income households in maintaining service. *Id*. at 14‑15.

Third, CAUSE-PA states that the CAP rates approved in the Recommended Decision are contrary to public policy, particularly in light of the ongoing pandemic. CAUSE-PA Exc. at 15. CAUSE-PA cites to Mr. Miller’s testimony, explaining that even with financial assistance, many low-income households are forced to forego other necessities or to keep their homes at unsafe temperatures. *Id*. (citing CAUSE-PA St. 1 at 28-30).  Mr. Miller also explained that energy poverty negatively impacts the entire economy, because termination of gas service is a common catalyst to eviction and homelessness, which costs communities’ additional resources and contributes to uncollectible expenses recovered from other residential consumers. CAUSE-PA Exc. at 15 (citing CAUSE-PA St. 1 at 21). CAUSE-PA submits that the need for relief from unreasonable and unaffordable rates is immediate, and helping low-income customers better afford service will ensure they have heat and hot water to properly wash, sanitize, and remain in their homes to help avoid the spread of COVID-19. CAUSE-PA Exc. at 16.

Fourth, CAUSE-PA argues that the CAP rates ALJ Pell approved violate the terms of a Commission-approved settlement. *Id*. CAUSE-PA submits that PECO’s failure to adjust its energy burden standards, consistent with the *Final CAP Policy Statement Order*, violates the terms of a 2015 Settlement and contradicts the terms of PECO’s currently effective, Commission-approved USECP. *Id*. (citing *PECO Energy Company Universal Service and Energy Conservation Plan for 2013-2015 Submitted in Compliance with 52 Pa. Code §§ 54.74 and 62.4*, Docket No. M‑2012-2290911 (Final Order entered July 8, 2015) (approving Joint Petition for Settlement) (referred to herein as 2015 Settlement)). CAUSE-PA states that Exhibit A at 2, n.3 of the 2015 Settlement, which was incorporated into PECO’s approved USECP, provided: “If the Commission changes the energy burden ranges set forth in its Policy Statement, PECO will utilize the new maximum allowable energy burden for each poverty level.” CAUSE-PA argues that PECO has not complied with this previously agreed-to term by adopting the Commission’s revised energy burden standards. CAUSE-PA Exc. at 16. For these reasons, CAUSE-PA asserts that the Commission must, as a matter of law and sound public policy, direct PECO to implement the maximum CAP energy burden standards contained in the Commission’s currently effective CAP Policy Statement. *Id*. at 17.

In its Replies to Exceptions, PECO explains that it currently operates its CAP according to its existing 2016-2018 USECP. PECO R. Exc. at 13 (citing *PECO Energy Company Universal Service and Energy Conservation Plan for 2016-2018 Submitted in Compliance with 52 Pa. Code §§ 54.74 and 62.4*, Docket No. M‑2015‑2507139 (Order entered Aug. 11, 2016)). PECO also explains that its proposed 2019-2024 USECP changes the format of the Company’s CAP from a FCO to a PIPP. Under the PIPP, CAP customers would receive a bill credit based on their annual income and the applicable EB percentage. PECO states that it has proposed to adopt the recommended EBs from the revised CAP Policy Statement for customers at 0%-50% and 51%-100% of the FPL and to maintain PECO’s existing EBs for customers at 101%‑150% of the FPL. PECO expects the PIPP to improve bill affordability for all CAP income groups compared to the Company’s current FCO. PECO R. Exc. at 13. PECO avers that the ALJ properly concluded that CAUSE-PA’s universal service proposals, including the CAP-specific recommendations, should be considered as part of the ongoing proceeding addressing PECO’s 2019-2024 USECP and that most of CAUSE‑PA’s CAP proposals are either pending before the Commission in other proceedings or already being implemented by the Company. *Id*. at 13-14.

PECO argues that the Commission should reject CAUSE-PA’s arguments for several reasons. First, PECO avers that the Commission did not make any final determination about the justness and reasonableness of PECO’s, or any other public utility’s, CAP or CAP rates in the revised CAP Policy Statement or the *Final CAP Policy Statement Order*. PECO R. Exc. at 14. PECO states that the Commission found it was appropriate to update its universal service recommendations, including EB proposals, for electric and gas utilities, and the Commission has acted consistently with its universal service obligations by providing updated guidance to public utilities through the CAP Policy Statement and by reviewing universal service programs through USECP proceedings. *Id*. at 14-15.

Second, PECO avers that CAUSE-PA’s proposal ignores a clear Commission directive about how to incorporate elements of the CAP Policy Statement. *Id*. at 15. PECO explains that the Commission directed public utilities to file an addendum to their existing or proposed USECP to reflect policy changes in the Revised CAP Policy Statement. *Id*. (citing *Final CAP Policy Statement* *Order* at 105). PECO states that there was no directive to address EBs, or any other part of the CAP Policy Statement, as part of a base rate proceeding and, in fact, *Columbia Gas* confirmed that rate proceedings are notthe proper context in which to consider EBs. PECO R. Exc. at 15 (citing *Columbia Gas* at 160).

Third, PECO contends that CAUSE-PA ignores that PECO’s compliance with the 2015 Settlement was recently affirmed by the presiding ALJ in a separate, fully-litigated proceeding where PECO directly addressed claims that it was violating the Settlement by failing to: (1) incorporate the EBs from the revised CAP Policy Statement; and (2) adjust CAP credits after a distribution base rate increase. PECO R. Exc. at 15 (citing *TURN*).

In its Replies to Exceptions, the OCA argues that the ALJ correctly declined to approve CAUSE-PA’s proposal to change PECO’s CAP energy burdens in this proceeding. OCA R. Exc. at 15. The OCA avers that CAUSE-PA’s argument that the law requires the Commission to revise PECO’s energy burdens in this proceeding is in error. *Id*. at 16. The OCA notes that the issue of the appropriate energy burdens for PECO’s USECP is currently the subject of two on-going proceedings. *Id*. (citing *TURN*; *2019-2024 USECP*)*.* The OCA submits that CAUSE-PA only considers the rate that CAP customers are charged and does not consider the rate in the context of the full CAP program, including the costs borne by other residential ratepayers. OCA R. Exc. at 16. The OCA states that as the Commission observed in *Columbia Gas*, the CAP Policy Statement does not consider the energy burdens in a vacuum. *Id*. (citing *Columbia Gas* at 161). The OCA believes that the need for additional cost controls, such as changes to the minimum payments or maximum CAP credits, must be evaluated as a part of the USECP. The OCA continues that the CAP Policy Statement also requires an evaluation of whether additional cost controls such as minimum payment terms, consumption limits, high usage treatments, and maximum CAP credits are necessary. OCA R. Exc. at 16 (citing 52 Pa. Code § 69.265(3)).

In response to CAUSE-PA’s argument that the Recommended Decision violates a Commission-approved Settlement, the OCA notes that the 2015 Settlement is currently the subject of the *TURN* Formal Complaint proceeding pending before the Commission. The OCA notes that in *TURN*, the ALJ recently issued a Recommended Decision concluding that PECO’s current energy burdens do not violate the 2015 Settlement. OCA R. Exc. at 16. The OCA asserts that any final Commission determination regarding the issues in *TURN* should be addressed in that proceeding. *Id*. at 16-17. Moreover, the OCA avers that the ALJ correctly deferred the issues CAUSE‑PA raised to be resolved as a part of the Company’s USECP, as the Commission stated that changes to energy burdens should be considered as a part of a utility-specific USECP. *Id*. at 17 (citing *Petition of Office of Consumer Advocate for Reconsideration/Clarification of the November 5, 2019 Final CAP Policy Statement Order at Docket No. M‑2019‑3012599*, Docket No. P-2020-3016885 (Order entered February 6, 2020), at 10‑11 (*February 2020 Reconsideration Order*)).

### CAUSE-PA Exception No. 3 and Replies

In its Exception No. 3, CAUSE-PA states that to the extent that any rate increase is approved in this proceeding, the Recommended Decision should be amended to require PECO to concurrently increase CAP credits by a percentage equal to the system-wide residential gas distribution rate, consistent with the terms of the 2015 Settlement. CAUSE-PA Exc. at 17. PECO notes that the 2015 Settlement provided the following: “If PECO is granted a gas base rate increase, the portion of each rate R customer’s Annual Credit that is attributable to distribution rates will be increased by a percentage equal to the system-wide residential gas distribution rate increase.” *Id*. at 17‑18 (citing 2015 Settlement, Exhibit A at 6). CAUSE-PA argues that PECO ignored this Settlement provision in its rate proposal and, instead, proposed to phase in adjustments to the CAP credits on a quarterly basis over a twelve-month period based on the customers’ actual usage rather than making immediate adjustments based on the approved system-wide average increase for residential rates consistent with the terms of the 2015 Settlement. CAUSE-PA Exc. at 18.

CAUSE-PA continues that if PECO’s approach to adjusting CAP credits is approved, PECO’s CAP customers will experience a higher percentage rate increase than the rest of the residential rate class. CAUSE-PA asserts that PECO’s approach will compound existing disparities in energy burdens and exacerbate the economic harm experienced by low-income consumers as a result of the pandemic and increase unaffordability. CAUSE-PA Exc. at 18. CAUSE-PA submits that failure to enforce clear, unambiguous terms of a settlement would have a chilling effect on the willingness of parties to negotiate settlements in the future. *Id*. at 19.

In its Replies to Exceptions, PECO reiterates that CAUSE-PA’s allegation of non‑compliance with the 2015 Settlement was raised in a separate, fully-litigated proceeding and was rejected by the ALJ in that proceeding. For this reason, PECO asserts that the Commission should reject CAUSE-PA’s argument concerning the adjustments of CAP credits. PECO R. Exc. at 15.

### Disposition

Upon review, we will not consider CAUSE-PA’s proposals relating to PECO’s energy burdens, PECO’s CAP, and other universal service program issues within the context of this base rate proceeding. We agree with the ALJ that CAUSE-PA’s proposals are more properly considered in the ongoing 2019-2024 USECP proceeding. This determination is consistent with the language in the *Final CAP Policy Statement Order*, at 60, 106, and the *February 2020 Reconsideration Order* at 10-11, which provide that energy burden levels and CAP credit issues should be addressed in a public utility’s USECP proceeding. The *May 2021 Tentative Order* contains a detailed discussion of various aspects of PECO’s CAP, including changes that are based on the amended CAP Policy Statement. The *May 2021 Tentative Order* requires additional information from PECO and allows for comments and reply comments from stakeholders.

We addressed similar issues in *Columbia Gas*, finding that issues related to Columbia Gas’s energy burden levels were more properly considered in the context of the Company’s next USECP filing. We concluded that energy burdens should not be considered separately from other parts of the Company’s CAP and universal service programs but should be considered as part of the Company’s entire universal service plan, including the need for changes and associated costs. *Columbia Gas* at 160. Additionally, as Mr. Colton aptly testified, because PECO serves both natural gas and electric customers, and this is only a natural gas rate proceeding, it is not clear that PECO could be directed to implement revised electric and natural gas CAP burdens in this proceeding. As a result, the potential for customer confusion would be significant, as PECO CAP customers who receive both electric and natural gas service from PECO would receive gas service under revised burdens and electric service under existing burdens. *See* OCA St. 5-R at 7. Accordingly, we are of the opinion that these issues are appropriately addressed in the 2019-2024 USECP proceeding which considers universal service program aspects pertaining to both gas and electric customers.

Moreover, under the circumstances in this case, many of the issues that CAUSE-PA raises in its Exceptions are currently being addressed in either or both the 2019-2024 USECP proceeding and the *TURN* proceeding. For instance, PECO’s proposed energy burdens in its CAP PIPP are addressed in great detail in the *May 2021 Tentative Order*. PECO, the OCA, and CAUSE-PA are participants in that proceeding. Issues concerning whether PECO’s energy burdens comply with the CAP Policy Statement and whether PECO is complying with the 2015 Settlement are before the Commission in the 2019-2024 USECP proceeding and *TURN* proceeding. PECO, the OCA, and CAUSE-PA are parties to that proceeding. As the Parties have had and will continue to have an opportunity to be heard on these issues in other active Commission proceedings, we find that these issues are appropriately resolved within the 2019-2024 USECP proceeding and the *TURN* proceeding. For these reasons, we shall deny CAUSE-PA’s Exceptions Nos. 2 and 3.

## Neighborhood Gas Pilot Rider (NGPR)

### Positions of the Parties

PECO proposed to extend the NGPR for five years beginning July 1, 2021, and to increase the annual NGPR cost to $7.5 million. PECO M.B. at 86; PECO St. 9 at 12-14. The Company also proposed to modify the NGPR in two ways. First, the Company will provide the first forty feet of gas main extension to each prospective residential natural gas customer at no cost, subject to unanticipated ground conditions or unusual permit requirements. Second, the Company will modify the calculation of the CIAC by assuming that 66% of prospective customers would take service during the first year of the extension. This differs from the current program in which the Company assumes that 66% of prospective customers will join over twenty years. PECO M.B. at 86; PECO St. 9 at 10-13. PECO stated that its proposed changes and increased budget are designed to increase customer participation in the program by lowering costs for all customers. PECO M.B. at 87; PECO St. 9-R at 11.

I&E proposed allowing up to forty feet of main line per contracted residential customer at no cost with certain limitations, such as abnormal underground conditions or unusual permit requirements as the Company stated. I&E also continued to recommend an annual allowance of $5,000,000 ($25,000,000 ÷ 5 years) for the capital costs associated with the proposed change to the NGPR, or a reduction of $2,500,000 ($7,500,000 - $5,000,000), to the Company’s claim. I&E M.B. at 60-61; I&E St. 2-SR at 39. I&E’s recommendations were based on its position that the Company has only spent $15,500,000 since the beginning of the NGPR, despite having a spending limit of $25,000,000. I&E M.B. at 61 (citing PECO St. 9 at 11-12). I&E’s recommendation was also based on the Company’s current CIAC calculation that assumes 66% of customers would take service over a twenty-year period. I&E averred that this calculation is flawed because only 44% of eligible customers have taken service since the beginning of the NGPR. I&E M.B. at 61; I&E St. 2-SR at 38.

### Recommended Decision

The ALJ recommended that the Commission approve the forty-foot gas main extension the Company proposed and that the Commission allow an annual allowance of $5 million for the capital costs associated with the proposed change to the NGPR. The ALJ agreed with I&E, finding that the Company did not supply any data that would demonstrate support for the increased allowance, such as how the cost of the forty‑foot allowance/increased interest would deplete the existing $5 million allowance. R.D. at 268.

### Disposition

No Party filed Exceptions on this issue with regard to the ALJ’s recommendation. We find the ALJ’s recommendation is reasonable and based on sound record evidence. Accordingly, we shall adopt the ALJ’s recommendation that permits PECO to modify its NGPR as proposed with regard to the forty-foot gas main extension with an annual allowance of $5 million for the capital costs associated with the proposed NGPR modification.

## EE&C Programs

### Positions of the Parties

As previously discussed, PECO requested $4.5 million in annual funding for its EE&C program to expand program offerings for both residential and low-income customers, fund pilot projects for emerging technologies, and use targeted marketing and customer outreach to increase customer participation in the program. PECO M.B. at 87; PECO St. 9 at 6-7. PECO proposed three new offerings for residential customers: an ENERGY STAR®+ furnace rebate, rebates for faucet aerators and showerheads, and a smart thermostat rebate. The Company also proposed doubling the existing rebate for ENERGY STAR® storage hot water heaters. PECO M.B. at 88; PECO St. 9 at 6-7. For low-income customers, the Company proposed a new Safe and Efficient Heating Program that would serve low-income customers who are not currently eligible for a LIURP heating audit. The program would include a site visit and unit inspection, provide information on unit maintenance along with extra filters, and install a carbon monoxide detector. PECO would also replace a limited number of furnaces and boilers as part of this program. PECO M.B. at 88; PECO St. 9 at 7-8.

The Company recognized that past customer participation levels have not met projections and that program expenditures have been less than budgeted amounts; however, the Company averred that its proposed budget will support expanded program offerings to encourage customer participation by giving customers more ways to participate and includes funding for targeted marketing campaigns that the Company believes will increase customer participation. PECO M.B. at 89; PECO St. 9 at 6-9. PECO also stated that if less than the $4.5 million is spent, the unspent funds will be returned to customers. PECO M.B. at 89; PECO St. 9 at 10.

In addition to the arguments set forth in Section VII.M (relating to EE&C Program Costs), I&E argued that promising to return unspent monies to customers for a program in which past customer participation levels have not met projections and program expenditures have been less than the budgeted amounts, does not constitute substantial evidence supporting a claim for increased funding to an underperforming program. I&E R.B. at 37-38.

The OCA recommended that the Commission: (1) deny the Company’s proposed increase to its voluntary natural gas EE&C portfolio; (2) re-allocate the Company’s existing budget consistent with the recommendation of OCA witness Mr. Crandall; (3) require the Company to perform and provide EMV studies of its EE&C programs; and (4) require the Company, consistent with its residential program reconciliation mechanism, to track unspent funds for its commercial EE&C programs and propose a plan to return those amounts to commercial customers in the Company’s next base rate proceeding. OCA M.B. at 143; OCA St. 6 at 29-38.

CAUSE-PA’s positions on this issue are set forth in detail in Section VII.M of this Opinion and Order, *supra* (relating to EE&C Program Costs).

### Recommended Decision

The ALJ addressed the issues pertaining to the Company’s EE&C programs in Section V.D.7.m. of the Recommended Decision. *See* R.D. at 130-31. We have summarized the ALJ’s findings in Section VII.M.2 of this Opinion and Order, *supra.*

### Disposition

The Exceptions and Replies to Exceptions pertaining to the Company’s EE&C programs are addressed in Section VII.M (relating to EE&C Program Costs) of this Opinion and Order.

## Quality of Service-Distribution Integrity Management Programs (DIMP)

### Positions of the Parties

PECO averred that it manages its natural gas distribution system in a safe and reliable manner that meets or exceeds federal and state pipeline operational requirements. PECO explained that to ensure safe and reliable pipeline operations, PECO complies with pipeline safety regulations under 49 C.F.R. Part 192 and the applicable provisions of the Pennsylvania Code under Title 52, Chapter 59. PECO explained further that its federally-mandated Distribution Integrity Management Program (DIMP) is PECO’s company-specific plan used to identify and resolve risks to the distribution system. According to PECO, the DIMP provides a rigorous framework for analyzing, ranking, and mitigating threats, and evaluating the effectiveness of those risk mitigation actions. PECO M.B. at 90 (citing PECO St. 1 at 14-15).

PECO provided that a key component of the DIMP is Risk Evaluation and Ranking. PECO calculates scores for a number of risk categories and creates a relative risk ranking to measure the performance of one group of assets compared to another. PECO M.B. at 91 (citing PECO St. 1-R at 5).

**[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]**

PECO noted that Ms. Bozhko expressed, in her direct and surrebuttal testimony, concerns that PECO has been ineffective at reducing corrosion risk on bare steel main and services. **[BEGIN COFIDENTIAL]**

**[END CONFIDENTIAL]**

I&E provided recommendations regarding PECO’s DIMP in I&E witness Elena Bozhko’s PROPRIETARY direct and surrebuttal testimony. I&E M.B. at 63 (citing I&E St. 4 at 6-24; I&E St. 4-SR at 7-9). I&E noted that while PECO’s witness Mr. Bradley provided confidential responses in rebuttal and oral rejoinder testimony regarding Ms. Bozhko’s recommendations, I&E continued to recommend the suggested methods to both monitor and reduce risk and damages to the PECO distribution system. I&E M.B. at 64 (citing PECO St. 1-R at 8).

### Recommended Decision

In response to I&E’s recommendations, the ALJ noted that PECO’s witness, Mr. Bradley, described PECO’s federally mandated DIMP used to identify and resolve risks to its gas distribution system. As noted by Mr. Bradley, the DIMP provides a rigorous framework for analyzing, ranking, and mitigating threats, and evaluating the effectiveness of those risk mitigation actions. R.D. at 269 (citing PECO St. 1-R at 7). **[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]**

Accordingly, the ALJ rejected I&E’s proposed recommendations based on Mr. Bradley’s testimony and the lack of any argument from I&E to the contrary. R.D. at 269.

### I&E Exception No. 1 and Replies

In its Exception No. 1, I&E maintains its position that the recommendations made by its witness Ms. Bozhko regarding PECO’s DIMP should be adopted by the Commission. I&E Exc. at 4 (citing I&E St. 4 at 2-19; I&E St. 4-SR at 3-9). **[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]**

I&E asserts that its recommendations are supported by the record evidence presented in Ms. Bozhko’s proprietary direct and surrebuttal testimony. I&E Exc. at 4 (citing I&E St. 4 at 2-19; I&E St. 4-SR at 3-9). Specifically, I&E points to Ms. Bozhko’s testimony that a review of the historical data reveals that PECO’s DIMP may not be effectively guiding efforts to proactively reduce system risks and might be inefficiently prioritizing the replacement projects to mitigate the riskiest threats in the distribution system. I&E Exc. at 4 (citing I&E St. 4 at 6). **[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]** I&E stressed that it is very important to consider material type, age, environment, size, pressure, location, leak history, and other information in order to mitigate risks though pipeline replacement. I&E Exc. at 5 (citing I&E St. 4 at 8). Ms. Bozhko concluded that a more granular asset category approach, including the division of asset groups into smaller measurable categories to measure performance more representatively, would allow PECO to increase the effectiveness of its threat remediation pursuant to 49 C.F.R. § 192.1007(e). *Id.*

In its Replies, PECO provides that I&E filed two exceptions to the Recommended Decision related to the ALJ’s rejection of I&E’s recommendations and proposed modifications to PECO’s DIMP, *infra*, to reduce leaks and damage to PECO’s distribution system. [**BEGIN CONFIDENTIAL]**

[**END CONFIDENTIAL]** Accordingly, PECO avers that the Commission should deny I&E’s Exceptions.

### Disposition

As noted, the ALJ rejected I&E’s recommendations because he was persuaded by the testimony of PECO’s witness Mr. Bradley, and that I&E offered no argument to the contrary. R.D. at 269. We, likewise, are persuaded by Mr. Bradley’s testimony, although, as discussed, *infra*, we also believe that Ms. Bozhko’s recommendation regarding DIMP categories has merit.

PECO’s witness Mr. Bradley submitted **[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]**

## Quality of Service-Leaks and Excavation Damage

### Positions of the Parties

**[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]**

PECO claimed that it uses a widely accepted industry damage rate metric for benchmarking that includes the total locate tickets received as part of the calculation, consistent with federal regulations. PECO averred that a closer review of the 2015 to 2019 period better reflects the impact of PECO’s damage reduction approaches. **[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]**

I&E provided that two of the main causes of reportable incidents are pipeline leaks caused by corrosion and damage to pipelines caused by third parties. I&E stated that it continues to recommend the suggested methods to both monitor and reduce risk and damages to the PECO distribution system as discussed in its witness Ms. Bozhko’s proprietary direct and surrebuttal testimonies. I&E M.B. at 64 (citing I&E St. 4 at 6-24; I&E St. 4-SR at 7-9).

### Recommended Decision

The ALJ stated that, as with the DIMP, I&E noted that two of the main causes of reportable incidents are pipeline leaks caused by corrosion and damage to pipelines caused by third parties. I&E proposed recommendations to monitor and reduce risks and damages to the PECO distribution system. R.D. at 269.

**[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]**

The ALJ recommend that the Commission reject I&E’s recommendations in light of Mr. Bradley’s testimony, as well as the lack of any argument from I&E to the contrary. R.D. at 270.

### I&E Exception No. 2 and Replies

In its Exception No. 2, I&E continues to assert that the recommendations made by its witness Ms. Bozhko regarding reducing risks associated with open leaks and excavation damage should have been recommended by the ALJ in his RD. I&E Exc. at 6 (citing I&E St. 4 PROPRIETARY at 14-24). These I&E recommendations include [**BEGIN CONFIDENTIAL]**

[[65]](#footnote-66) **[END CONFIDENTIAL]**

I&E maintains that its recommendations are supported by the record evidence presented in its witness Ms. Bozhko’s proprietary direct and surrebuttal testimony.I&E Exc. at 7 (citing I&E St. 4 at 14-24; I&E St. 4-SR at 3-9). Specifically, I&E notes the testimony of Ms. Bozhko that **[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]**

PECO provided its Reply to I&E Exception No. 2 in its Reply to I&E Exception No. 1, *supra*.

### Disposition

**[BEGIN CONFIDENTIAL]**

[[66]](#footnote-67) **[END CONFIDENTIAL]** Therefore, we shall grant, in part, I&E’s Exception No. 2, and modify the ALJ’s Recommended Decision consistent with the above discussion in this disposition.

# Rate Structure

This section of the Opinion and Order addresses the ALJ’s recommendations pertaining to cost of service, revenue allocation, and rate design. When a utility files for a rate increase and the proposed increase exceeds $1 million, the utility must include with its filing an allocated class cost-of-service study (ACCOSS or ACCOS Study) in which it assigns to each customer class a rate, based upon operating costs that it incurred in providing that service. 52 Pa. Code § 53.53; *Lloyd*, *supra*. Cost allocation studies require a considerable amount of judgment and are described as more of an accounting/engineering art rather than science. *Application of Metropolitan Edison Co.*, Docket No.R-00974008 (Order entered June 30, 1998); *Pa. PUC v. Pennsylvania Power & Light Co.*,1983 Pa. PUC Lexis 22. Public utility rates should enable the utility to recover its cost of service and should allocate this cost among its customers. These rates are required by statute to be just, reasonable, and non-discriminatory. 66 Pa. C.S. §§ 1301, 2804(10).

In this proceeding, there are nine different tariffed rate classes to which PECO allocates these costs. Those rate classes are as follows:[[67]](#footnote-68)

1. General Service – Residential (GR);[[68]](#footnote-69)
2. General Service – Commercial and Industrial (GC);[[69]](#footnote-70)
3. Large High Load Factor Service (L);
4. Motor Vehicle Service – Firm (MV-F);
5. Motor Vehicle Service - Interruptible (MV-I);
6. Interruptible Service (IS);
7. Temperature Controlled Service (TCS);
8. Gas Transportation Service – Firm (TS-F); and
9. Gas Transportation Service – Interruptible (TS-I).

## Allocated Class Cost of Service Study (ACCOSS)

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

The ACCOSS presented by PECO in this proceeding was sponsored by PECO’s witness Ms. Jiang Ding and utilized the Average and Excess (A&E) methodology to allocate non-directly assignable costs associated with distribution mains, as opposed to the Peak and Average (P&A) methodology advocated for by the OCA, as discussed *infra*, both of which rely heavily on annual or average throughput.[[70]](#footnote-71) *See* PECO Exh. JD-1-6.

PECO Exhibit JD-6 and pages 18 through 21 of PECO Exhibit JD-2, show the development of the external and internal allocation factors, respectively, used in performing the functionalization, classification, and class allocation procedures within its A&E ACCOSS. Utilizing its A&E ACCOSS, PECO quantified the revenue deficiency based on operating costs and revenues, as adjusted for the FPFTY. PECO Exh. JD-1. The increase or decrease needed for each rate class was calculated by comparing the revenue requirements for each rate class to the forecasted revenue at present rates for that class for the FPFTY. This was the same method used by PECO’s witnesses Mr. Michael J. Trzaska in Schedule A-1 of PECO Exhibit MJT-1 and Mr. Joseph A. Bisti in PECO Exhibit JAB-1, with respect to the overall revenue requirement and deficiency.

Based on several corrections to errors in its ACCOSS that were discovered through the discovery process and the direct testimony of the various Parties, PECO developed a revised ACCOSS, changing the factors which Mr. Bisti had relied upon in the development of the Company’s proposed revenue allocation.[[71]](#footnote-72) *See* PECO St. 7-R at 3‑5; PECO Exh. JD-1R through JD-6R. PECO Exhibit JAB-1 Revised (Corrected) contains the Company’s revised proposed revenue allocation, proposed increase by class, and class rates of return and relative rates of return under proposed rates. The Company’s revised revenue increase request of $66,279,000 reflected its revisions to its ACCOSS, as well as the previously discussed changes PECO had made to its requested revenue requirement.[[72]](#footnote-73)

The Company’s revised A&E ACCOSS provided class revenues at proposed rates based upon the Company’s attempt to move all classes toward an equalized rate of return (all classes’ revenues produce the proposed overall rate of return of 7.64%), which can be used as a rough target for apportioning class revenue increases. PECO Exh. JD-2R, p. 31. The results of such studies can be utilized to determine the relative cost of service for each class and help determine the individual class revenue requirements and, to the extent a particular class is above or below the system average rate of return, show the additional revenues each class is to receive or conversely the additional revenues that each class is to contribute to the Company’s overall revenues. In addition to the relative provision of revenues, relative rates of return are also provided which show how the rate of return for each class compares to the system average rate of return, indicating if each class is either under-paying or over-paying its allocated cost of service. PECO Exh. JAB-1 Revised (Corrected). This information is then used to determine the manner in which the proposed revenue increase should be allocated among the various rate classes with the goal of moving each rate class towards the system average rate of return. The results at equalized rates of return do not necessarily dictate the exact levels of class revenues proposed. The proposed class revenues may depart from the equalized rates of return in order to recognize a number of factors, including such things as gradualism, to provide for the total revenue requirement, public acceptability and feasibility of application, and to fairly apportion the total cost of service among the various customer classes. However, as the ALJ noted throughout his discussion and analysis, several of the parties point to *Lloyd*, wherein the Commonwealth Court determined that cost of service is the “polestar” of ratemaking. R.D. at 377-78, 393.

### Positions of the Parties

PECO stated that the largest component of its plant investment and associated fixed costs consists of mains. The Company explained that approximately 1% of the cost of its mains was directly assigned and the remaining balance of the cost of mains was allocated using the A&E methodology. PECO noted that the A&E methodology was used by PECO in its last gas base rate case[[73]](#footnote-74) and that it has been recognized as an acceptable methodology by the American Gas Association’s *Gas Rate Fundamentals* (1987 ed.) (*Gas Rate Fundamentals*). PECO M.B. at 98 (citing PECO St. 6 at 13-14). PECO offered the following description of the A&E method:

Under the A&E method, the portion of the cost of mains equal to the system average load factor is allocated among the rate classes based on their average daily deliveries (annual deliveries divided by 365 days). The balance of mains costs is allocated based on excess demand, which is the amount by which the design peak demand exceeds average demand for each class. The excess demand is allocated among rate classes in proportion to each class’ peak demand over its average demand.

*Id.* (citing PECO St. 6 at 13).[[74]](#footnote-75) In short, PECO offered that the A&E methodology “allocates mains costs based in part on average demand and in part on the portion of peak demand that exceeds average demand.” PECO R.B. at 62.

I&E agreed with the Company’s proposed A&E methodology as a reasonable method to allocate costs and revenues. I&E provided that, although it has historically supported the P&A methodology and the 50% peak / 50% average mains allocation, I&E has also supported the A&E methodology when it was presented in previous cases. I&E’s witness, Mr. Cline, offered that both the A&E and 50% peak / 50% average methodologies are reasonable solutions for a natural gas utility. Mr. Cline further noted that the Company’s proposed main allocation methodology is reasonable. I&E R.B. at 40; I&E M.B. at 65-66; I&E St. 3-SR at 15-16.

The OCA submitted that PECO’s arguments supporting its use of the A&E methodology are not persuasive. Accordingly, the OCA provided that the P&A methodology, in which peak demand and average demand are weighted equally, should be adopted. OCA R.B. at 82, 89.

The OCA’s witness, Mr. Glenn A. Watkins, asserted that the A&E methodology is rarely used to classify mains and that the Company’s approach to its A&E methodology does not conform to the A&E methodology cited in *Gas Rate Fundamentals.* OCA R.B. at 82 (citing OCA St. 4 at 18; OCA St. 4, Sch. GAW-2 at 4). The OCA also contended that the Company’s assertion that the Commission has adopted the A&E methodology as its preferred methodology for allocation of natural gas distribution mains is not supported by past Commission precedent. The OCA explained that, in *Pa. PUC v. PPL Gas Utilities Corp*oration, Docket No. R-00061398 (Order entered February 8, 2007) (*2007 PPL Gas Order*), the A&E methodology was accepted because it was the only methodology under consideration. OCA R.B. at 83-84 (citing *2007 PPL Gas Order* at 176-178). Further, the OCA detailed that, in *Pa. PUC v. Philadelphia Gas Works*, Docket No. R‑00061931 (Order entered September 28, 2007) (*2007 PGW Order*), the Commission adopted a modified ACCOSS because it was specific to the record evidence that attempted to achieve an equal balance between peak and annual demands, even though the Commission stated that allocating a percentage of the cost of distribution mains based on customer count was inappropriate. OCA R.B. at 84-85 (citing *2007 PGW Order* at 120-24). Moreover, the OCA cited to the Commission’s decision in *Columbia Gas* to defend the P&A methodology as the recognized precedent for allocation of distribution mains costs. OCA R.B. at 85, 87-88 (citing OCA M.B. at 175; OCA St. 4-R at 15; *Columbia Gas* at 215, 217-18). Mr. Watkins also clarified the difference between peak demand and average day demand, explaining that average demand, annual throughput and energy measure the utilization of resources over time, whereas peak demand measures the highest level of demand placed on the system and represents the amount of load on a system at a single point in time. OCA R.B. at 88-89 (citing OCA St. 4-SR at 2-3).

The OSBA submitted that PECO’s A&E methodology should be rejected because the load-factor-weighting used in its methodology is nearly identical mathematically to a pure peak demand allocator, with essentially no costs allocated based on average demand, and is inconsistent with the Commission precedent set forth in the *2007 PGW Order*. The OSBA added that, if an A&E methodology is retained and until a modern utility cost allocation methodology is developed, the Commission should rely upon the precedent set in the *2007 PGW Order*, wherein the average and excess components are each weighted at 50%. OSBA M.B. at 9‑11.

The OSBA’s witness, Mr. Robert D. Knecht, agreed with the OCA’s witness, Mr. Watkins, that when the 50/50 A&E factor approved by the Commission in the *2007 PGW Order* is applied to PECO, it is equal to an allocation method based on 67% peak demand and 33% average demand. OSBA M.B. at 9 (citing OSBA St. 1-S at 3-4; OCA St. 4-R at 8). Further, Mr. Knecht referenced the *2007 PGW Order* to argue that, when approving a 50/50 A&E allocation factor, the Commission indicated that the allocation of mains costs should rely on both average and peak demand. OSBA M.B. at 9-10 (citing OSBA St. 1 at 23-24). Moreover, the OSBA referenced *Columbia Gas* to note that the Commission chose a 50/50 weighted P&A methodology and, as a result, the OSBA now views the 50/50 P&A methodology as the most relevant Commission precedent regarding gas mains cost allocation. OSBA M.B. at 10. Mr. Knecht also addressed his concern regarding the Company’s initial derivation of class-specific design day demands for smaller, non-daily-metered customers and the TS-F rate class customers by applying a statistical analysis of the historical weather sensitivity of customer loads to develop alternative estimates for design day demand. OSBA M.B. at 11-12 (citing OSBA St. 1-S at 6-7, 13; OSBA St. 1 at 26, 28).

PAIEUG submitted that it supports the Company’s proposed A&E methodology, which includes a system load factor weighting, to allocate distribution main costs. PAIEUG asserted that this methodology is reasonable because it aligns with industry standards, Commission precedent and cost causation principles. PAIEUG cited several cases to note that NGDCs often rely upon A&E methodology for cost allocation of distribution mains and that the Commission has previously approved of the use of an A&E methodology and system load factor weighting by NGDCs.[[75]](#footnote-76) Further, PAIEUG noted that the A&E methodology aligns with how PECO designs and incurs costs related to its distribution system, explaining that peak demand is the driver of main costs rather than average demand, because the Company incurs distribution main-related costs when, due to potential peak operating conditions, expansion or an upgrade to the distribution system is necessary. Moreover, PAIEUG averred that using a system load factor weighting properly signals that the excess demand should be more heavily weighted due to the importance of a class’s peak demand in designing PECO’s distribution system. PAIEUG R.B. at 7-9; PAIEUG M.B. at 11-13 (citing PAIEUG St. 1‑R at 3-5; PECO St. 6-R at 7).

### Recommended Decision

The ALJ recommended that the Commission use PECO’s proposed A&E ACCOSS methodology. The ALJ agreed with the Company that its proposed methodology is reasonable because it aligns with the principles of cost causation. In support of his recommendation, the ALJ stated:

As PAIEUG indicates in support of the Company’s COSS, an A&E methodology using a system load factor weighing is the most consistent with cost causation for PECO. Pursuant to *Lloyd* and related Commission precedent, a COSS must have its foundation in cost of service and allocate costs to classes based on the manner in which they are incurred. Peak demand drives PECO’s distribution system planning, and therefore, PECO incurs distribution main costs based on each class’s peak demand. The average demand component of the A&E calculation represents the class’s average throughput. The excess demand component equals the design peak demand minus the average demand. Using a system load factor weighting properly signals that the excess demand component of the calculation should be more heavily weighted because a class’s peak demand is more important than its average demand when PECO is designing its distribution system.

R.D. at 404-05 (citing *Lloyd*; *Pa. PUC v. PPL Electric Utilities Corporation*, Docket No. R-2010-2161694 (Order entered October 15, 2010) at 63; *see also Pa. PUC v. Metropolitan Edison Company and Pennsylvania Electric Company,* Docket Nos. R‑00061366 and R‑00061367 (Order entered January 11, 2007), at 231; PECO St. 6-R at 7; PAIEUG St. 1-R at 3-5; PECO St. 6 at 13; PECO Exh. JD-6R at 5).

The ALJ noted that he was unable to conclude that the A&E methodology is unacceptable. According to the ALJ, although the Commission noted in its decision in *Columbia Gas* that the P&A methodology has been consistently utilized for NGDCs, the Commission did not rule out the use of the P&A methodology in future base rate proceedings. R.D. at 405 (citing *Columbia Gas* at 214).

### Exceptions and Replies

#### OCA Exception No.7 and Replies

In its Exception No. 7, the OCA argues that the ALJ erred in adopting the Company’s proposed A&E methodology to allocate distribution mains because it claims that the Company’s ACCOSS: (1) is inconsistent with cost causation and Commission precedent; (2) utilizes excess demand for distribution mains investment allocation; and (3) requires residential and small commercial classes to subsidize the higher load factor customer classes. The OCA asserts that the Commission should adopt Mr. Watkins’ P&A methodology because it: (1) reflects the principles of cost-causation; (2) weights the contribution to average and peak demand equally; (3) is consistent with long-standing Commission precedent; and (4) represents the most reasonable allocation method of distribution mains investment that is reflective of how PECO’s distribution system is used each day. OCA Exc. at 23-24, 30-31 (citing R.D. at 404).

The OCA refers to the testimony of its witness, Mr. Watkins, to assert that the Company measures the usage pattern of each class relative to its average usage instead of each class’ contribution to peak load, resulting in little excess demand assigned to classes with stable usage patterns, such as high load factor customer classes. The OCA claims that using excess demand to allocate distribution mains investment burdens the residential class because, with the exception of a few peak days, it has low usage throughout the year. The OCA affirms that allocating distribution mains in this way is inconsistent with how NGDCs operate their systems. OCA Exc. at 25-27 (citing OCA St. 4 at 8-10).

The OCA further cites Mr. Watkins’ testimony to contend that PECO’s use of excess demand weighting in its A&E methodology effectively weights the cost of distribution mains investment on the basis of peak demand. The OCA explains that Mr. Watkins calculated the actual weights given to average demand (annual use) and peak demand to determine that PECO’s analysis is similar to allocating distribution mains by 82.6% based on each class’ contribution to peak demand. The OCA references the *2007 PGW Order* to note that this type of weighting conflicts with Commission precedent that an ACCOSS should reflect both annual and peak demands. OCA Exc. 27 (citing OCA St. 4-R at 4; *2007 PGW Order* at 123-24).

The OCA also contends that the Company’s A&E ACCOSS does not align with the design of PECO’s system nor does it reflect how its system is used. The OCA provides that Mr. Watkins testified that when relying on the non-coincident peak, the Company’s use of a modified A&E approach, in which excess demand is not assigned to the interruptible class, is inappropriate. Further, the OCA notes Mr. Watkins’ claim that PECO’s evaluation of mains investment is based on both peak throughput and the annual margin revenues to be generated from that investment. Moreover, the OCA offers Mr. Watkins’ claim that, given that the allocation of mains is only relevant to the assignment of pipe costs and there is no clear relationship between the peak load capacity of a main and the cost of that pipe, weighting excess demand is not necessary. OCA Exc. at 28-29 (citing OCA St. 4 at 15-19).

In concluding its Exceptions, the OCA repeats that in the *2007 PPL Gas Order*, only PPL’s A&E methodology was considered as a P&A methodology was not presented. OCA Exc. at 30 (citing OCA St. 4-R at 5; *2007 PPL Gas Order* at 176-78). The OCA also reiterates that in the *2007 PGW Order*, the Commission, in selecting an A&E methodology that weighted both average and excess demand by 50 percent, found that “the allocation of distribution mains investment costs should be done using both *annual* and *peak* demands.” *Id.* (citing *2007 PGW Order* at 80).

In its Replies, PECO maintains its reliance on the A&E methodology, countering that the P&A methodology, which allocates mains costs based on average demand and total peak demand for each class, double-counts average demand, once in the average demand component and again as part of the total peak demand composition. PECO claims that this results in a bias against high load-factor customers who use the distribution system more efficiently than customers whose peak demands are much higher than their average usage. Further, PECO claims that because residential customers have temperature-sensitive demand and low load factors, the double-counting of average demand in the P&A methodology understates the cost of service for that class while overstating the cost of service of more efficient users. Moreover, PECO contends that the OCA’s argument that the Company’s A&E methodology is inconsistent with the design and use of PECO’s system was contradicted by its witness, Ms. Ding, who testified that PECO’s design criteria is driven by peak demand and not average usage. PECO R. Exc. at 21-22 (citing PECO R.B. at 62-63, 65-66; PECO M.B. at 101; PECO St. 6-R at 7).

In its Replies, I&E agrees with using the Company’s proposed A&E methodology, as it is a reasonable method to allocate costs and revenues. I&E reiterates that it has supported the A&E methodology as well as a 50% peak / 50% average mains allocation when it was presented in previous cases. I&E maintains that when performing an ACCOSS, both the P&A and the A&E methodologies are reasonable solutions for gas utilities; however, I&E notes that it found that the Company’s proposed allocation methodology is reasonable. I&E R. Exc. at 19 (citing I&E M.B. at 66).

In its Replies, PAIEUG maintains that PECO’s proposed A&E methodology is consistent with cost causation principles because peak demand, rather than average demand, is the primary driver of the Company’s distribution main costs. PAIEUG R. Exc. at 2-3 (citing PECO St. 6‑R at 7). PAIEUG repeats that PECO’s proposed methodology aligns with Commission precedent and industry practice, noting that the same methodology, with a system load factor weighting, was approved by the Commission in the *2007 PPL Gas Order* and has been relied upon by other Pennsylvania NGDCs in prior rate case filings. PAIEUG R. Exc. at 3-5, 7 (citing *2007 PPL Gas Order* at 176-78; *2020 PGW Order*; *2010 UGI CPG Order*).

PAIEUG counters that the OCA’s proposed P&A methodology includes the application of equal weighting to peak and average demand, which is not in accordance with how PECO incurs distribution main costs. PAIEUG R. Exc. at 4-5 (citing PAIEUG M.B. at 16; PAIEUG St. 1-R at 3, 5-6). PAIEUG also criticizes the OCA’s reliance on the Commission’s acceptance of the P&A methodology in *Columbia Gas*, explaining that the Commission did not have an opportunity to compare both the A&E and P&A methodologies in that proceeding. PAIEUG R. Exc. at 5 (citing OCA Exc. at 29-30; *Columbia Gas* at 214-15).

PAIEUG also rebuts the OCA’s claim that the A&E methodology burdens the low load factor customers, explaining that the A&E methodology is reasonable because it allocates a larger percentage of costs to low load factor customers as compared to high load factor customers whose demand remains more stable over time which, as a result, does not lead to additional costs for distribution system expansion. PAIEUG R. Exc. at 5 (citing OCA Exc. at 26; PAIEUG R.B. at 11). Further, PAIEUG responds to the OCA’s contention that PECO’s proposed methodology is equal to allocating distribution mains on the basis of peak demand, explaining that the Company’s methodology uses a system average load factor weighting for cost allocation based on average demand with the remaining costs allocated based on excess demand, which is consistent with industry standards and Commission precedent. PAIEUG R. Exc. at 6 (citing OCA Exc. at 27; PAIEUG St. 6-R at 7; PAIEUG St. 1-R at 3-6). Moreover, PAIEUG contends that contrary to the OCA’s assertion that excess demand represents a class’s usage pattern relative to average use, excess demand represents the excess of peak demand over average demand for each customer class, thereby providing a reasonable basis for allocation of distribution main costs. PAIEUG R. Exc. at 7 (citing OCA Exc. at 26; PAIEUG St. 6 at 13).

#### OSBA Exception No. 2 and Replies

In its Exception No. 2, the OSBA argues that the ALJ erred in adopting the Company’s ACCOSS methodology for allocating mains costs and requests clarification regarding which ACCOSS methodology is preferred in NGDC case litigation. Specifically, the OSBA requests that, if the P&A methodology is the standard, then the Commission should affirm as such and apply it in this proceeding. Alternatively, the OSBA requests that, if the Company’s version of the A&E ACCOSS methodology is equally acceptable, then the Commission should affirm that while “recognizing that it is overturning its long-held position that the allocation of gas mains should be based in part on average demand.” OSBA Exc. at 4. The OSBA maintains that there is little difference between the Company’s methodology and a pure peak demand allocation methodology. The OSBA adds that if the choice of methodology is impacted by the specific circumstances of the utility, then the Commission should clarify the specific factors that are considered when alternative mains cost allocation methods are evaluated. *Id.* (citing OCA St. 4-R at 2-4; OSBA St. 1 at 23).

In its Replies, PECO rebuts that the OSBA is incorrect to argue that if the A&E methodology is validated, then the Commission would be “overturning a long-held position.” PECO repeats that the A&E methodology is described as a recognized and well-accepted ACCOSS methodology in *Gas Rate Fundamentals*, and its use was previously approved by the Commission in the *2007 PGW Order* and the *2007 PPL Gas Order*. PECO also counters that it does not believe that the Commission should mandate uniform industry-wide adoption of either the A&E methodology or the P&A methodology in a single rate case without notice and an opportunity for a hearing. PECO R. Exc. at 22-23 (citing OSBA Exc. at 4).

In its Replies, I&E maintains its agreement with using the Company’s proposed A&E methodology on the basis that it is a reasonable method to allocate costs and revenues. I&E reiterates that it has supported the A&E methodology as well as a 50% peak / 50% average mains allocation when it was presented in previous cases. I&E asserts that when performing an ACCOSS, both the P&A and the A&E methodologies are reasonable solutions for gas utilities. I&E R. Exc. at 22-23 (citing I&E M.B. at 66).

In its Replies, PAIEUG cites *Colorado Interstate Gas Company v. Federal Power Commission*, 324 U.S. 581, 589 (1945), to offer that it may be inappropriate for the Commission to develop a specific set of rules governing the allocation of distribution main costs in an ACCOSS. PAIEUG asserts that although a separate proceeding could be initiated, the Commission should continue to recognize that factual distinctions exist among utilities and between cases that might cause differing methodologies to be reasonable in future NGDC rate cases. PAIEUG R. Exc. at 7-8.

### Disposition

The selection of the appropriate ACCOSS in this proceeding centers on whether the costs of PECO’s distribution mains should be allocated based on: (1) part average demand and part excess demand; or (2) 50% average demand and 50% peak demand. The Parties that support and agree with the Company’s proposed A&E methodology are PECO, I&E, and PAIEUG. In their Exceptions, the OCA and the OSBA each support the adoption of an ACCOSS based on an equally weighted (50%/50%) P&A methodology, while the OSBA also supports a 50%/50% A&E methodology. Of particular note, another dispute exists regarding the OSBA’s preference that in this proceeding and in all future NGDC proceedings, the Commission establish specific factors that will be considered by the Commission in evaluating proposed ACCOSS methodologies.

Based on a review of the respective advocates’ arguments in support of the record ACCOSSs before us, we believe that the Company’s proposed A&E methodology is reasonable and best suited for this proceeding. We agree with the ALJ and PECO that the A&E methodology is reasonable and acceptable for an NGDC because it aligns with cost causation principles and the design of PECO’s distribution system. Indeed, despite the contentions raised against the Company’s proposed methodology, the Commission has supported its use when it was presented in previous cases.

Regarding the design of PECO’s distribution system, we find PECO’s argument and the testimony of PECO’s witness, Ms. Ding, more compelling. As discussed earlier, excess demand (the amount by which peak demand exceeds average demand for each rate class) is allocated among rate classes in proportion to each class’ peak demand over its average demand. PECO R. Exc. at 20 (citing PECO M.B. at 98). Ms. Ding testified that PECO’s distribution mains system is designed to meet the demands of its system on a design day that all customers can be served. Ms. Ding continued, “[a]ccordingly, it is inappropriate and in conflict with cost causation principles to treat the cost of excess capacity as an incremental cost instead of the primary cost driver.” PECO St. 6-R at 7. Therefore, we conclude that the excess demand component of PECO’s distribution mains system garners considerable weight in the balance of mains costs. Accordingly, we find that the Company’s proposed A&E methodology most closely aligns with the principles of cost causation in this instance.

Moreover, we are also persuaded by PECO’s argument regarding the implicit double counting of average demand in the P&A methodology. Again, the A&E methodology allocates mains costs based, in part, on average demand and, in part, on the portion of peak demand that exceeds average demand. Alternatively, mains costs are allocated under the P&A methodology based, in part, on average demand and, in part, on the total peak demand. Consequently, average demand is included in the average demand component and in the peak demand component, which includes average demand. Accordingly, due to residential customers having temperature-sensitive demand and corresponding low-load factors, double-counting average demand understates the residential cost of service while overstating the cost of service of more efficient gas users. PECO R. Exc. at 21-22; PECO M.B. at 101. Based on the above, we find that the Company’s proposed A&E methodology is more reflective of an accurate representation of PECO’s mains distribution system.

In addition, we agree with I&E that both the A&E and P&A methodologies are reasonable studies for gas utilities; however, as we discuss in the Revenue Allocation section, *infra*, the P&A and A&E methodologies are, generally, two different types of weighted average methods. PECO provides an appropriate analogy of the two methods:

[T]he practical differences between the class cost allocations under the A&E and P&A methods are not as great as the OCA’s arguments suggest. As the OCA itself acknowledges, the A&E method allocates 58.3% of PECO’s total investment in distribution mains to the residential class, while the OCA’s preferred P&A method would allocate 56.23% of PECO’s distribution mains investment to that class. The narrowness of that differential is mirrored in the allocation of the revenue increase to the residential class, which (at PECO’s total proposed overall increase) is $62 million under I&E’s allocation and $60 million under the OCA’s proposed allocation.

PECO R. Exc. at 23 (citing OCA Exc. at 25, 29, 31-32). Notwithstanding, we are persuaded by the arguments for using PECO’s A&E ACCOSS in this proceeding. Therefore, we will deny the OCA’s Exception No. 7.

Regarding the OSBA’s request that the Commission affirm an ACCOSS methodology as the standard for future NGDC proceedings, as well as its selection criteria for ACCOSSs, we find that development of a regulation for determining the allocation of mains costs distribution is inappropriate at this current procedural stage of the case. We agree with PAIEUG that the inherent distinctions between utilities and rate cases may result in different methodologies to be reasonable for different reasons. In other words, the best-suited ACCOSS may depend on the circumstances of the situation on a case-by-case basis. Furthermore, we agree with PAIEUG that “a separate generic proceeding . . . in which all interested stakeholders could participate,” is the appropriate path forward for this discussion. PAIEUG R. Exc. at 8. It is well-established that the introduction of a new argument at the exceptions stage of a proceeding would leave the other Parties to this proceeding disadvantaged of the opportunity to provide a response. *Hess* at 265-266*; Apollo Gas* 1994 Pa. PUC Lexis, at \*8-14. Therefore, we find that it would be a violation of the other Parties’ due process rights to address this discussion. Accordingly, we will deny the OSBA’s Exception No. 2.

## Revenue Allocation

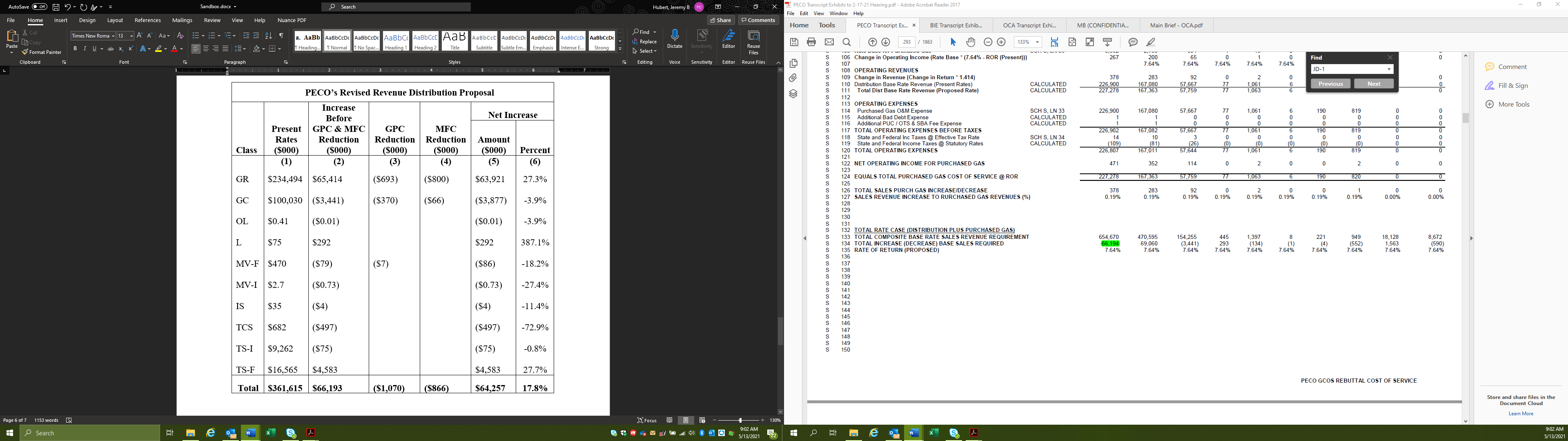
### Positions of the Parties

PECO submitted that cost of service studies are the touchstone for reasonable allocations of revenue responsibility among rate classes, while other factors such as fairness and gradualism should also be considered. PECO M.B. at 95. PECO’s Reply Brief cited to the Commission’s decision in *Columbia Gas*, indicating that, under *Lloyd*, cost of service is the “polestar” of utility rates. PECO R.B. at 4 (citing *Columbia Gas* at 51-52). The Company asserted that its proposal is reasonable as it was calculated utilizing the Company’s COSS, moves all rate classes closer to the cost of service indicated by the COSS, eliminates the remaining difference between the class rates of return for Rates GC and L and the system average rate of return, and properly considers customer impacts, including gradualism. PECO M.B. at 114.

As discussed above, PECO used its A&E ACCOSS to guide its revenue allocation and rate design process. In PECO’s initial presentation, PECO’s witness Mr. Bisti explained that the revenue allocation and relative rates of return were developed based on four factors: (1) the ACCOSS prepared by Ms. Ding; (2) consideration of the 2008 settlement while making limited but meaningful movement of rate classes closer to their indicated cost of service;[[76]](#footnote-77) (3) adjustments based on proposed changes to PECO’s Gas Procurement Charge (GPC) rate and Merchant Function Charge (MFC) uncollectible write-off factors; and (4) moderation of the impact on each major rate class while making meaningful movement toward each class’ cost of service. *See* PECO St. 7 at 9. Regarding its commitment to eliminate the remaining difference between the class rates of return for rates GC and L and the system average rate of return as required by the 2008 Settlement, the Company initially proposed to more closely align the class rates of return for rate GC and rate L with the proposed system average rate of return, *without completely eliminating the remaining difference*, while limiting the degree to which rates for other classes diverged from their indicated cost of service. The Company’s initial revenue allocation proposal was presented by Mr. Bisti and is set forth in PECO Exhibit JAB-1.

As explained by PAIEUG, PECO’s original revenue allocation included several errors: (1) PECO overstated the calculated rates of return from the classes that are currently below cost and understated the rates of return from classes currently above cost; (2) PECO moved all classes away from their cost of service; (3) PECO proposed revenue increases that were inappropriate based on these classes’ relative rates of return; and (4) PECO’s methodology did not consider gradualism. PAIEUG St. 1 at 5, 8-9, 11. Accordingly, PECO developed a revised revenue allocation proposal, which is set forth in PECO Exhibit JAB-1 Revised (Corrected), in order to conform to its revised ACCOSS, incorporating the revisions to its requested revenue requirement, and also to completely eliminate the remaining difference between the system average rate of return and the class rates of return for rate GC and rate L as required under the terms of the 2008 Settlement.[[77]](#footnote-78) PECO St. 7-R at 4-5. As shown in Table 5, below, PECO has proposed a 387% increase for the L rate class and increases of approximately 27% for the GR and TS-F classes while proposing rate decreases for the remaining classes. The proposed 387% increase for the L rate class is the Company’s effort to satisfy its obligation, pursuant to the 2008 Settlement, to move tariff revenues for rate L in line with allocated costs for this class in this proceeding.

**Table 5: PECO’s Revised Revenue Distribution Proposal**

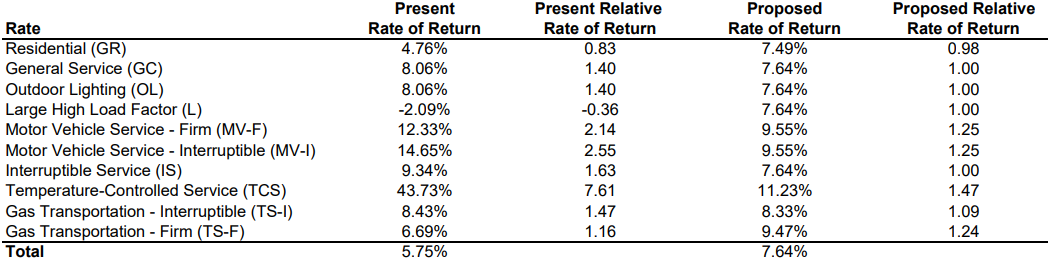


*See* PECO Exh. JAB-1 Revised (Corrected). The total revenue requirement increase of $66,194,000 in PECO’s A&E ACCOSS (PECO Exh. JD-1R, p. 3, line 134) is for base distribution revenue only and it is consistent with the Company’s base rate revenue increase request in PECO Exhibit MJT-1 Revised, Schedule A-1.[[78]](#footnote-79) To ensure a comparison between present and proposed distribution revenues on an “apples-to-apples” basis, PECO adjusted proposed distribution revenues to properly separate and account for proposed changes to both its GPC and its MFC uncollectible write-off factors. To this end, PECO Exhibit JAB-1 Revised (Corrected) (See Table 5, above) shows the aforementioned GPC and MFC adjustments as reductions to distribution revenues at proposed rates for each rate class, as well as the proposed net revenue increase for each rate class. PECO Exhibit JAB-1 Revised (Corrected) also shows class rates of return and relative rates of return at present and proposed rates (See Table 6, below).

In regard to the alternative revenue allocation proposals offered by I&E, the OCA, the OSBA, and PAIEUG in this proceeding, discussed, *infra*, the Company contended that its proposed revenue allocation provides an appropriate balance of the competing interests of the Company’s major classes and makes reasonable progress in moving all classes, except for the TS-F rate class, closer to their respective cost of service, consistent with well-accepted ratemaking principles, as demonstrated by the following indexed relative rates of return by customer class at present and proposed rates:

**Table 6: PECO’s Class & Relative Rates of Return**

**(A&E ACCOSS)**



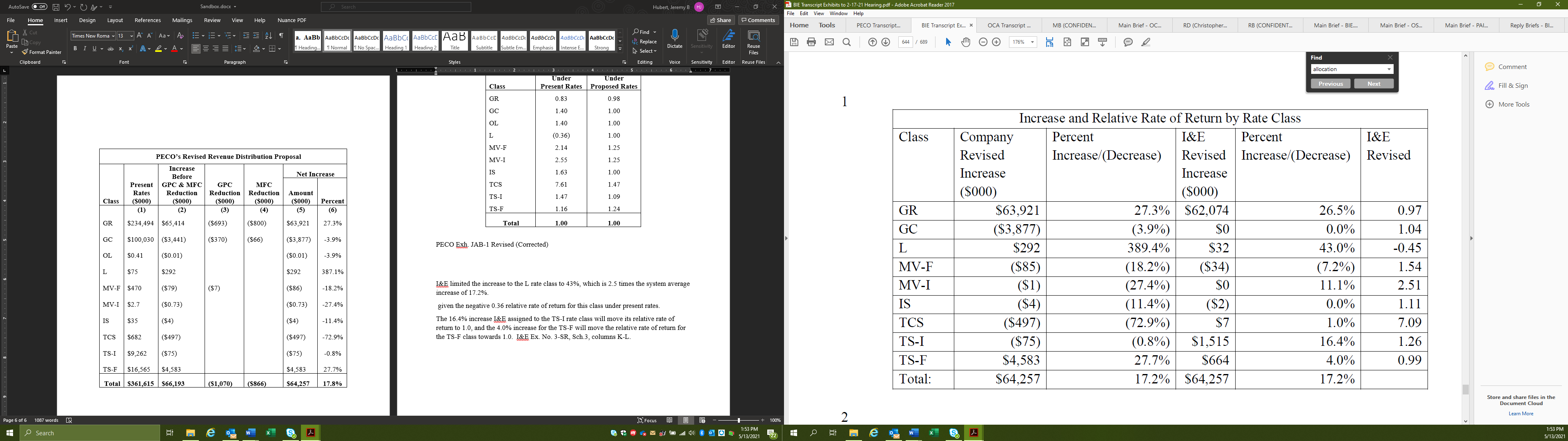
*See* PECO Exh. JAB-1 Revised (Corrected). Additionally, PECO explained that, to the extent the allowed increase is less than that proposed by the Company, PECO proposes to use its revenue allocation and rate design to scale back rates proportionally, excluding the Company’s proposed customer charges. PECO M.B. at 115.

In their respective Briefs, I&E, the OCA, the OSBA, and PAIEUG each presented alternative recommendations for how to allocate revenue to the various customer classes. I&E M.B. at 67-69; OCA M.B. at 176-81; OSBA M.B. at 15-19; PAIEUG M.B. at 20-29.[[79]](#footnote-80)

I&E identified two specific issues regarding the Company’s proposed rate allocation methodology, supporting its contention that PECO’s proposed revenue allocation is not reasonable and should be rejected: (1) the large rate increase (387%) for the L rate class is excessive and violates the concept of gradualism and could result in rate shock for those customers; and (2) in a shared concern with the OCA, given the economic hardships all of the rate classes are experiencing, it does not appear to be fair for some rate classes to experience a rate decline while others experience a rate increase. I&E M.B. at 67 (citing I&E St. 3-SR at 19).

As provided in the ALJ’s discussion, I&E’s final proposed revenue allocation was arrived at using the data provided by the Company in PECO Exhibits JD‑1R through JD-6R by first creating a schedule that shows the calculation of relative rates of return based on proposed revenue, expenses, taxes, net income, and rate base by class. R.D. at 303 (citing I&E M.B. at 68); *see also* I&E Exh. 3-SR, Sch. 3. Then, based on this schedule and taking into consideration the issues brought forth by the OCA and the OSBA, I&E developed its recommended revenue allocation, as shown in Table 7, below:[[80]](#footnote-81)

**Table 7: Increase and Relative Rate of Return by Rate Class**

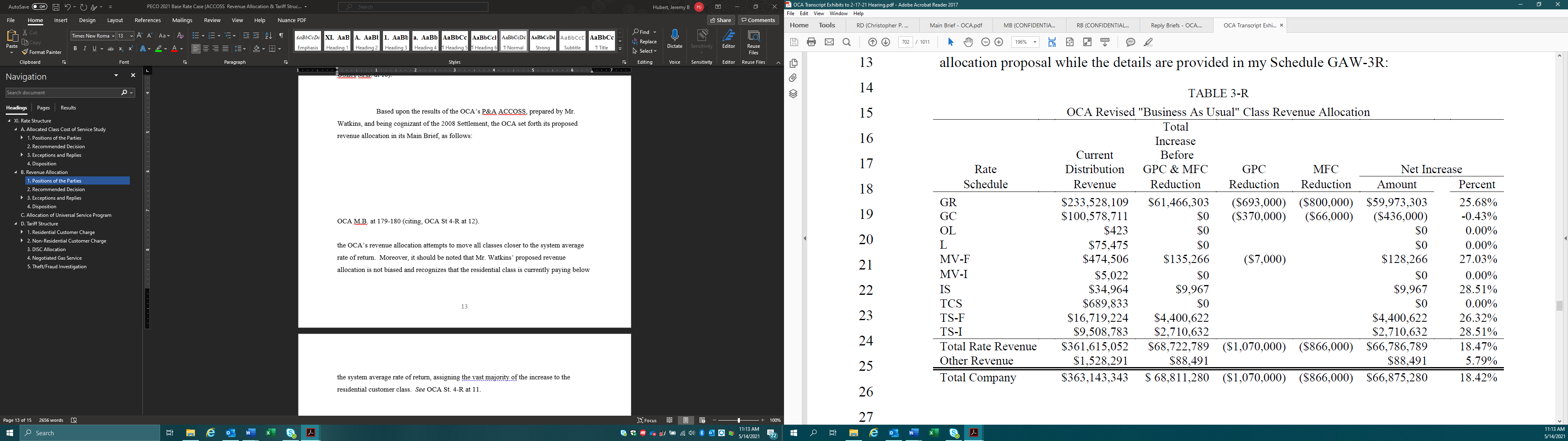


*See* I&E St. 3-SR at 21. I&E explained that, in keeping with the principle of gradualism, its recommendation limited the increase to the L rate class to 43%, which is 2.5 times the system average increase of 17.2%. Furthermore, the 16.4% and 4.0% increases I&E assigned to the TS-I and TS-F rate classes, respectively, will move their relative rates of return towards 1.0. I&E St. 3-SR at 17-21. Finally, I&E recommended a proportional scale back for all rate classes that receive an increase, based on the ACCOSS ultimately approved by the Commission, and disagreed with the Company’s proposal to exclude customer charges from any scale back. I&E St. 3 at 37; I&E St. 3-SR at 13-14, 25-26.

As discussed, *supra*, while the OCA submitted that it is not appropriate to increase a utility’s rates at this time, the OCA has nonetheless, after its evaluation and critique of PECO’s proposed revenue allocation, prepared a revenue allocation of its own should the Commission determine an increase should be given to the Company. The OCA contended that PECO’s proposed revenue allocation is unreasonable because it was guided by the results of its A&E ACCOSS and because of its strict compliance with the terms of the 2008 Settlement. OCA M.B. at 165-75, 178. The OCA argued that the elimination of any difference between the average rate of return and the class rates of return for the GC and L rate classes at this time, pursuant to the 2008 Settlement, would result in inappropriate rate reductions for certain classes, largely requiring the residential class to make up any lost revenue. OCA R.B. at 91. The OCA asserted that in this proceeding, the Commission must exercise its discretion in this matter, since the 2008 Settlement explicitly states that “[a]ll parties retain their rights, in such future rate proceedings, to challenge that proposal through the use of class rates of return obtained through alternative cost of service studies or other ratemaking principles.” *Id.* at 91-92 (citing 2008 Settlement at 5-6). The OCA noted that I&E and the OSBA, likewise, recognize this is problematic and do not assign any rate decrease to any customer class. *Id*. at 91 (citing I&E M.B. at 67-68; OSBA M.B. at 16).

Based upon the results of the OCA’s P&A ACCOSS, prepared by Mr. Watkins, while being cognizant of the 2008 Settlement, the OCA set forth its proposed revenue allocation in its Main Brief, which we included in Table 8, below:

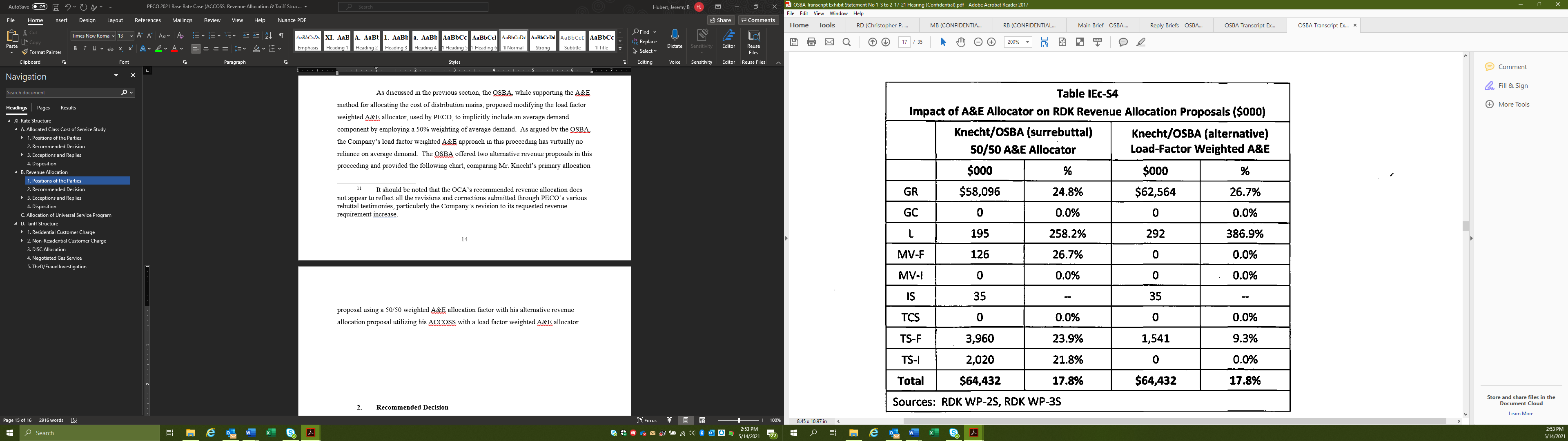
**Table 8: OCA Revised “Business As Usual Class Revenue Allocation**



OCA M.B. at 179-80 (citing OCA St 4-R at 12).[[81]](#footnote-82) The OCA explained that Mr. Watkins’ proposed revenue allocation assigns no increase or decrease in base rate revenues to those classes that are currently earning higher than the 7.70% rate of return requested by PECO. This includes the GC, OL, L, MV-I, and TCS rate classes. With respect to the MV-F, IS, and TS-I rate classes, Mr. Watkins recommended that these classes receive one and a half times the system average increase as these classes’ current rate of returns are significantly deficient under Mr. Watkins’ P&A ACCOSS. Lastly, the OCA noted that the relative rate of returns for the GR and TS-F rate classes are at reasonably close parity at current rates (86% and 79%, respectively) such that Mr. Watkins allocated equal percentage increases to these two classes based on the remaining overall increase. OCA M.B. at 179. Additionally, the OCA submitted that if less than the full proposed revenue increase is granted, then any increase should be distributed proportionally to the recommended class revenue allocations with no decreases to the GC, OL, MV-I, and TCS rate classes (before recognition of GPC and MFC charges). OCA M.B. at 181. Also, similar to I&E, the OCA recommended that the residential customer charge be included in any proportional scale back of rates. OCA R.B. at 94-95.

As discussed in the previous section, while supporting the A&E method for allocating the cost of distribution mains, the OSBA proposed modifying the load factor weighted A&E allocator, used by PECO, to implicitly include an average demand component by employing a 50% weighting of average demand. As argued by the OSBA, the Company’s load factor weighted A&E approach in this proceeding has virtually no reliance on average demand. The OSBA offered two alternative revenue proposals in this proceeding, particularly questioning the proposed allocations to the IS, MV-I, TCS, and TS-F rate classes. OSBA St. 1-S at 10-14. Table 9, below, compares Mr. Knecht’s primary allocation proposal, using a 50/50 weighted A&E allocation factor, with his alternative revenue allocation proposal, utilizing his ACCOSS with a load factor weighted A&E allocator.

**Table 9: Impact of A&E Allocator on RDK Revenue Allocation Proposals ($000)**



*See* OSBA St. 1-S at 14-15. The OSBA noted that, in general, rate increases were limited to a floor of zero and an upper bound of 1.5 times system average, with the rate TS-I limit applying to non-negotiated rate customers.[[82]](#footnote-83) OSBA St. 1-S at 12. In explaining his alternate revenue allocation, Mr. Knecht stated:

In particular, classes that require a rate decrease to move rates into line with allocated cost are assigned a zero increase, namely GC, MV-F and TS-I. The market-based rate classes are assigned zero increases, except to reflect elimination of the Rate IS sharing mechanism. Rate L revenues are set at allocated cost, reflecting its change in status to a bundled standby service. The required rate increase for Rate GR is capped at 1.5 times system average.

OSBA St. 1-S at 15.

Regarding any scale back of the proposed rates if less than the full proposed revenue increase is granted in this proceeding, the OSBA recommended a “hybrid” approach:

In this case, there is (somewhat unusual) agreement among the parties that the Rate GC class is substantially over‑recovering allocated costs and should be assigned a minimal increase at the full revenue requirement. Much of the progress toward cost-based rates for that class would be lost, however, with a proportional scaleback and a material reduction in the rate increase. I therefore propose a hybrid approach to a scaleback, in which the rate reduction is scaled back partly based on the proportional scaleback method and half based on current rate revenues.

OSBA St. 1-R at 19. Mr. Knecht continued, as follows:

[T]his approach allows the GC class to partially share in the overall reduction of the revenue requirement, much of which would be lost in a traditional proportional scaleback. It may, of course, be argued that assigning the Rate GC class a rate decrease is inequitable when all other classes are assigned rate increases.

However, I note (a) [I&E witness] Mr. Cline actually proposes a rate decrease for rate GC even at the full revenue requirement, (b) not allowing the Rate GC class to benefit at all from a significant reduction in the revenue requirement would be inequitable, and (c) there is significant agreement among the parties that the Rate GC class revenues should be reduced materially relative to all other rate classes to reflect allocated costs.

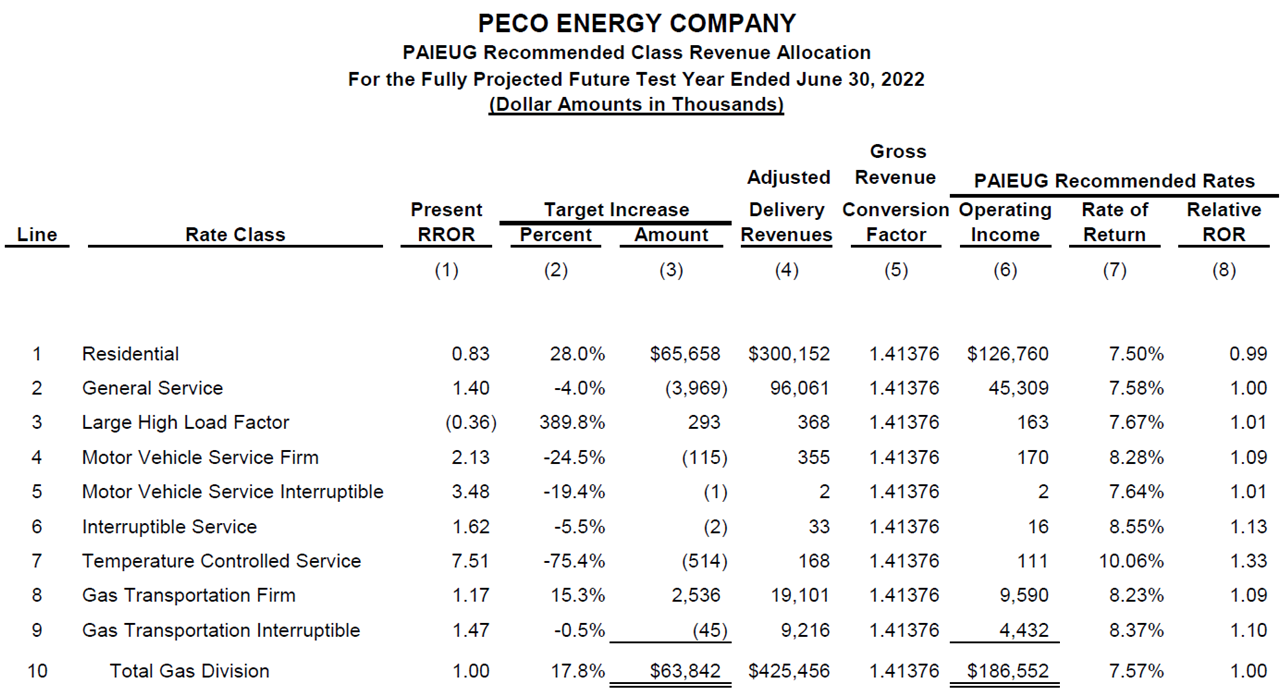
Thus, in the context of this proceeding, I do not believe this scaleback proposal is inequitable or unreasonable.

OSBA M.B. at 18-19 (citing OSBA St. 1-R at 20).

As previously discussed, PAIEUG generally agreed that PECO’s revised A&E ACCOSS is suitable for allocating the cost of distribution mains. However, regarding revenue allocation, although PAIEUG indicated that PECO’s A&E ACCOSS should be accepted by the Commission and used to inform the class revenue allocation in this proceeding, PAIEUG argued that PECO failed to follow its own A&E ACCOSS in presenting its revenue allocation proposal, based upon PECO’s unjustified rate increase proposal for the TS-F rate class. PAIEUG explained that PECO’s revenue allocation to the TS-F rate class imposes a substantially above average rate increase to a class already paying an above system average rate of return, moving the TS-F rate class away from its cost of service. PAIEUG M.B. at 22 (citing PAIEUG St. 1-S at 3-4). As discussed by PAIEUG in its Main Brief, PECO’s revenue allocation to the TS-F rate class violates Section 1304 of the Code, which requires NGDCs not to “establish or maintain any unreasonable differences as to rates, either as between localities or between classes of service.” *See* PAIEUG M.B. at 21-23 (citing 66 Pa. C.S. § 1304).

In place of PECO’s proposed revenue distribution, PAIEUG presented its own proposal for revenue distribution as shown in Table 10, below:

**Table 10: PAIEUG Recommended Class Revenue Allocation**



*See* PAIEUG Exh. BSL-1S. PAIEUG contended that its proposed revenue allocation offers the most equitable solution for all classes as compared to other Parties’ proposed revenue allocations in this proceeding, as, consistent with *Lloyd*, it moves all classes closer to their cost of service while ending the prolonged cross-subsidization of rate L, which is consistent with the 2008 Settlement commitments.[[83]](#footnote-84) PAIEUG M.B. at 24-25. Additionally, regarding any scale back of the proposed rates if less than the full proposed revenue increase is granted in this proceeding, PAIEUG submitted that a proportional scale back of rates for all customer classes, based upon PAIEUG’s proposed revenue allocation, is reasonable. Moreover, this scale back should apply to both volumetric charges and customer charges. PAIEUG M.B. at 28-29.

### Recommended Decision

Although ALJ Pell acknowledged the commitments made by PECO in the 2008 Settlement, he agreed with I&E that “the 389% rate increase for the L Class is excessive and violates the concept of gradualism and could result in rate shock for L Class customers.” R.D. at 405-06. Furthermore, the ALJ’s recommendation rejected rate decreases for the GC, TCS, and TS-I rate classes, among others, as proposed by the Company. ALJ Pell stated as follows:

I also agree with I&E and the OCA regarding the fairness of certain rate classes receiving rate increases, some excessively so, while other rate classes are receiving decreases. As such, I cannot recommend adoption of the Company’s revenue allocation.

R.D. at 406. Accordingly, the ALJ recommended that I&E’s revenue allocation should be adopted. Furthermore, the ALJ recommended the Commission order a proportional scale back of rates if less than the full increase is granted. *Id.*

### OCA Exception No. 8 and Replies

In its Exception No. 8, the OCA submits that the Commission should reject the ALJ’s recommended adoption of I&E’s proposed revenue allocation, in favor of the OCA’s proposed revenue allocation, because it relies upon PECO’s erroneous A&E ACCOSS. OCA Exc. at 31-33. The OCA argues that its recommended revenue allocation, guided by its P&A ACCOSS is eminently fair, as it keeps those rate classes that are currently paying above their cost to serve at existing levels and recognizes that the residential class is currently below the system average rate of return by assigning approximately 89.3% of the increase to the residential class. The OCA maintains its arguments regarding revenue allocation, paralleled by its Exception No. 7 discussed above, which takes issue with the ALJ’s reasoning for recommending that the Company’s A&E ACCOSS be used in guiding revenue allocation in this proceeding. As the Parties’ positions, as well as the ALJ’s recommendation on this issue, including the Exceptions thereto, have been extensively discussed and addressed in the previous section, they will not again be addressed here. Additionally, the OCA indicates that it has no objection to the ALJ’s recommendation to order a proportional scale back of rates if less than the full increase is granted but submits that the OCA’s recommended revenue allocation should be the basis for proportionally scaling back a smaller than requested rate increase. *Id*. at 32-33.

In reply, PECO, I&E, and PAIEUG each refute the arguments contained in the OCA’s Exception No. 8, submitting that the ALJ properly accepted I&E’s proposed revenue allocation over the OCA’s proposal. PECO R. Exc. at 23-24; I&E R. Exc. at 20‑21; PAIEUG R. Exc. at 8-10. PECO avers that I&E’s revenue allocation simply uses the Company’s A&E ACCOSS as a “guide,” while also considering other factors. PECO suggests that because the ALJ correctly rejected the OCA’s cost allocation methodology, the OCA’s revenue allocation methodology should be summarily rejected. PECO R. Exc. at 23-24.

Furthermore, PECO argues that the practical consequences flowing from the theoretical difference between the OCA’s reliance on its P&A ACCOSS and I&E’s reliance on PECO’s A&E ACCOSS, to which the OCA is opposed, are not as great as the OCA would suggest:

As the OCA itself acknowledges, the A&E method allocates 58.3% of PECO’s total investment in distribution mains to the residential class, while the OCA’s preferred P&A method would allocate 56.23% of PECO’s distribution mains investment to that class. The narrowness of that differential is mirrored in the allocation of the revenue increase to the residential class, which (at PECO’s total proposed overall increase) is $62 million under I&E’s allocation and $60 million under the OCA’s proposed allocation. Even that differential is reduced if the overall revenue increase granted to PECO is less than the Company proposed.

PECO R. Exc. at 23 (citations omitted).

In its Replies, I&E simply proffers its disagreement with the OCA’s argument contained in the OCA’s Exception No. 8 and submits that the ALJ was correct to recommend that if the Commission determines that a rate increase is justified, that the Commission use I&E’s proposed revenue distribution, as set forth in I&E Exhibit 3‑SR, Schedule 3. I&E R. Exc. at 20-21.

In its reply, PAIEUG indicates its agreement with the ALJ’s determination that moving the GC and L rate classes to cost in this proceeding would be unreasonable. Therefore, accepting this aspect of the ALJ’s recommendation, PAIEUG submits that the ALJ correctly determined that I&E’s revenue allocation is the most reasonable revenue allocation proposal. PAIEUG explains that the main difference between its alternative revenue allocation and I&E’s proposal is the treatment of the GC and L rate classes. PAIEUG moved the GC and L rate classes to the system average rate of return consistent with those commitments in the 2008 Settlement, while I&E moved the classes closer, but not entirely, to the system average rate of return. PAIEUG R. Exc. at 8-9. Furthermore, PAIEUG avers that since the OCA’s revenue allocation is premised on its flawed P&A ACCOSS, its resulting revenue allocation was properly rejected by the ALJ.  *Id*. at 9.

PAIEUG’s Replies also refer to its Letter, in which PAIEUG indicated its observance of one administrative issue with the Recommended Decision. PAIEUG explains that, although the ALJ adopted I&E’s revenue allocation presented in I&E’s surrebuttal testimony, the ALJ inadvertently did not reflect the minor corrections made by I&E in a subsequent Errata filing on February 16, 2021. PAIEUG R. Exc. at 9-10 (citing R.D. at 406; I&E St. 3-SR ERRATA; I&E Exh. 3-SR ERRATA). Accordingly, PAIEUG requests that “[t]he Final Order should include the corrected chart from I&E’s Errata filing.” PAIEUG R. Exc. at 10.

### Disposition

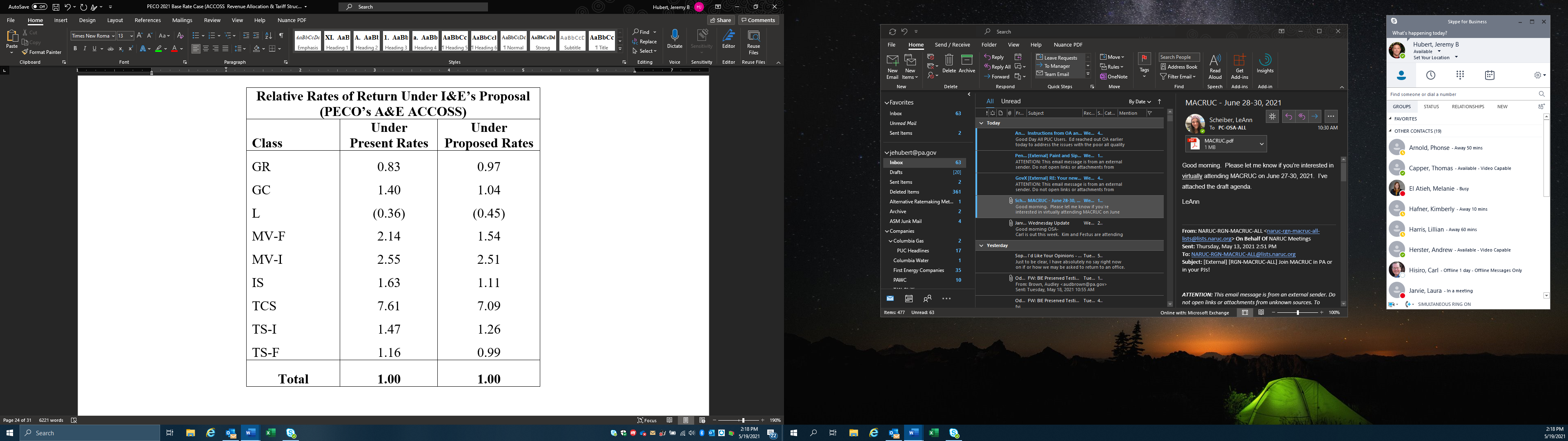
Once an appropriate cost of service study has been adopted, the rate design process may begin, which involves two primary functions. The first step is the determination of inter-class rates, which involves the assignment of the revenue requirement between the various customer classes. The second step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

Therefore, based upon our prior determination and discussion, *supra*, with respect to the rejection of the OCA’s P&A ACCOSS, in favor of PECO’s A&E ACCOSS, we agree with the ALJ that I&E’s proposed revenue allocation should be approved. As I&E’s revenue allocation recommendation is based upon the Company’s A&E ACCOSS, which we have accepted as a reasonable guide, we conclude that its allocation proposal should similarly be accepted. As discussed in the previous section, if all customers were the same size and had identical usage characteristics, cost allocation would be simple, even unnecessary. However, in reality, a utility’s customer base is not so simple. Customers, or customer groups, tend to vary greatly in the amount of service required throughout the year such that there are small usage and large usage customers. Therefore, differences in usage should be considered. In this proceeding, the cost allocation methodologies relied upon by the Parties essentially fell into two categories: (1) the OCA’s P&A methodology; and (2) various iterations of the Company’s A&E methodology. Each method is essentially a weighted average of two different allocation methods: (1) the average demand allocation method; and (2) some other allocation method. As previously discussed, although the P&A methodology may be, in a sense, a more simplistic version of the A&E methodology, both the P&A and A&E methodologies are examples of energy weighting methods, and the fact that a part of each of these two allocation methodologies incorporates each class’ portion of system average demand is an implicit acknowledgement that average load drives a major portion of the demand-related costs. Nevertheless, as discussed, *supra*, we find the argument for using PECO’s A&E ACCOSS in this proceeding is more compelling.

With regard to rate class revenue levels, the rate of return results show that certain rate classes are being charged rates that recover less than their indicated costs of service (GR and L rate classes). As a result, rates for the other rate classes provide for recovery of more than the indicated costs of serving these other rate classes (GC, OL, MV-F, MV-I, IS, TCS, TS-I, and TS-F rate classes). As illustrated in the Table 11, below, we find that I&E’s revenue allocation proposal is consistent with *Lloyd* and moves all rate classes, with the exception of the L rate class (which moves from a relative rate of return of -0.36 at current rates to a relative rate of return of -0.45 at proposed rates), closer to the cost of service in a reasonable manner. This movement away from its cost of service that the L rate class experiences under I&E’s proposed revenue allocation is due to the limited increase assigned to the L rate class, equal to 2.5 times the system average increase, to comport with the principles of gradualism.

**Table 11: Relative Rates of Return Under I&E’s Proposal**

**(PECO’s A&E ACCOSS)**



*See* I&E St. 3-SR at 21; PECO Exh. JAB-1 Revised (Corrected).

Additionally, we find that I&E’s revenue allocation proposal considers the principle of gradualism. As indicated by PAIEUG, although there are no definitive rules for determining what kind of rate increase would violate the principle of gradualism, limiting the maximum average rate increase for any particular class to 1.5 to 2.0 times the system average increase is one common metric that has been used by experts in the Commonwealth. PAIEUG M.B. at 25 (citing *Columbia Gas* at 233). In the instant case, I&E’s proposal for the L rate class is slightly above this, with a 2.5 factor (43% for the L rate class over the 17.2% for the system average). The second largest increase is 26.5% proposed for the GR rate class, which falls within the common metric referenced above with a 1.54 factor (26.5% ÷ 17.2 % = 1.54). Nonetheless, we note that even with the 43% increase that the L rate class customers will experience under I&E’s proposal, the revenue recognition from that class is still shown to be below its cost to serve and therefore continues to be subsidized by other rate classes. For this reason, we do not consider I&E’s proposal to be unreasonable. Accordingly, we shall deny the OCA’s Exception No. 8.

Furthermore, since we have not granted the entirety of PECO’s requested revenue increase, an important consideration is the determination of how the proposed revenue allocation will be affected by the scale back in rates. Because there was no dispute that the cost of serving each rate class varied and that rates for certain classes were subsidizing rates for others, any scale back should be utilized to bring the rates of each rate schedule closer to the cost of service. However, applying this concept blindly may result in reductions to customers who were not expecting an increase, or greater reductions to some customers than were originally proposed, to the detriment of those whose rates will rise more than necessary. Therefore, the ALJ recommended that I&E’s proposal to apply any scale back on a proportional basis to only those rate classes that receive increases should be adopted by the Commission. We agree with the ALJ’s recommendation and find it necessary for the Company to proportionately scale back the increase to the various customer classes, limited to those classes receiving an increase, based on PECO’s A&E ACCOSS and I&E’s recommended revenue allocation, when filing its compliance tariff(s).

Regarding PAIEUG’s request that this Opinion and Order modify the ALJ’s Recommended Decision to reflect certain corrections presented through I&E’s *Errata* to its surrebuttal testimony, which PAIEUG claims were inadvertently excluded from the Recommended Decision, we find this modification unnecessary. Upon review of the record, we find that there was no need for I&E’s Errata to its surrebuttal testimony filed on February 16, 2021. Therefore, we find no error in the ALJ’s recommendation, which adopts I&E’s revenue allocation, as set forth in Schedules 3 and 4 of I&E Exhibit 3-SR. Accordingly, PAIEUG’s request is denied.

## Allocation of Universal Service Program

### Positions of the Parties

The OCA submitted that universal service charges should be allocated to all ratepayers and between customer classes on a competitively neutral basis based on a percentage of revenue provided by each customer class at base rates. OCA M.B. at 181. The OCA averred that this cost allocation issue should be addressed in this proceeding and that the OCA made its proposal based on the Commission’s *Final CAP Policy Statement Order* and the CAP Policy Statement. The OCA took the position that although the Commission declined to allocate universal service costs to all customers in *Columbia Gas*, the Commission should reach a different conclusion in this proceeding based on the additional record evidence presented regarding the impact of the proposed rate increase on residential customers and, particularly, on low-wage customers who do not otherwise qualify for any assistance. OCA M.B. at 183-184.

The OCA noted that its witness Mr. Colton presented evidence that examined two aspects of poverty: (1) those customers at or below 150% of the FPL and (2) “near poor” customers whose incomes are above 150% of the FPL but still struggle to make ends meet. Mr. Colton also discussed the housing stock in PECO’s service territory, specifically that aged housing stock exists in PECO’s service territory and this often places a higher energy burden on low-income families that live in these homes. OCA M.B. at 185, 187. The OCA further noted the broad economic benefit of allocating universal service program (USP) costs to all customer classes, including improving employee productivity. *Id*. at 192-97. The OCA further submitted that the allocation of universal service costs to all customer classes is consistent with sound ratemaking principles and, specifically, that the costs of PECO’s universal service program should be considered a “public good” and be allocated across all customer classes. *Id*. at 198-200.

CAUSE-PA also proposed that PECO’s USP costs be allocated to all customer classes. CAUSE-PA noted that the COVID-19 pandemic is causing the number of low-income households in PECO’s service territory to reach an all-time high and that the pandemic is likely to lead to unprecedented levels of long-term unemployment for low-wage workers, evictions, foreclosures, and utility terminations. CAUSE-PA M.B. at 41-42. CAUSE-PA contended that considering this growing need, it is not appropriate for PECO to continue to recover its universal service costs exclusively from the residential class. CAUSE-PA averred that energy insecurity impacts all customer classes, and non-residential customers both contribute to the need for and benefit from the operation of PECO’s universal service programs. CAUSE-PA argued that PECO failed to comply with the Commission’s stated expectation that utilities will address the issue of cross-class recovery of universal service costs in the context of its next rate case. Accordingly, CAUSE-PA submitted that PECO should be ordered to develop a proposal to recover universal service program costs equitably from all ratepayers and to seek approval for such a proposal within one year of a final order in this proceeding. *Id*. at 42.

PECO currently allocates universal service costs to the residential class, and PECO has not proposed any changes to the allocation of universal service costs in this proceeding. PECO Exh. JAB-2. PECO states that this gas distribution base rate case is not the appropriate proceeding in which to consider broad universal service cost allocation proposals, particularly because PECO’s gas-only CAP population is a small part of its total CAP population. PECO also states that the Commission recently rejected proposals to allocate universal service costs to non-residential gas customers in *Columbia Gas*. The Company explained that it plans to address the allocation of universal service costs in its next electric base rate proceeding. PECO M.B. at 115; PECO R.B. at 74.

The OSBA argued that the factual considerations that led to the Commission’s decision in *Columbia Gas* are similar to those in this proceeding and, accordingly, the manner in which PECO allocates its universal service costs should not be altered in this proceeding. OSBA M.B. at 19-20. Specifically, the OSBA stated that the timing, duration, and effectiveness of recovery from the pandemic remain in doubt, and the ratepayer impacts for larger customers are likely to be the same. *Id*. at 20.

Additionally, the OSBA observed that no Party other than the OSBA has attempted to evaluate the impact of including an alternative allocation of universal service costs in the context of overall revenue allocation. The OSBA submitted that Mr. Knecht’s analysis demonstrates that the cost allocation analysis using any of the COSSs filed in this proceeding would imply that the Rate GC should be assigned a significant rate decrease. According to the OSBA, under its proposal, that increase would be set to zero, to reflect rate gradualism considerations as well as the impacts of the COVID-19 pandemic; however, even if the OCA alternative allocation for universal service costs were approved, a reasonable overall revenue allocation approach would still produce a zero increase for the Rate GC class. OSBA M.B. at 21.

PAIEUG similarly believed that PECO’s USP costs should be funded by the residential customer class because, in PAIEUG’s opinion, this is the class of customers eligible to participate in the Company’s universal service programs. PAIEUG maintained that allocating USP costs to non-residential classes would violate cost‑causation principles, would not provide any direct benefit for non-residential classes, would compound the economic hardships commercial and industrial customers are experiencing due to the COVID-19 pandemic, and would ignore recent Commission precedent, specifically *Columbia Gas*. PAIEUG M.B. at 29-34. Additionally, PAIEUG averred that CAUSE-PA did not propose a methodology for collecting USP costs from all customers, and that the OCA’s proposal is general and lacks any meaningful detail by which the Commission can determine its appropriateness. PAIEUG asserted that the OCA’s proposal appears to be unreasonable as it ignores the basic ratemaking principle of cost-causation by tying customer class revenue to the funding of a program for which all customers do not benefit. *Id*. at 34-35.

### Recommended Decision

The ALJ recommended that the Commission deny the OCA and CAUSE‑PA’s proposal to allocate PECO’s USP costs to all customer classes. The ALJ reasoned that the COVID-19 pandemic has had harsh economic impacts on commercial and industrial and small business customers, and it is unclear when these economic conditions will improve. The ALJ found that because these non-residential customers do not directly benefit from the USP programs, it was not appropriate to change the manner in which PECO’s USP costs are allocated. R.D. at 408.

### OCA Exception No. 9, CAUSE-PA Exception No. 5, and Replies

In its Exception No. 9, the OCA argues that the ALJ erred in denying the OCA’s proposal to allocate universal service costs to all ratepayers. The OCA contends that despite the evidence presented by the OCA’s witness, Mr. Colton, the ALJ erroneously concluded that commercial and industrial customers do not benefit from universal service programs and ignored the public good benefit of the programs. OCA Exc. at 33-34. The OCA notes that some of the benefits identified by Mr. Colton include the following: addressing utility payment problems; reducing housing abandonment; improving educational attainment; improving adverse health outcomes for payment-troubled customers; reducing the need for local government services, such as public health services and public safety costs; increasing available income to be used in the retail economy that drives additional job creation, income generation, and economic activity; helping to off-set low wages paid by businesses; increasing employee productivity; decreasing employee turnover; and decreasing time missed from work due to family care responsibilities and illness. *Id*. at 34 (citing OCA St. 5 at 58-83).

Moreover, the OCA argues that Mr. Colton presented new evidence in this proceeding that Mr. Colton had not presented in prior base rate proceedings. For instance, the OCA states that the new evidence examined the impact of the allocation of universal service costs on businesses during the COVID-19 pandemic in response to PAIEUG’s witness Ms. Billie LaConte. The OCA explains that Mr. Colton found that the allocation of universal service costs in other states has not impacted the economic circumstances of businesses, even during COVID-19. OCA Exc. at 35. Specifically, Mr. Colton compared the impact of the COVID-19 recession on key economic indicators in Ohio, a state that allocates universal service costs to all customers, and Pennsylvania. *Id*. (citing OCA St. 5-SR at 31-32). The OCA also explains that Mr. Colton testified about the Brookings Institute study that found no impact on the key economic indicators, as the data from that study shows that the allocation of utility universal service costs is not the factor that drives economic metrics in a state or metropolitan area. OCA Exc. at 35-36 (citing OCA St. 5-SR at 31-32).

Further, the OCA submits that the ALJ’s determination ignores the economic impacts of the pandemic on low-wage and near-poor customers. The OCA states that Mr. Colton testified regarding the challenges faced by businesses during the COVID-19 pandemic, but he also testified that the challenges experienced by businesses should not override the impact of COVID-19 on residential customers. OCA Exc. at 36. Mr. Colton stated that the economic difficulties experienced by businesses due to COVID-19 is not a sufficient reason, by itself, to decline to allocate universal service costs among all customer classes. *Id*. at 36-37 (citing OCA St. 5 at 83).

In its Exception No. 5, CAUSE-PA avers that the ALJ erred in approving PECO’s proposal to recover universal service costs solely from residential customers and that the Recommended Decision should be amended to ensure equitable recovery of public purpose program costs. CAUSE-PA Exc. at 23. In support of its position, CAUSE-PA states that the Competition Act provides that the Commission must ensure that universal service programs are “appropriately funded and available” so that low-income customers can “maintain natural gas service” to their homes. *Id*. at 24 (citing 66 Pa. C.S. §§ 2202, 2203(7), (8)). CAUSE-PA also states that the Competition Act authorizes the recovery of universal service program costs through a nonbypassable rate mechanism; however, commercial and industrial customers have been permitted to bypass universal service costs. CAUSE-PA Exc. at 24 (citing 66 Pa. C.S. § 2203(6)). CAUSE-PA further states that in the *Final CAP Policy Statement Order*, the Commission found it appropriate to consider the recovery of CAP costs from all ratepayers and that utilities should be prepared to address the recovery of CAP costs and other universal service costs from any ratepayer classes within individual rate cases. CAUSE-PA Exc. at 24 (citing *Final CAP Policy Statement Order* at 7, 80, 97; 52 Pa. Code §§ 69.625(1), 69.266(b)). CAUSE-PA submits that although the Commission did not direct utilities to propose a specific allocation, it indicated that individual utility rate cases are the appropriate forum in which to consider recovery of CAP costs from all ratepayer classes. CAUSE-PA Exc. at 24-25 (citing *Final CAP Policy Statement Order* at 7, 97).

CAUSE-PA disagrees with the ALJ’s rationale that it was not appropriate to change the manner in which PECO allocates its USP costs on the basis that commercial and industrial customers do not derive a direct benefit from the USP programs. CAUSE-PA Exc. at 25 (citing R.D. at 408). CAUSE-PA believes that ALJ Pell’s rationale overlooks the impacts of the pandemic on the residential class and gives undue weight to the impact that universal service costs may have on commercial and industrial customers without examining the impact that current cost recovery of universal service programs has on residential consumers. CAUSE-PA Exc. at 25. CAUSE-PA notes that the ALJ’s reliance on the impact of the pandemic on commercial and industrial customers in this context is inconsistent with the ALJ’s earlier conclusion that pandemic relief for residential customers is unnecessary given recent improvements in the economic outlook. *Id*. (citing R.D. at 265). CAUSE-PA states that while residential and commercial and industrial consumers are all experiencing unprecedented economic impacts due to the pandemic, the record in this case shows that low-income consumers have been the most significantly impacted, which will likely result in a substantial increase in universal service program enrollment. CAUSE-PA Exc. at 25-26 (citing CAUSE-PA St. 1 at 14-15).

Additionally, CAUSE-PA asserts that contrary to the ALJ’s conclusion, all customers, including commercial and industrial customers, derive direct and identifiable benefits from the availability of universal service programs. CAUSE-PA Exc. at 26 (citing CAUSE-PA St. 1 at 49-53). CAUSE-PA notes that its witness, Mr. Miller, testified that energy poverty is driven, at least in part, by low wages paid by commercial and industrial consumers, noting that the majority (65.4%) of natural gas CAP customers received employment or retirement income, yet cannot afford natural gas services without assistance. CAUSE-PA Exc. at 26-27 (citing CAUSE-PA St. 1 at 50). Mr. Miller also testified that the availability of universal service programs benefits employers by reducing time away from work necessary to address utility issues, which can undermine worker productivity and increase employee turn-over and absenteeism. CAUSE-PA Exc. at 27 (citing CAUSE-PA St. 1 at 50). Mr. Miller further testified regarding the broader societal benefits of universal service programs, including reduced homelessness and improved health and safety of the broader community. CAUSE-PA Exc. at 27 (citing CAUSE-PA St. 1 at 21-30).

Moreover, CAUSE-PA cites to the *Final CAP Policy Statement Order*, in which the Commission stated:

The Commission agrees that poverty, poor housing stock, and other factors that contribute to households struggling to afford utility service are not just ‘residential class’ problems. Further, helping low-income families maintain utility service and remain in their homes is also a benefit to the economic climate of a community. . . . Clearly, there is a persuasive argument to be made that home heating and energy assistance for low-income households serves a public good whose responsibility is not merely other residential ratepayers.

CAUSE-PA Exc. at 27-28 (citing *Final CAP Policy Statement Order* at 94-95). CAUSE PA states that the Commission concluded that costs could be allocated across classes “even if one discounts any non-residential benefits.” CAUSE-PA Exc. at 28 (citing *Final CAP Policy Statement Order* at 95). CAUSE-PA asserts that in this case, the record demonstrates that universal service programs provide clear and identifiable benefits to all ratepayers and should be recovered accordingly. CAUSE-PA submits that cost-sharing for these critical public purpose programs would reduce the burden of energy poverty on residential customers while providing more affordable services to CAP customers and more fairly allocating the costs of these programs between all consumers. CAUSE-PA Exc. at 28.

In its Replies to Exceptions, PECO argues that the ALJ appropriately preserved the Company’s existing universal service cost allocation. PECO states that the ALJ’s recommendation in this case is consistent with the Commission’s determination on this issue in *Columbia Gas*, in which the Commission denied proposals to reallocate universal service costs to non-residential customers. PECO R. Exc. at 16.

In its Replies to Exceptions, the OSBA notes that the CAP Policy Statement calls for the Commission to consider both revenue and expense impacts in evaluating CAPs for ratemaking purposes. OSBA R. Exc. at 3 (citing 52 Pa. Code § 69.266(a)). The OSBA states that neither the OCA nor CAUSE-PA provided any specifics regarding how USP costs would be recovered from non-residential classes or any revenue and expense impact analysis. OSBA R. Exc. at 3. The OSBA submits that its witness, Mr. Knecht, explained the OCA proposal, as follows:

Mr. Colton recommends that the costs be allocated on a ‘competitively neutral’ basis, based on ‘the percentage of revenue provided by each customer class at base rates.’ In so doing:

Mr. Colton does not specify the test year magnitude of universal service costs, or even define what specific cost items would be included in his proposed allocation;

Mr. Colton does not provide any allocation calculations, or assessment of the impact of the proposed change on allocated costs;

Mr. Colton also does not offer any recommendations regarding whether the ‘flex’ rate classes with market-based rates or the negotiated rate customers should be assigned surcharges related to universal service costs;

Mr. Colton does not offer any proposal for rate recovery of the allocated costs.

*Id*. (citing OSBA St. 1-R at 25-26).

The OSBA avers that while the OCA did not provide any guidance on the impact of having non-residential customers pay for universal service costs, Mr. Knecht attempted to calculate that impact. The OSBA states that Mr. Knecht calculated that the OCA proposal would save the average residential customer seventy-six cents per month. In comparison, Mr. Knecht concluded that “large businesses would face a cost increase of three to six cents per mcf, while small businesses would face cost increases over fifteen cents per mcf.” OSBA R. Exc. at 4 (citing OSBA St. 1-R at 26-27). The OSBA argues that the OCA and CAUSE-PA proposal to allocate universal service costs to all customer classes does not satisfy the expense and revenue impact test of 52 Pa. Code § 69.266(a). The OSBA asserts that *de minimis* savings for the residential class, but significant impacts on the rates PECO’s small businesses pay, is not a just and reasonable result. OSBA R. Exc. at 4.

Moreover, the OSBA states that this issue of USP cost recovery from non-residential customers was addressed in *Columbia Gas*, in which the Commission found that it was not appropriate to change the manner in which USP costs have traditionally been allocated. OSBA R. Exc. at 4-5 (citing *Columbia Gas* at 261). The OSBA believes that the facts that led to the Commission’s decision in *Columbia Gas* are identical to those in the current proceeding. Specifically, the OSBA states that the timing, duration, and effectiveness of the recovery from the COVID-19 pandemic remain in doubt. The OSBA also states that ratepayer impacts for larger customers are likely to be significant, particularly if the Commission adopts the 50/50 P&A mains cost allocation methodology it did in the *Columbia Gas Order.* The OSBA notes that rate increases for the TS-F and TS-I classes proposed by the OSBA and the OCA in this proceeding are well above system average and are constrained by rate gradualism concerns, resulting in rate increases that are insufficient to move revenue into line with allocated costs. OSBA R. Exc. at 5.

In its Replies to Exceptions, PAIEUG avers that the ALJ correctly determined that the status quo for PECO’s allocation of USP costs should remain for two reasons. PAIEUG R. Exc. at 13. First, PAIEUG argues that the ALJ properly found that the allocation of PECO’s USP costs should adhere to cost causation principles, and non‑residential customers do not directly benefit from PECO’s USP as non-residential customers are not eligible to participate in it. PAIEUG submits that because the costs of PECO’s USP are incurred only to serve residential customers, cost-causation principles mandate that the residential class fund this USP. *Id*. at 14.

PAIEUG disagrees with the OCA and CAUSE-PA’s argument that the ALJ ignores the economic impacts of COVID‑19 on residential customers. PAIEUG contends that the OCA and CAUSE-PA’s proposal would result in additional costs on non‑residential customers for a program in which they cannot participate and would compound the problems non-residential customers face from the COVID-19 pandemic, as the ALJ prudently recognized. PAIEUG R. Exc. at 15. PAIEUG states that the study the OCA presented does not examine the effects of allocating USP costs to non-residential customers during the COVID-19 pandemic. *Id*. (citing OCA St. 5-SR at 31‑32). Rather, PAIEUG submits that the study merely identifies the impacts of the COVID-19 pandemic on some key economic indicators in a number of cities, including Philadelphia and Pittsburgh. PAIEUG R. Exc. at 15-16. PAIEUG argues that the OCA’s conclusion regarding the study, ignores several factors, including: (1) how Ohio has handled the COVID-19 pandemic versus how Pennsylvania has addressed the COVID-19 pandemic in relation to business and industry; (2) the impact of data from areas in Pennsylvania outside of Philadelphia and Pittsburgh; and (3) whether Ohio’s application of USP costs on a statewide basis (*i.e.*, a macro level) would be applicable to application of USP costs on PECO’s natural gas system (*i.e*., a micro level). PAIEUG believes that the OCA attempts to use an overarching and generalized study to support specific claims on PECO’s system and that this study does not hold weight, because it offers nothing more than an apples-to-oranges comparison. *Id*. at 16.

Second, PAIEUG argues that the ALJ’s recommendation is supported by precedent from Pennsylvania courts and Commission decisions. PAIEUG avers that neither the Competition Act nor the CAP Policy Statement provide support for CAUSE‑PA’s proposal. PAIEUG states that the purpose of the Competition Act was to restructure the natural gas utility industry in Pennsylvania and because the natural gas industry has been “restructured” for approximately two decades, a claim of non‑bypassability related to the Competition Act is irrelevant to determining whether PECO’s USP costs should be collected from all ratepayers in this proceeding. PAIEUG R. Exc. at 17. Additionally, PAIEUG states that CAUSE-PA implies that the CAP Policy Statement requires adoption of proposals to recover CAP costs from all ratepayer classes, when the CAP Policy Statement merely indicates that it is appropriate to consider such proposals in rate case proceedings. *Id*. at 17-18. PAIEUG asserts that all Parties in this proceeding had ample opportunity to present arguments on whether USP costs should be allocated to all rate classes, and the ALJ considered these arguments in reaching his determination. *Id*. at 18.

### Disposition

Upon review, we determine that PECO should continue its existing practice of recovering USP costs solely from the residential class. We have historically approved public utilities’ practices of recovering universal service costs, including CAP costs, from only residential customers based on the “narrowly tailored” nature of these programs and the potential negative economic impact on Pennsylvania’s businesses if these costs were recovered from all ratepayer classes. *Final CAP Policy Statement Order* at 90; *see also* *Met-Ed Indus. Users Group*; *Pa. PUC v. PPL Electric Utilities Corporation*, Docket No. R-00049255 (Order entered July 25, 2007); *Final Investigatory Order on CAPs: Funding Levels and Cost Recovery Mechanisms*, Docket No. M-00051923 (Order entered December 18, 2006); and *Pa. PUC v. Valley Energy, Inc*., Docket No. R-00049345 (Order entered April 21, 2005). However, we recently stated in the *Final CAP Policy Statement Order* that our review of Pennsylvania’s current universal service model in the *Review* and *Energy Affordability* proceedings[[84]](#footnote-85) provided reasons to reconsider this position, noting that the current cost-recovery method for universal services, including CAP costs, is placing a significant burden on residential customer bills. *Final CAP Policy Statement Order* at 90.

In the *Final CAP Policy Statement Order*, we also definitively addressed the legal issues concerning cost allocation of universal service costs and, specifically, whether universal service costs could be recovered from non-residential classes. We stated the following:

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. Universal service funding from non-residential classes, 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.

*Final CAP Policy Statement Order* at 96 (citing *MEIUG*, 960 A.2d at 202; *Lloyd*).

As a result, we decided to amend the CAP Policy Statement to address the recovery of CAP costs and found it appropriate to consider recovery of CAP costs from all ratepayer classes. We advised utilities and stakeholders “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.” *Final CAP Policy Statement Order* at 97. While we stated that CAP cost recovery from all ratepayer classes should be considered in rate cases, we carefully noted that we were not making a precedential decision concerning cost recovery within the *Final CAP Policy Statement Order*. *Id*., n.150.

Accordingly, while we find it appropriate to consider universal service costs in this rate case, our decision will be based on the substantial evidence in the record and whether or not the OCA and CAUSE-PA have satisfied their burden of proving that USP costs should be distributed among all the classes. Under the circumstances in this case, we conclude that the OCA and CAUSE-PA have not satisfied this burden.

The OCA and CAUSE-PA presented evidence regarding their positions that the costs of PECO’s universal service program should be considered a “public good” and allocated across all customer classes and that nonresidential customers contribute to the cost of and the need for the program and derive a benefit from the program. These Parties also provided evidence regarding the financial harm that residential ratepayers, including lower-income customers that fall short of qualifying for assistance programs or chose not to receive assistance, are currently experiencing. *See, e.g*., OCA St. 5 at 58-83; CAUSE-PA St. 1 at 49-53. On the other hand, the OSBA and PAIEUG presented evidence (of at least co‑equal weight to that of the OCA and CAUSE-PA) on their positions that the principle of cost-causation supports that residential customers should fund universal service programs because that class is the only class that benefits from them, as well as their positions that there are flaws in the OCA and CAUSE-PA’s proposals, including the proposed cost allocation methodology. *See, e.g*., OSBA St. 1-R at 21-30; PAIUG St. 1-R at 10-13.

The OSBA testified regarding deficiencies in the OCA and CAUSE-PA’s proposals. For example, Mr. Knecht stated that the OCA witness Mr. Colton offers a general cost allocation methodology for implementing the OCA’s recommendation, and CAUSE-PA witness Mr. Miller does not offer a cost allocation methodology. Mr. Knecht testified that neither witness offers a specific revenue allocation or rate design proposal for the recovery of these costs from the non-residential classes or for the credit to the residential class, and neither witness offers a rate impact analysis for their proposals. OSBA St. 1-R at 21. In response to Mr. Colton’s proposal that universal service costs be allocated on a “competitively neutral” basis based on “the percentage of revenue provided by each customer class at base rates,” Mr. Knecht stated that Mr. Colton: (1) does not specify the test year magnitude of universal service costs or define the specific cost items that would be included in his proposed allocation; (2) does not provide any allocation calculations or assessment of the impact of the proposed change on allocated costs; and (3) does not offer any proposal for rate recovery of the allocated costs. *Id*. at 25-26. As such, we agree with the OSBA that the OCA did not provide sufficient information to enable the Commission to consider the revenue and expense impacts in evaluating CAPs for ratemaking purposes as provided in 52 Pa. Code § 69.266(a).

While it is accurate that the OCA has presented some evidence in this proceeding that it did not present in prior base rate proceedings, including *Columbia Gas*, we do not find that this evidence warrants a different conclusion than the ALJ reached on this cost allocation issue. Information regarding how the allocation of universal service costs in other states has impacted the economic circumstances of businesses in those states during COVID-19 is not necessarily indicative of how businesses in Pennsylvania would be impacted if they shared in the costs of universal service programs in this state. We also did not find the Brookings Institute study compelling, and we agree with PAIEUG that the study does not examine the effects of allocating USP costs to non-residential customers during the COVID-19 pandemic, but, rather, the study merely identifies the impacts of the COVID-19 pandemic on some key economic indicators in certain cities. For these reasons, we shall deny the OCA’s Exception No. 9 and CAUSE PA’s Exception No. 5.

## Tariff Structure

### Residential Customer Charge

#### Positions of the Parties

In PECO’s presently effective residential rate schedule GR, a large portion of the distribution revenue is being collected through volumetric charges. *See* PECO Exh. JAB-4 Revised (Corrected). The results of PECO’s customer cost analysis indicated that residential customers should be paying a much greater monthly customer charge than the current monthly charge of $11.75. *See* PECO Exh. JD-5R, p. 1. In this proceeding, PECO has proposed raising the GR customer charge from its present $11.75 per month to $16.00 per month. The Company pointed out that its ACCOSS supports a monthly charge of $28.07, and this increase moves the rate class closer to the cost of serving it.[[85]](#footnote-86) PECO witness Mr. Bisti explained the importance of aligning residential customer‑related costs (costs that vary based on the number of customers and not usage, *i.e.*, costs associated with meters, customer service lines, billing, and meter reading) with the residential customer charge:

A utility should, to the extent practicable, avoid including customer-classified costs in variable distribution charges because to do so would make the recovery of customer-related costs a function of customers’ gas usage, which they are not.

Misplacing customer costs in variable distribution charges has adverse consequences. First, it can create inappropriate intra‑class subsidies, because some customers will pay more than their share of customer-classified costs and others less, based on their relative levels of usage each month. Second, because customer costs, which are a fixed amount per customer, would be recovered in a charge that applies to usage, which varies, the Company could recover either too little or too much of its customer-related costs as a consequence of variations in customer usage.

PECO St. 7 at 13.

The Company further noted that its current residential customer charge is below the corresponding charges of all other major gas distribution companies in Pennsylvania and will still fall within the range of the residential customer charges of the other major gas distribution companies in Pennsylvania at the Company’s proposed increase. PECO M.B. at 116-17.

Although I&E disagreed with the Company that the customer charges of other NGDCs should be the determining factor for the rates of PECO’s customers, I&E did not object to the Company’s requested increase of $4.75, or 36%, to the residential customer charge, since PECO demonstrated that the residential customer charge has been significantly below its cost of service for many years. Although I&E recognized that such an increase was not insignificant, I&E opined that the requested increase was not unreasonable given the results of PECO’s A&E ACCOSS but recommended that the customer charge be included in the scale back of rates if the Commission grants less than the full requested increase. I&E M.B. at 70-71; I&E R.B. at 43-44.

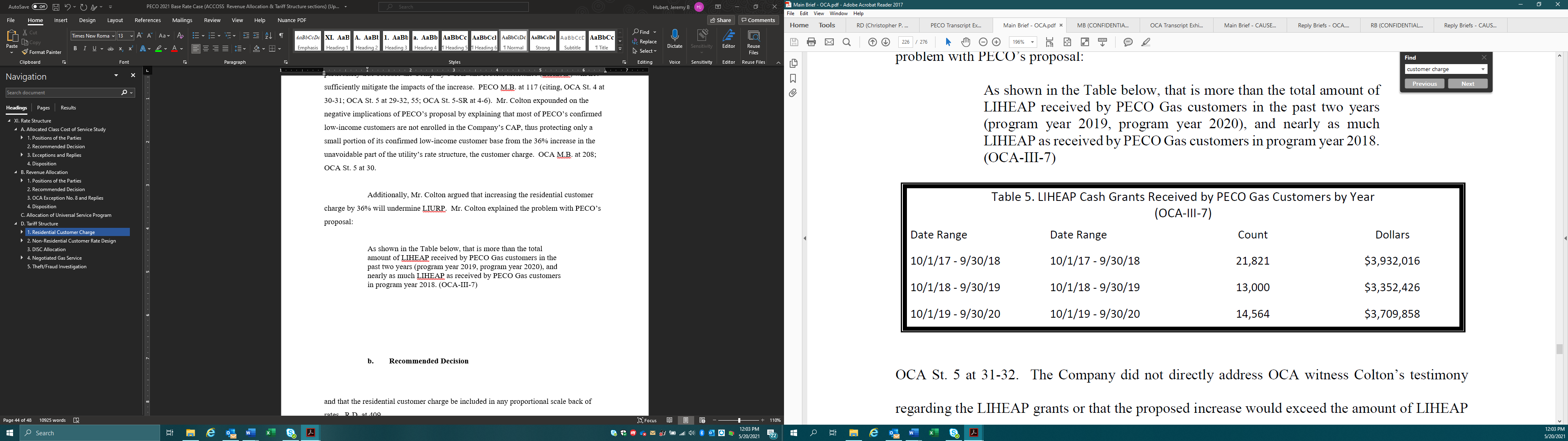
While I&E did not raise any objections to the Company’s requested increase to the residential customer charge, Mr. Watkins and Mr. Roger Colton on behalf of the OCA, and Mr. Miller on behalf of CAUSE-PA, submitted testimony opposing the Company’s proposed residential customer charge increase, including various concerns with respect to the impacts of the proposed customer charge on low‑income customers, discussed, *infra*. OCA M.B. at 207-15; OCA St. 4 at 30-31; OCA St. 5 at 29-55; OCA St. 5-SR at 4-6; CAUSE-PA M.B. at 49-52; CAUSE-PA St. 1 at 41-44; CAUSE-PA St. 1-SR at 2-3.

Mr. Watkins agreed with fellow OCA witness Mr. Rubin’s general position that there should be no rate increase, and therefore, there should be no change to PECO’s residential customer charge. However, Mr. Watkins stated that if the Commission does grant a rate increase under a “business as usual” scenario, the residential customer charge should be increased to no more than $13.00 per month, or an increase of 10.6%. OCA St. 4 at 31. Mr. Watkins asserted that notwithstanding the current state of affairs, regarding the COVID-19 pandemic, the Company’s proposed 36% increase in the fixed monthly charge clearly violates the principle of gradualism and is contrary to the goal of promoting energy conservation. *Id.* at 30. In addition, similar to I&E, Mr. Watkins recommended that if the Commission awards a lower revenue requirement than requested by the Company, the residential customer charge should be included in any proportional scale back. *Id*. at 31.

The OCA’s witness Mr. Colton agreed with the recommendation of Mr. Watkins, arguing that any increase to the residential customer charge would disproportionately impact low-income customers, which, as Mr. Colton’s evidence attempts to demonstrate, are on average, low-use customers who cannot otherwise off-set the proposed fixed customer charge. OCA St. 5 at 29-55. Mr. Colton argued that this is particularly true because the Company’s CAP and federal assistance (Low-Income Home Energy Assistance Program (LIHEAP)) will not sufficiently mitigate the impacts of the increase. PECO M.B. at 117 (citing OCA St. 4 at 30-31; OCA St. 5 at 29-32, 55; OCA St. 5-SR at 4-6). Mr. Colton expounded on the adverse implications of PECO’s proposal by explaining that most of PECO’s confirmed low-income customers are not enrolled in the Company’s CAP, thus protecting only a small portion of its confirmed low-income customer base from the 36% increase in the unavoidable part of the utility’s rate structure, the customer charge. OCA M.B. at 208; OCA St. 5 at 30.

Additionally, Mr. Colton explained that increasing the residential customer charge by 36% will diminish the benefits of federal LIHEAP grants:

As shown in the Table below, that is more than the total amount of LIHEAP received by PECO Gas customers in the past two years (program year 2019, program year 2020), and nearly as much LIHEAP as received by PECO Gas customers in program year 2018. (OCA-III-7)



OCA St. 5 at 31. Mr. Colton contended that the proposed residential customer charge increase would exceed the amount of LIHEAP cash grants that PECO’s low-income customers receive, effectively reducing the benefit of LIHEAP assistance to nothing. OCA M.B. at 210.

Further Mr. Colton contended that PECO’s proposal will result in additional harms, resulting from the payment difficulties of low-income customers: (1) increase in the depth and breadth of customer arrears;[[86]](#footnote-87) (2) increase in frequency of service disconnections and threat of service disconnections;[[87]](#footnote-88) (3) diminished ability of low-income customers to respond to their inability-to-pay through usage reductions; and (4) increase in the Home Energy Insecurity. OCA St. 5 at 33; OCA St. 5-SR at 14.

CAUSE-PA pointed out that most of the impact of the proposed rate increase for residential customers comes from this substantial increase to the fixed monthly service charge;[[88]](#footnote-89) thus, homes with the lowest usage levels will see the largest percentage increases, while homes with higher usage levels will see a lower percentage increase. CAUSE-PA M.B. at 49.

CAUSE-PA’s witness Mr. Miller recommended that the fixed monthly customer charge remain at $11.75. In support, Mr. Miller’s assertions echoed some of the same concerns proffered by the OCA, specifically that the Company’s proposed increase to its residential customer charge will impair energy efficiency efforts and adversely impact low-income customers. CAUSE-PA St. 1 at 41-44; CAUSE-PA St. 1‑SR at 2-3. He explained that low-income customers already struggle to pay for natural gas service and rely on the ability to reduce bills through conservation and usage reduction: “[r]egardless of the level of household usage, any increase to the fixed charge prevents customers from exercising the ability to use conservation measures to mitigate that portion of the rate increase.” CAUSE-PA St. 1 at 41.

CAUSE-PA argued that assigning such a high percentage of the proposed rate increase to the fixed charge would untether a substantial percentage of a customer’s bill from energy conservation bill reductions. As Mr. Miller explained, “if the proposed increase in the fixed customer charge is approved, PECO’s customers will lose the ability to control (on average) between 3-5% of their monthly bill through energy conservation and consumption reduction efforts –undermining the effectiveness of LIURP to achieve meaningful bill savings for low-income consumers.” CAUSE-PA St. 1 at 43.

Mr. Miller also explained that, in addition to undermining the effectiveness of millions of dollars in Low-Income Usage Reduction Program (LIURP) investments, PECO’s high fixed charge proposal will also “undermine the millions of ratepayer dollars that the Company is proposing to invest in energy efficiency through its voluntary Energy Efficiency and Conservation Program Plan.” CAUSE-PA St. 1 at 43.

#### Recommended Decision

The ALJ agreed with I&E that the Company’s proposed monthly customer charge of $16.00 is supported by PECO’s customer cost analysis. Nonetheless, the ALJ expressed concerns about gradualism and found that the residential customer charge should be reduced in proportion to the final revenue increase approved in this case. ALJ Pell reasoned that a 36% increase to the customer charge would violate the principle of gradualism, adding that this monthly charge cannot be avoided or reduced. R.D. at 409.

#### Exceptions and Replies

##### **PECO Exception No. 9 and Replies**

In its Exception No. 9, PECO argues that the ALJ erred by concluding that the residential customer charge should be included in any scale back of rates in this proceeding should the Commission ultimately grant PECO less than the full requested increase. PECO Exc. at 31-32 (citing R.D. at 409). PECO maintains that its residential customer charge proposal reduces the disparity between its current customer charge and a cost-based customer charge, that traditional ratemaking methodology dictates that a utility be permitted to recover fixed customer costs through the fixed customer charge, and that its proposed increase is consistent with principles of gradualism because it falls below the level of demonstrated residential class customer-related costs and would be within a reasonable range of the residential customer charges of other major Pennsylvania gas utilities. PECO Exc. at 31-32. PECO contends that scaling back the proposed residential customer charge as the ALJ recommended would be unreasonable because it would move the charges further away from the indicated cost of service. *Id*. at 32.

In reply, both I&E and the OCA counter that the ALJ properly recognized that the fixed customer charge cannot be avoided by customers or reduced, and therefore, as the ALJ reasoned, including the residential customer charge in the proportional scale back mitigates the gradualism concern, which a 36% increase to the residential customer charge would incite. I&E R. Exc. at 10-11; OCA R. Exc. at 12. The OCA notes that, although it agrees with the ALJ that it is appropriate to include the residential customer charge in any scale back, in accordance with the OCA’s Exception No. 10, it maintains that any increase to the residential customer charge should be capped at $13.00, and any proportional scale back should start from that amount. OCA R. Exc. at 13.

##### OCA Exception No. 10 and Replies

In its Exception No. 10, the OCA disagrees with the decision of ALJ Pell to the extent it relies on a proportional scale back to address the overstatement of the customer charge, arguing that the OCA proffered substantial testimony demonstrating the impacts any increase on the residential customer charge can have upon low-income customers. OCA Exc. at 37-38. The OCA argues that the ALJ erred in declining to adopt the OCA’s proposal to cap PECO’s monthly residential customer charge at $13.00, limiting any increase to $1.25 per month, and using that amount as the starting point for any proportional scale back. *Id*.

In reply, PECO maintains that, in addition to the residential customer charge being excluded from any scale back, the proposed monthly residential customer charge of $16.00 should be adopted, as it is not unreasonable given the results of its customer cost analysis. PECO reiterates its contention that customers can still adopt energy efficiency measures to reduce their overall bill. PECO further notes that neither the OCA nor CAUSE-PA offered a cost-of-service basis for its recommendation. PECO R. Exc. at 24‑25.

In its Replies, I&E maintains its support for the ALJ’s recommendation that PECO’s residential customer charge be included in any scale back of rates and incorporates its response to PECO’s Exception No. 9 by reference as if fully set forth. I&E R. Exc. at 21-22.

##### CAUSE-PA Exception No. 6 and Replies

In its Exception No. 6, CAUSE-PA maintains its opposition to any increase in PECO’s residential customer charge, as well as its contention that increasing the fixed monthly charge as proposed will undermine the ability for consumers to control costs through energy conservation, thus undermining the explicit goals of LIURP. Further, CAUSE-PA reiterates its argument that the customer cost analysis should not outweigh the public interest in protecting the ability of low-income households to lower their utility costs by reducing consumption and preserving the effectiveness of LIURP. CAUSE-PA Exc. at 29-31.

PECO maintains that CAUSE-PA’s and the OCA’s positions are contrary to the fundamental ratemaking principle that the customer component of total cost of service should be recovered in the service charge. In its reply to CAUSE-PA’s Exception No. 6, PECO incorporates its response to the OCA’s Exception No. 10; therefore, it will not again be stated here.

In its Replies, I&E maintains its support for the ALJ’s recommendation that PECO’s residential customer charge be included in any scale back of rates and incorporates its responses to PECO’s Exception No. 9 and the OCA’s Exception No. 10 by reference as if fully set forth. I&E R. Exc. at 24-25.

#### Disposition

Rate design requires a careful balance of the competing interests of customer classes as well as prudent application of the principles of cost causation, gradualism, and overall fairness. In light of the results of the Company’s ACCOSS and the customer cost analysis provided therein, we do not believe that the proposed increase is unreasonable. As previously noted, the primary purpose of cost-of-service studies and corresponding rate allocation and design is to move the rates assigned to the various customer classes toward their respective costs of service. Rate design should reflect the cost of service to each rate class and should eliminate cross-subsidization. *Lloyd*, *supra.* PECO’s ACCOSS demonstrated that residential customers have a monthly customer cost of $28.07. *See* PECO Exh. JD-5Rat 1. Therefore, the Company’s proposed monthly residential customer charge of $16.00 is clearly justified by the results of its ACCOSS. A customer charge that better approximates the total customer-related costs provides a more accurate price signal and offers greater transparency to customers about the fixed costs that PECO incurs to connect them to the system, regardless of the amount of energy consumed. Improved price signals can translate into more economically efficient energy usage.

As discussed, in the interest of gradualism, PECO proposed a residential customer charge of $16.00 per month, not the full amount that could currently be supported by its ACCOSS. On this issue of gradualism, we concur with the ALJ and recognize that an increase in the monthly residential customer charge from $11.75 to $16.00 is not insignificant. However, as we have previously found, to the extent that gradualism factors into the allocation and design of rates, it should also be considered in the context of the entire increase to a customer class, rather than to an individual element or component of the rate design.  *See* *UGI Electric* at 174. As previously indicated, (at PECO’s total proposed overall increase) the allocation of the revenue increase to the residential class is $62 million (26.5% or 1.54 times the system average) under I&E’s proposal adopted by the ALJ. Under the OCA’s proposal, the revenue increase allocated to the residential class ($60 million, or 25.7%) was only 0.8% less than that proposed by I&E. As previously noted, although there are no definitive rules for determining what kind of rate increase would violate the principle of gradualism, limiting the maximum average rate increase for any particular class to 1.5 to 2.0 times the system average increase is one common metric that has been used by experts in the Commonwealth. *Columbia Gas* at 233. Therefore, with regard to the alternative proposals of the OCA and CAUSE-PA that PECO’s monthly residential customer charge should remain at $11.75, or as alternatively proposed by the OCA, that the residential customer charge should be increased to no more than $13.00 per month to account for gradualism, we find them to be without merit. Further, by this Opinion and Order, we are ultimately approving a lower revenue increase than that sought by the Company. Accordingly, PECO’s actual customer charge that results from this revenue increase will be reduced as a result of the scale back that will be applied.

Furthermore, the OCA and CAUSE-PA have rightfully noted the important factor that rate design plays in promoting conservation and energy efficiency. However, we find unpersuasive the contention that increasing PECO’s monthly residential customer charge to $16.00 will impede energy conservation efforts by stunting the incentives for consumers to take charge of their energy costs by reducing usage. Under PECO’s proposal, the proposed residential customer charge will remain only a small portion of a customer’s total bill; thus, still providing residential customers with an opportunity to save money by lowering energy usage that is applied to both the usage-based distribution charge and a gas commodity charge, or the Purchased Gas Cost rate. For example, under PECO’s proposal, assuming the Company’s entire request is approved, the total monthly bill for an average residential customer using 80 hundred cubic feet (Ccf) per month would increase by approximately $11.64 from $80.10 to $91.74 per month, or by 14.5%.[[89]](#footnote-90) Of that $91.74, only $16.00 (17.4%) represents the fixed customer charge, whereas approximately $75.74 (82.6%) represents the variable portion. As this calculation shows, more than 80% of an average monthly residential bill is based on volumetric rates, which still preserves the ability of consumers to control costs through efficiency, conservation, and consumption reduction, which was found to be of particular interest for low-income customers. We acknowledge that under I&E’s recommended revenue allocation, adopted by the ALJ, the volumetric distribution charge will be reduced slightly from that proposed by PECO, as to reflect the reduced revenue allocation to the residential class, from the 27.3% increase proposed by PECO to I&E’s proposal of 26.5%. However, this slight revision to the revenue recognition from the residential class will not materially affect the marginal impact of consumption. As such, regarding the OCA’s and CAUSE-PA’s arguments that increasing the Company’s monthly residential customer charge to $16.00 will restrict how much control customers have over how much they pay, making it more difficult for customers to pay less by using less, we find them to be without merit.

Additionally, we find no merit in the arguments of the OCA and CAUSE‑PA that PECO’s requested increase to the residential customer charge will have a disproportionate adverse effect on PECO’s low-income customers. Rather, we find that PECO has successfully rebutted the argument that low-income customers would be disproportionately impacted. As we have already found, the OCA and CAUSE-PA have not supported their assertions that the Company’s proposed increase to the residential customer charge will impair low-income, low-use customers’ ability to partially off-set the rate increase through conservation efforts. Additionally, we find persuasive PECO’s argument that the proposed increase to the residential customer charge will provide a relative benefit to high-use, low-income customers by lessening the impact of the overall rate increase. PECO indicated its belief that its proposal to provide a relative benefit to high-usage, low-income customers, who are more likely to experience high monthly bills, is reasonable. *See* PECO M.B. at 118. Moreover, we find compelling the testimony of PECO witness Ms. Colarelli, which addressed bill affordability for low-income customers, including the Company’s pending proposal to transition its CAP to a PIPP structure. *See* PECO St. 10-R.

Although we have determined that PECO’s proposed customer charge is not unreasonable, we nonetheless note that PECO’s proposed increase to the customer charge is not insignificant. Therefore, we find that, as a matter of fairness, the customer charge should be scaled back along with the other rates. PECO’s Exception on this point is denied.

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

### Non-Residential Customer Charge

#### Rate GC Customer Charge

##### **Positions of the Parties**

The Company noted its initial proposal to increase its rate GC customer charge. The OSBA’s witness, Mr. Knecht, recommended no increase to rate GC, offering that the charge should reflect the costs for smaller customers within the class. Consequently, PECO revised its position and proposed to maintain its current rate GC customer charge of $28.55 per month. PECO M.B. at 119; OSBA M.B. at 24.

##### Recommended Decision

The ALJ recommended that the Commission adopt PECO’s proposal to keep the rate GC customer charge at its current charge of $28.55 per month. R.D. at 409.

##### Disposition

No Party filed Exceptions on this issue. Finding the ALJ’s recommendation to be reasonable, we shall adopt it without further comment.

#### Rate GC Declining Block Volumetric Charge Differential

##### **Positions of the Parties**

The Company noted that its rate GC contains a two-tier declining block volumetric tariff charge. Mr. Knecht, upon analyzing the factors that justify a rate differential between smaller and larger customers within the GC rate class, recommended that the Company reduce the volumetric tariff charge differential. PECO accepted Mr. Knecht’s proposal and the OSBA noted its support of the Company’s proposed declining block rates for rate GC. PECO M.B. at 120; OSBA M.B. at 25-26.

##### Recommended Decision

The ALJ recommended that the Commission adopt PECO’s proposed rate GC declining block volumetric differential. R.D. at 410.

##### Disposition

No Party filed Exceptions on this issue. Finding the ALJ’s recommendation to be reasonable, we shall adopt it without further comment.

#### Rate TSF and TS-I Volumetric Change Differential

##### Positions of the Parties

PECO provided that, despite its opposition to creating a separate rate classification for such customers, it adopted the proposal from the OSBA’s witness, Mr. Knecht, to reduce the differentials in its rate TS-F and rate TS-I volumetric charges for annual gas consumption capability of at least 18 MMcf [[90]](#footnote-91)(large rate schedule) and less than 18 MMcf (small rate schedule), and incorporated the changes into its proposed rate design for TS-F and TS-I. The Company clarified that its witness, Ms. Ding, accepted one of the two options presented by Mr. Knecht, and then its witness, Mr. Bisti, implemented that option in the proposed rate design. Accordingly, PECO submitted that the Commission should approve the Company’s proposed rate design for rates TS-F and TS‑I.[[91]](#footnote-92) PECO M.B. at 120-21 (citing PECO Exh. JAB-4 Revised (Corrected)); PECO R.B. at 78.

PECO noted that, upon the request of PAIEUG’s witness, Ms. LaConte, it provided the following to all of the Parties: (1) in Excel, a corrected version of the Company’s proof of revenues for rates TS-F and TS-I (consistent with PECO Exh. JAB-4 Revised (Corrected)); and (2) a history of the different versions of volumetric distribution charges under the proposed rates for both classes. PECO further insisted that its proposal will not result in rate shock to TS-F customers, elaborating that the large commercial and industrial TS-F customers have enjoyed the benefit of no rate increase since new rates went into effect following the Company’s 2010 base rate case. PECO R.B. at 78-79.

As noted, *supra*, Mr. Knecht recommended that the volumetric rate differentials be narrowed for service above and below 18 MMcf per year in the TS-F and TS-I tariffs, thereby improving the alignment of rates with the relative load factors of smaller and larger customers. The OSBA provided that the Company’s revised proposals for rate differentials between small and large customers in rates TS-F and TS-I are consistent with Mr. Knecht’s proposals. Therefore, the OSBA recommended that the Company’s revised proposals for differentials in rates TS-F and TS-I be approved. OSBA M.B. at 26-27 (citing OSBA St. 1-S at 22; OSBA St. 1 at 52-56).

PAIEUG submitted that the burden of proof for modification of the volumetric differentials has not been met by the OSBA or PECO, reasoning that the OSBA did not offer additional support for its proposal and PECO failed to provide adequate data to the OSBA and PAIEUG. PAIEUG contended that the current volumetric differentials are reasonable and should remain in place. Accordingly, PAIEUG recommended that the Commission reject the OSBA’s proposed changes to the volumetric differentials in the rates TS-F and TS-I. PAIEUG further opined that any additional analysis on this matter that the Commission deems necessary should be reserved for future PECO rate case consideration with all supporting data directed to be shared among the parties at the outset of that proceeding. PAIEUG R.B. at 25-26, 27-28 (citing PECO M.B. at 120-21; OSBA M.B. at 24-27; PAIEUG M.B. at 36-39).

PAIEUG asserted that the Company and its witnesses, Ms. Ding and Mr. Bisti, remain inconsistent in their positions regarding whether the rate differentials for TS-F and TS-I customers using above and below 18 MMcf should be modified. PAIEUG noted that, although PECO expresses support for the OSBA’s proposal, PECO acknowledges that different factors justify different rate treatment. Further, PAIEUG noted that, given the differences in rate treatment for large and small rate TS-F and TS-I customers, the Company did not provide analysis to support why the OSBA’s proposal is reasonable. PAIEUG R.B. at 26 (citing PECO M.B. at 110-11, 121; PECO St. 6‑R at 23‑24; PECO St. 7-R at 15). Moreover, PAIEUG disagreed with the Company’s position that because PECO has not filed a gas rate case since 2010, a 56.2% increase in volumetric differentials is not representative of rate shock. PAIEUG R.B. at 26-27 (citing PECO M.B. at 111); PAIEUG St. 1-S at 7. PAIEUG countered that rate shock occurs when a significant rate increase is imposed on customers in one rate case rather than over a series of rate cases, consistent with the principles of gradualism. PAIEUG R.B. at 27 (citing *Lloyd* at n. 14).

##### Recommended Decision

According to the ALJ, PAIEUG’s argument that the Company failed to provide data in a workable format is not persuasive; however, the ALJ was persuaded by PAIEUG’s determination that there was a 56.2% increase in volumetric rates. The ALJ agreed with PAIEUG that this would constitute rate shock and conflicts with the principles of gradualism. The ALJ was not persuaded by the Company’s argument that the increase is justified because TS-F customers are large commercial and industrial users that have enjoyed the benefit of no rate increase since new rates went into effect after the Company’s last base rate case. The ALJ added that he is not aware of an exception that, because a customer has not experienced a rate increase in several years, a significant rate increase is permitted. Accordingly, the ALJ recommended that the Company’s proposal to reduce the volumetric differentials for rates TS-F and TS-I be denied. R.D. at 411.

##### PAIEUG’s Motion to Strike, Answer, and Disposition

###### PAIEUG Motion and OSBA Answer

In its Motion, PAIEUG maintains that portions of the OSBA’s Exception No. 3, *infra,* raise new factual claims regarding the veracity of PAIEUG’s testimony and exhibits supporting the 56.2% rate increase associated with the OSBA’s proposal, and must be stricken from the record and given no weight by the Commission. PAIEUG asserts that the 56.2% rate increase is undisputed in the evidentiary record and the OSBA’s new claims, which are raised for the first time on pages 7 through 8 in its Exceptions, are not supported by evidence in the record and do not include citations to the record.[[92]](#footnote-93) Motion at 3-6 (citing OSBA Exc. at 7-8, Appendix A).

PAIEUG cites Commonwealth Court and Commission precedent to argue that parties may not raise new factual claims, such as extra-record evidence, in their Exceptions.[[93]](#footnote-94) PAIEUG explains that the Commonwealth Court agreed that the Commission did not abuse its discretion by striking a portion of the Exceptions that raised, for the first time in the proceeding, factual claims that disputed another issue in the record. Motion at 3-4 (citing *Hess* at 266). Further, PAIEUG provides that the Commonwealth Court further recognized that the admission of new evidence during the exceptions stage of a proceeding is in violation of the opposing party’s due process rights. Motion at 4 (citing *Hess* at 267). Moreover, PAIEUG cites Section 5.431(a) of the Commission’s Regulations to note that once the record has closed, extra-record evidence is not permitted to be raised at the exceptions stage of a proceeding. *Id.* (citing 52 Pa. Code § 5.431(a)). PAIEUG also cites the following from Section 5.533(c) of the Commission’s Regulations:

[S]tatements of reasons supporting the exceptions must, insofar as practicable, incorporate by reference and citation, relevant portions of the record and passages in previously filed briefs.

*Id.* (citing 52 Pa. Code § 5.533(c)). Additionally, PAIEUG emphasizes its position that by the OSBA presenting new assertions and a new exhibit at this point in the proceeding, the OSBA has, in effect, prevented PAIEUG from submitting a response, submitting discovery to the OSBA or cross-examining the OSBA’s witness, a violation of PAIEUG’s due process rights. Motion at 4-5.

In its Answer to the Motion, the OSBA contends that it’s correcting the ALJ’s failure to address the impact to revenue allocation and rate design while considering rate shock. The OSBA explained that Mr. Knecht recommended narrowing the volumetric rate differentials for service above and below 18 MMcf per year in the TS‑F and TS-I tariffs to better align rates with the relative load factors of small and large customers. The OSBA avers that the basis for Mr. Knecht’s rate recommendation is an unrebutted analysis detailing the customer load factors within the TS-F and TS-I rate classes to determine the magnitude of charge difference supported by the different load patterns. Answer to Motion at 2 (citing OSBA St. 1 at 52-56).

The OSBA notes that the Company agreed to the OSBA’s recommendation and submits that PECO’s revised rate design proposal and proposed revenue allocation for the TS-F class, which is supported by PAIEUG Exhibit BSL-2S, would result in an increase in the base volumetric rates for the larger TS-F rate class of 56.2%. Answer to Motion at 2-3 (citing PAIEUG St. 1-S at 7; PAIEUG Exh. BSL-2S). The OSBA elaborates:

However, the increase in the volumetric rates is not the overall bill impact, which includes the effect of the customer charge. Furthermore, part of the increase in the volumetric rates is due to the roll-in of the DSIC and TCJA charges into rates, which does not represent an actual increase in rates.

Unfortunately, the [ALJ] uses this evidence to reject the proposed rate design for both the TS-F and TS-I rate classes, whereas the 56.2 percent value applies only to TS-F. Consequently, there is no evidentiary basis for concluding that the TS-I increase supported by the quantitative evidence of the OSBA and accepted by the Company constitutes rate shock.

PAIEUG makes much of OSBA’s failure to attempt to address Witness LaConte’s assertion of a 56.2 percent increase in the TS-F volumetric rates (unadjusted for the impact of the DSIC roll-in and unadjusted for the customer charge impact). However, as the OSBA explains in its exceptions, the 56.2 percent increase in the TS-F volumetric rates was based on the Company’s revenue allocation for that class. That revenue allocation was rejected by the OSBA, by PAIEUG, and eventually by the [ALJ]. In fact, as shown in Mr. Knecht’s surrebuttal testimony, the OSBA’s recommendation for revenue allocation to both the TS-F and TS-I rate classes matched that put forward by PAIEUG.

Answer to Motion at 3 (citing OSBA St. 1-S at 14). In short, the OSBA contends that the ALJ’s decision regarding intra-class rate design support for the TS-F rate class is not supported because, under the ALJ’s recommendations regarding revenue requirement and revenue allocation, the basis of the 56.2% is irrelevant. Answer to Motion at 4.

In further argument, the OSBA counters that its Exception No. 3 and Appendix A to its Exceptions include several citations to the record evidence in support of its mathematical corrections to the ALJ’s Recommended Decision and that a cross‑examination of Ms. LaConte would not have uncovered mathematical errors in the ALJ’s Recommended Decision. Answer to Motion at 4-5.

The OSBA points out that the purpose of its analysis is to demonstrate to the Commission that the intra-class rate impact on TS-F customers is largely dependent on decisions by the regulator involving revenue requirement and revenue allocation. The OSBA concludes that if the Commission adopts a revenue requirement and/or a revenue allocation that is different from that recommended by the ALJ, the OSBA encourages the Commission to take on its own evaluation of intra-class rate implications of the cost-based rate design proposals. Answer to Motion at 5.

###### Disposition of Motion

Upon review, we shall grant PAIEUG’s Motion. We agree with PAIEUG that the OSBA’s Exceptions acknowledge and make use of extra-record material in an attempt to advance arguments not previously made and factual evidence not of record; specifically: (1) the discussion on page 7, beginning with, “[t]he [ALJ’s] reliance on this evidence in support of rate shock . . .” through the end of page 8 challenging the ALJ’s reliance on the evidence supporting the 56.2% rate increase associated with the OSBA’s proposal, which does not include any citations to the evidentiary record; and (2) a one-page spreadsheet titled “Rate TS-F Proof of Revenue” that was not previously entered into the record.[[94]](#footnote-95) *See* OSBA Exc. at 7-8, Appendix A.

We will disregard the extra-record material, specifically, the one-page spreadsheet titled “Rate TS-F Proof of Revenue” under “Appendix A” and the associated language on pages 7-8 of the Exceptions, as consideration of this extra-record information and accompanying new arguments. It is well-established that parties cannot raise new arguments and introduce new evidence at the exceptions stage. *Hess* at 265‑66*; Apollo Gas* 1994 Pa. PUC Lexis, at \*8-14. As noted earlier, the record closed on March 15, 2021. R.D. at 5. To allow the OSBA’s new arguments and evidence, including Appendix A, at this late stage in the proceeding would deprive the other Parties to this proceeding of the opportunity to respond to the evidence and the arguments based on it. *See Hess* at 267. Therefore, we will grant PAIEUG’s Motion to Strike, and we will not consider the extra-record material and arguments referenced by the OSBA in its Exception No. 3.

##### OSBA Exception No. 3, Replies, and Disposition

###### OSBA Exception No. 3 and Replies

In its Exception No. 3, the OSBA disagrees with the ALJ’s recommendation that the reduction of the TS-F and TS-I differentials be rejected, arguing that the ALJ’s use of the term “rate shock” is inconsistent with regulatory policy. OSBA Exc. at 5-6 (citing R.D. at 411). The OSBA elaborates, as follows:

In general, rate shock concerns can and should reasonably be used to limit the progress toward cost-based rates where such rate shifts would be unreasonably large. However, in those circumstances, rate shock is used to *mitigate* the progress, not *eliminate it* entirely. The [ALJ], however, concludes that rate shock concerns justify a rate design that fails to make any progress toward intra-class balancing of revenues and costs, and simply retains the status quo relationship. While rate shock is a reasonable concern, the OSBA respectfully submits that it does not justify perpetuating intra-class inequities.

OSBA Exc. at 6 (emphasis in original).

The OSBA further contends that the ALJ failed to consider the revenue allocation proposal of its witness, Mr. Knecht, when evaluating rate shock and that the ALJ’s reliance on the evidence supporting the 56.2% increase in the base volumetric rates for the large TS-F customers is a problem. OSBA Exc. 6-7 (citing PAIEUG St. 1-S at 7; PAIEUG Exh. BSL-2S).

In its Replies, PAIEUG argues that the ALJ properly rejected the OSBA’s requested change because it violates principles of gradualism and creates rate shock. PAIEUG R. Exc. at 11-12 (citing R.D. at 411). PAIEUG references *Sharon Steel Corporation v. Pa. PUC*, 468 A.2d 860 (Pa. Cmwlth. 1983), *Barasch v. Pa. PUC*, 515 A.2d 651 (Pa. Cmwlth. 1986) and *Lloyd*to counter that the Commission often relies on principles of gradualism when setting utility rates to avoid rate shock to any customer class. Further, PAIEUG contends that a 56.2% increase in rates in a single rate case violates gradualism principles and would lead to rate shock. PAIEUG R. Exc. at 11. Moreover, PAIEUG states that the current rate designs for rates TS-F and TS-I are included in PECO’s tariff and are deemed *prima facie* reasonable. PAIEUG R. Exc. at 13 (citing 66 Pa. C.S. § 316). Accordingly, PAIEUG asserts that the Commission should adopt the ALJ’s recommendation and reject the OSBA’s proposed changes to rates TS-F and TS-I, adding that the current volumetric differentials within rates TS-F and TS-I should remain in place. PAIEUG R. Exc. at 13*.*

PAIEUG challenges the OSBA’s claim that its analysis supporting updates to the volumetric changes for rates TS-F and TS-I was not rebutted, countering that the Company submitted contradictory testimony regarding whether any of its proposed changes to the rate designs of TS-F and TS-I are cost-based and reasonable. PAIEUG R. Exc. at 12 (citing OSBA Exc. at 5; PAIEUG M.B. at 37). PAIEUG explains that PECO witness Ms. Ding, despite accepting the OSBA’s proposed changes to the volumetric differentials, offered other testimony disputing the OSBA’s position that rates TS-F and TS-I reflect unreasonably large rate differentials for customers above and below annual volumes of 18 MMcf. PAIEUG R. Exc. at 12*.* (citing PECO St. 6-R at 23‑24; PECO St. 7-R at 15). PAIEUG further notes that, according to Ms. Ding, the current rate differentials in TS-F and TS-I are justified based on several factors, such as “total connected and concurrent load, the customer’s location(s), and the manner in which the customer operates its equipment.” PAIEUG R. Exc. at 12 (citing PECO St. 6-R at 24).

###### Disposition

Based on our review, we find that the ALJ properly weighed the evidence of record in reaching his recommendation. We agree with the ALJ that the Company’s argument that TS-F customers will not experience rate shock because they have enjoyed the benefit of no rate increase since new rates went into effect after the Company’s 2010 base rate case is not persuasive. We also agree with the ALJ that PAIEUG’s determination that a 56.2% increase in volumetric rates is persuasive and constitutes rate shock, contrary to the principles of gradualism. Therefore, we shall deny the OSBA’s Exception No. 3 and adopt the ALJ’s decision on this issue.

#### Rate L and Standby Sales Service

##### **Positions of the Parties**

The OSBA proposed eliminating standby sales service under rate L due to obsolescence. The OSBA’s witness, Mr. Knecht, recommended that the Company shift the distribution costs related to delivering standby gas supplies back to transportation customers, thereby aligning the gas supply cost for gas standby sales with standby rates. OSBA M.B. at 28-31; OSBA St. 1‑S at 23. PECO argued that under existing rates, rate L revenues make up $75,000 with only a portion associated with standby sales service. The Company further argued that implementation of the OSBA’s recommendation would result in wholesale changes in the relationship between rate L and rate TS-F, as well as administrative costs and IT changes that would exceed the revenues that would be reassigned to other classes. PECO R.B. at 79-80. Mr. Knecht concluded that, although his approach is superior to the Company’s strategy, there is little difference between the Company’s proposal and his recommendation. OSBA St. 1-S at 25.

##### Recommended Decision

The ALJ agreed with the Company and, upon noting the costs to achieve Mr. Knecht’s recommendation, as well as Mr. Knecht’s conclusion that his proposal is consistent with the Company’s proposal, recommended that the OSBA’s proposal to eliminate standby sales service under rate L be denied. R.D. at 412.

##### Disposition

No Party filed Exceptions on this issue. Finding the ALJ’s recommendation to be reasonable, we shall adopt it without further comment.

#### Elimination of Rate IS Margin Sharing

##### **Positions of the Parties**

PECO noted that customers that take interruptible service under rate IS, which is linked to a customer’s cost of alternative fuel, are charged a customer charge plus a rate that is: (1) no less than PECO’s commodity cost of gas for the month plus three cents; and (2) no more than the price of the alternative fuel able to be consumed by the customer. The Company stated that from this price, the weighted average cost of flowing gas is subtracted and the remainder, which is PECO’s gross margin, is divided between PGC customers and shareholders. The OCA and the OSBA recommended that the Company eliminate the margin sharing mechanism, explaining that a sharing mechanism is no longer appropriate in the context of a competitive natural gas supply market. PECO agreed to eliminate rate IS margin sharing on or before December 1, 2021, as part of its next annual PGC reconciliation filing. PECO M.B. at 122-23; OCA M.B. at 216-19; OSBA M.B. at 27.

##### Recommended Decision

Upon noting that the Company’s proposal satisfies the concerns raised by the OCA and the OSBA, and because no party opposed PECO’s proposal, the ALJ recommended that the Commission adopt PECO’s proposal to eliminate the rate IS sharing mechanism on or before December 1, 2021, as part of the Company’s next annual PGC reconciliation filing. R.D. at 413.

##### Disposition

No Party filed Exceptions on this issue. Finding the ALJ’s recommendation to be reasonable, we shall adopt it without further comment.

#### Elimination of Rate IS, MV-1, and TCS

##### **Positions of the Parties**

The OSBA recommended that the Commission consider phasing out rate classes MV-I, TCS and IS in a future rate case or as soon as possible. The OSBA explained that these rate classes represent bundled service in an unbundled environment and the tariffs could be used to provide PECO with an inequitable competitive gas supply advantage. PECO asserted its opposition to elimination of rate classes MV-I, TCS and IS, explaining that maintaining interruptible customers is crucial to protecting firm customers from system interruptions and enabling the Company to avoid investments that might otherwise be necessary to support reliability if all customers were firm. PECO also noted that the OSBA did not provide evidence that justified elimination of these rates. PECO R.B. at 80-81; OSBA M.B. at 27-28.

##### Recommended Decision

Upon noting that the OSBA did not provide evidence that eliminating rate classes MV-I, TCS and IS will provide a greater benefit to the Company’s distribution system and customers than keeping these interruptible rates in place, the ALJ recommended that the Company maintain rates IS, MV-I and TCS. R.D. at 414.

##### Disposition

No Party filed Exceptions on this issue. Finding the ALJ’s recommendation to be reasonable, we shall adopt it without further comment.

### DSIC Allocation

The OSBA’s witness, Mr. Knecht, initially expressed concern regarding an issue in the Company’s allocated Distribution System Improvement Charge (DSIC) costs among rate GC customers. Mr. Knecht explained that following the submittal of rebuttal testimony by PECO’s witness Mr. Bisti, his concern was incorrect. Nevertheless, PECO concluded that after considering Mr. Knecht’s testimony, it would adopt the OSBA’s recommendation to modify PECO’s budgetary cost allocation procedures to distribute DSIC-eligible costs among the rate classes based on total base rate revenues. Consequently, the OSBA acknowledged that its concerns regarding the DSIC allocation issue were resolved. R.D. at 414; PECO M.B. at 124-25; OSBA M.B. at 31-32 (citing OSBA St. 1-S at 18).

### Negotiated Gas Service

#### Positions of the Parties

PECO provided that its current Commission-approved tariff permits the Company to offer negotiated, or discounted, gas service to customers under specified circumstances, pursuant to the Company’s rate NGS. PECO explained that, to be eligible for service under rate NGS, a customer must: (1) either have a history of at least 18,000 Mcf of annual billed gas usage or, if a new customer, establish that the facilities to be served are likely to consume at least 18,000 Mcf of annual gas usage; (2) document a viable, currently available competitive alternative to service under rates GC, L, TS-F, or TS-I; and (3) execute an NGS agreement that agrees with all provisions set forth in rate NGS. The Company noted that six customers currently take service under rate NGS. PECO R.B. at 81 (citing PECO Exh. JAB-2 at 76-77).

PECO stated that its Commission-approved tariff for rate NGS does not require the Company to reevaluate customer eligibility for rate NGS at any point, except when a customer applies for service and, at that time, the Company and its customers evaluate the potential benefits of a long term NGS service agreement. PECO asserted that a requirement to review the eligibility of its rate NGS customers over regular intervals (*i.e.,* every five years) would create instability for the Company’s NGS customers and, therefore, make it less likely that customers would enter into competitive agreements. PECO added that such customers might be more likely to pursue alternatives to PECO service, resulting in a risk of lost revenues. PECO R.B. at 82-83 (citing PECO M.B. at 126-27; PECO St. 7-R at 22-23).

I&E recommended that the Company provide an update to the competitive alternative analysis for any customer that has not had its alternative fuel source verified for a period of five years or more at the point at which PECO files a base rate case. I&E also recommended that PECO cease NGS service to any customer that does not have a verified alternative supply and switch those customers to the appropriate tariffed rate. Additionally, I&E recommended that, in future base rate cases, PECO separate the costs and revenues of customers discounted or reduced rates in their own class in the ACCOSS. I&E R.B. at 44-45 (citing I&E M.B. at 73).

I&E emphasized the importance of periodically analyzing alternatives to ensure that the rates of flex rate customers are not discounted lower than is necessary and thereby avoiding the customer deciding to choose an alternative supply. Further, I&E noted that, because the other customers make up the revenue shortfall that results when flex-rate customers pay less than tariff rates, providing excessive discounts to customers would be harmful to both the Company and its customers. Moreover, I&E argued that, whether the Company is providing service to those customers or not, the rates of non-negotiated customers will always be higher than if the negotiated customers were paying non-discounted rates. I&E added that the verification of competitive alternatives for the negotiated rate customers is the only protection that customers have from absorbing the costs from excessively discounted rates. I&E R.B. at 45-46 (citing I&E M.B. at 73).

The OCA’s witness, Mr. Watkins, noted that, upon his review of the Company’s six customer negotiated rate discount agreements, he observed that three of the older contracts had not experienced an increase for several years. OCA M.B. at 219. As a result, Mr. Watkins recommended that the Commission require the Company to reevaluate the terms and rates, including an alternative fuel analysis and financial analysis for proposed negotiated rates going-forward, for each of the three negotiated NGS contracts identified by Mr. Watkins in his testimony. PECO agreed with the OCA’s recommendation and stated that it would provide the requested information with its next base rate filing. OCA R.B. at 119 (citing OCA M.B. at 219-21; PECO M.B. at 125‑26).

The OSBA submitted that the Commission should adopt strict rules, policies, and procedures for the conditions under which negotiated rates apply for larger customers, as well as for the evidence that must be submitted by utilities to justify those rates. The OSBA asserts that this will preclude those larger customers and the utilities from doing an “end-run around Commission cost allocation policy by the unfettered use of negotiated rates.” OSBA M.B. at 33-34 (citing OSBA St. 1-S at 40; OSBA St. 1 at 39‑40).

The OSBA noted that the Company offers negotiated rate service to six customers through rate NGS and, in some cases, at a large rate discount. The OSBA contends that the Company has not met its burden with respect to negotiated rates for five of the six customers and, therefore, the Company’s claimed revenue increase should be reduced by the amount of the unjustified rate discounts to these customers. OSBA M.B. at 34 (citing OSBA St. 1 at 39-42; OSBA St. 1-S at 16-17).

PAIEUG supported the OSBA’s position that PECO shareholders should be responsible for such costs, explaining that the customers at issue have entered into good faith contracts with the Company and have budgeted for the term accordingly. Therefore, PAIEUG asserted that if the Commission determines that such a discounted rate is not appropriate, then these customers should not be required to bear the difference between the negotiated rate and the tariff rate, as it would be unjust, unreasonable, and inappropriate. PAIEUG R.B. at 28-29

#### Recommended Decision

Upon reciting I&E’s recommendations, the ALJ noted that he agreed with I&E for the reasons provided by I&E, *supra*. The ALJ found that I&E’s approach in the instant proceeding is consistent with Commission precedent and, specifically, I&E’s approach in *Columbia Gas*. R.D. at 415 (citing *Columbia Gas* at 240). Accordingly, the ALJ recommended that the Commission adopt I&E’s recommendation that PECO provide an update to the competitive alternative analysis for any customer that has not had its alternative fuel source verified for a period of five years or more at the point when PECO files a base rate case. R.D. at 416.

#### PECO Exception No. 12 and Replies

In its Exception No. 12, PECO opposes the ALJ’s recommendation. PECO is of the opinion that it is unreasonable to require the Company to evaluate all NGS customers based on a verification of alternative fuel sources, asserting that, although customers are not required to have an alternative fuel source for rate NGS eligibility, a customer can be eligible due to a pipeline bypass or a relocation opportunity. PECO also provides that, when its customers enter rate NGS agreements, they evaluate the potential benefits of an NGS service agreement over a lengthy period and, therefore, the imposition of a five-year review could create instability for the Company’s rate NGS customers and potentially lessen the chance that customers enter into competitive agreements with the Company. PECO Exc. at 36 (citing PECO R.B. at 82-83; PECO St. 7-R at 22‑23).

Additionally, PECO requests that, if the Commission ultimately accepts the ALJ’s recommendation, the Commission clarify that it is not accepting the other Parties’ recommendations related to rate NGS. PECO notes that, although the ALJ stated that he agreed with I&E’s requests, no other requests were included in his recommendation. *Id.* (citing R.D. at 416).

In its Replies, I&E disagrees with PECO’s reasoning for its opposition to the ALJ’s recommendation, adding that the recommendation was “clear and un‑ambiguous.” I&E R. Exc. at 13 (citing PECO Exc. at 36, R.D. at 415-16). I&E notes that it maintains the same reasoning it relied upon in the recent *Columbia Gas* decision, namely that periodic analysis of competitive alternatives is important to ensure that the rates of flex rate customers are not discounted lower than is necessary to avoid the customer choosing the alternative supply. Further, I&E repeats its position that providing excessive discounts to customers would be harmful to both PECO and its customers because the other customers make up the revenue shortfall that results from flex-rate customers paying less than tariff rates. Moreover, I&E reiterates that the rates of non-negotiated customers will always be higher than if the negotiated customers were paying non-discounted rates, and the only protection customers have from enduring the costs from excessively discounted rates is the verification of competitive alternatives for the negotiated rate customers. *Id.* (citing R.D. at 307; I&E St. 3 at 34).

In its Replies, the OCA submits that the ALJ’s decision is supported by ample record evidence as well as recent Commission precedent. The OCA notes that several of the existing negotiated rate customers currently served by the Company have not had their rates reevaluated for several years. OCA R. Exc. at 14 (citing OCA St. 4 at 32). The OCA also cites from the Commission’s decision in *Columbia Gas* to argue that the ALJ’s decision in this proceeding should be upheld by the Commission:

Rather, we agree with the ALJ and I&E that it is important to periodically analyze competitive alternatives to ensure that the rates of the flex-rate customers are not discounted lower than is necessary to avoid the customer choosing the alternative supply. As I&E witness Mr. Cline indicated, this analysis is needed to provide an accurate and up-to-date analysis of competitive alternatives to show the flex rate is necessary and reasonable and to ensure that flex-rate customers make the maximum contribution to fixed costs. I&E St. 3-SR at 5. We especially agree with the ALJ and I&E that providing excessive discounts to customers is not in the public interest and would be harmful to both the Company and its customers, since the other customers would be

required to make up the lost revenues when flex-rate customers pay less than tariff rates.

OCA R. Exc. at 15 (citing *Columbia* *Gas* at 240). The OCA adds that to the extent that the Commission declines to adopt the ALJ’s recommendation, the OCA requests that its recommendation that the Commission require PECO to reevaluate the terms and rates for each of the three negotiated rate contracts identified by the OCA’s witness, Mr. Watkins, in his direct testimony and present those findings upon filing of its next rate case. OCA R. Exc. at 15 (citing OCA M.B. at 219-21).

#### Disposition

We are not persuaded by the Company’s arguments to reject the ALJ’s recommendation. Consistent with our decision in *Columbia Gas*, we agree with the ALJ and I&E that periodic analysis of competitive alternatives is important to ensure that the rates of the flex rate customers are not discounted lower than is necessary to avoid the customer choosing the alternative supply. We particularly agree with the ALJ and I&E that providing excessive discounts to customers is not in the public interest and would be harmful to both the Company and its customers, since the other customers would be required to make up the lost revenues when flex rate customers pay less than tariff rates.

In response to PECO’s request for clarification, the ALJ recommended that the Commission adopt I&E’s recommendation that PECO provide an update to the competitive alternative analysis for any customer that has not had their alternative fuel source verified for a period of five years or more at the point when PECO files a base rate case. R.D. at 416. Based on the foregoing, we find no reason to disturb the ALJ’s recommendation nor to deviate from Commission precedent. Accordingly, the Company’s Exception No. 12 is denied.

### Theft/Fraud Investigation

The Company’s proposed Tariff Rule 17.7, regarding theft/fraud investigation, states:

If the Company’s meters or other Company equipment on the customer’s premises have been tampered or interfered with by any means whatsoever, the customer being supplied through such equipment whether an applicant or a customer as defined at pa [sic] C.S. § 1403 shall pay a theft/fraud investigation charge in addition to any amount that the Company estimates is due for service used, but not registered on the Company’s meter. These theft/fraud investigation charges listed below include allocated overheads, all investigative costs and administrative cost [sic] deemed necessary by the Company to correct any and all unauthorized conditions at the premise. The Company reserves the right to assess theft/fraud investigation charges as a precedent to reconnection of service as well as the right to assess a separate reconnection charge as described in Rule 17.6.

PECO Exh. JAB-2 at 29. PECO also proposed a fee for investigation and remediation of theft or fraud of $460. *Id*.

#### Positions of the Parties

After its initial filing, PECO clarified that: (1) Rule 17.7 applies only in cases of confirmed, active theft of gas; (2) the $460 fee associated with the proposed rule is consistent with the average cost to investigate and remediate theft only; and (3) the term “fraud” should be stricken from the proposed rule. PECO R.B. at 84; PECO M.B. at 128.

The OCA opposed the Tariff Rule 17.7, arguing that the removal of fraud language does not address the remaining overbroad language. Further, the OCA contends that the Company has not met its burden to demonstrate that the proposed $90 increase to the existing theft/fraud fee is cost-based and should be applied as proposed to both customers and applicants.[[95]](#footnote-96)  Moreover, the OCA argues that the Company has not adequately explained how the inclusion of overhead and administrative costs will be off-set by the proposed $10,000 adjustment to base rate revenues, as well as why a double-recovery of these costs remains. OCA R.B. at 120-22 (citing OCA M.B. at 221-28).

In reply, PECO countered that it is prudent to provide a specific definition of theft as the meaning of tampering evolves over time. PECO also contended that actual cost information supporting its $460 proposed theft charge was acknowledged as provided by the OCA. PECO R.B. at 84 (citing OCA St. 5-SR at 9). The Company also argued that costs associated with theft investigations should not be comingled with all customer costs via base rates, explaining that its proposed $10,000 revenue adjustment for “budgeted theft fee revenue” is based on the $9,740 of actual gas revenues collected in 2019 under existing Rule 17.6, related to the investigation and remediation of theft. PECO R.B. at 84-85 (citing PECO St. 8-R at 3). Finally, PECO argued that it provided an explanation regarding the circumstances under which an applicant could be appropriately assessed a fee under proposed Rule 17.7. PECO R.B. at 85 (citing PECO M.B. at 129).

#### Recommended Decision

The ALJ agreed with the OCA that the language of proposed Rule 17.7 is vague and overbroad; therefore, the ALJ recommended that the Commission not approve PECO’s proposed Tariff Rule 17.7. The ALJ reasoned that the theft of service charge applying to an applicant is not a concern, explaining that it is conceivable that a person whose service was previously terminated for theft at one address may try to establish service at another address without paying the theft of service charges associated with the first address. R.D. at 417.

The ALJ did express concern, however, regarding the lack of explanation for the language, “interfered with by any means whatsoever.” R.D. at 417 (citing PECO Exh. JAB-2 at 29). According to the ALJ, this could potentially leave a customer subject to a penalty in the event of accidental or unintentional interference with the meter. *Id.* Further, the ALJ expressed concern with the $90 increase to the current $370 theft/fraud fee, elaborating that, although the Company claimed that the $460 fee is consistent with the average cost to investigate and remediate theft or fraud, the Company failed to substantiate its claim. Moreover, the ALJ agreed with the OCA that it is inappropriate to include overhead and administrative costs in the charge when such costs are otherwise recovered through base rates. R.D. at 417.

#### Disposition

No Party filed Exceptions on this issue. Finding the ALJ’s recommendation to be reasonable, we shall adopt it without further comment.

# Conclusion

Based on our review of the record in this proceeding, we shall: (1) grant, in part, and deny, in part, the Exceptions filed by PECO and I&E; (2) deny the Exceptions filed by the OCA, the OSBA, and CAUSE-PA; (3) deny the request set forth in PAIEUG’s Letter; (4) grant PAIEUG’s Motion to Strike; and (5) approve an annual revenue increase of $29,118,484 to the Company’s *pro forma* revenue at present rates of $590,014,312, or approximately 4.94%; **THEREFORE,**

**IT IS ORDERED:**

1. That the Exceptions filed by PECO Energy Company – Gas Division on April 26, 2021, are granted, in part, and denied, in part, consistent with this Opinion and Order.
2. That the Exceptions filed by the Commission’s Bureau of Investigation and Enforcement on April 26, 2021, are granted, in part, and denied, in part, consistent with this Opinion and Order.
3. That the Exceptions filed by the Office of Consumer Advocate on April 26, 2021, are denied, consistent with this Opinion and Order.
4. That the Exceptions filed by the Office of Small Business Advocate on April 26, 2021, are denied, consistent with this Opinion and Order.
5. That the Exceptions filed by the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania on April 26, 2021, are denied, consistent with this Opinion and Order.
6. That the request set forth in the Letter Observing an Administrative Issue, filed by the Philadelphia Area Industrial Energy Users Group on April 26, 2021, is denied, consistent with this Opinion and Order,
7. That the Motion to Strike Portions of the Office of Small Business Advocate’s Exceptions, filed by the Philadelphia Area Industrial Energy Users Group on May 3, 2021, is granted and, accordingly, the language on page 7, beginning with, “[t]he DCALJ’s reliance on this evidence in support of rate shock . . .” through the end of page 8, as well as the attached Appendix A of the Office of Small Business Advocate’s Exceptions, is stricken, consistent with this Opinion and Order.
8. That the Recommended Decision of Deputy Chief Administrative Law Judge Christopher P. Pell, issued on April 12, 2021, is adopted as modified by this Opinion and Order.
9. That PECO Energy Company – Gas Division shall study and re‑evaluate its Distribution Integrity Management Program asset groups **[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]** consistent with this Opinion and Order.

1. That PECO Energy Company – Gas Division shall develop **[BEGIN CONFIDENTIAL]**

**[END CONFIDENTIAL]** consistent with this Opinion and Order.

1. That the corrections and modifications directed by this Opinion and Order reflected in the PECO Energy Company – Gas Division, Docket No. R‑2020‑3018939 (Commission Tables Calculating Allowed Revenue Increase), attached hereto, are adopted as in the public interest.
2. That PECO Energy Company – Gas Division shall not place into effect the rates, rules, and regulations contained in Tariff Gas - Pa. P.U.C. No. 4, as filed.
3. That PECO Energy Company – Gas Division is authorized to file tariffs, tariff supplements and/or tariff revisions, on at least one day’s notice, and pursuant to the provisions of 52 Pa. Code §§ 53.1, *et seq.*, and 53.101, designed to produce an annual distribution rate revenue increase of approximately $29,118,484, to become effective for service rendered on and after June 30, 2021.
4. That PECO Energy Company – Gas Division shall file detailed calculations with its tariff filing, which shall demonstrate to the Commission’s satisfaction that the filed tariff adjustments comply with the provisions of this final Opinion and Order.
5. That PECO Energy Company – Gas Division shall allocate the authorized increase in operating distribution revenue to each customer class, and rate schedule within each customer class, in the manner prescribed in this Opinion and Order.
6. That, upon acceptance and approval by the Commission of the tariff supplements filed by PECO Energy Company – Gas Division, consistent with its Final Order, the investigation at Docket No. R-2020-3018939 be marked closed.
7. That a copy of this Opinion and Order be served on the Bureau of Consumer Services, Division of Policy; the Bureau of Investigation and Enforcement, Pipeline Safety Division; and the Bureau of Technical Utility Services, Finance/Tariffs Division for monitoring and compliance.
8. That the Formal Complaint filed by the Office of Consumer Advocate in this proceeding at Docket No. C-2020-3022400 be dismissed and marked closed.
9. That the Formal Complaint filed by the Office of Small Business Advocate in this proceeding at Docket No. C-2020-3022414 be dismissed and marked closed.
10. That the Formal Complaint filed by Philadelphia Area Industrial Energy Users Group in this proceeding at Docket No. C-2020-3022745 be dismissed and marked closed.

**BY THE COMMISSION,**

Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: June 17, 2021

ORDER ENTERED: June 22, 2021

# LIST OF ABBREVIATIONS

|  |  |
| --- | --- |
| A&E | Average and Excess |
| ACCOSS | Allocated Class Cost of Service Study |
| ALJ | Administrative Law Judge |
| ASC | Financial Accounting Standards Codification |
| BPS | book value per share |
| CAP | Customer Assistance Program |
| CAPM | Capital Asset Pricing Model |
| CAUSE‑PA | Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania |
| Ccf | hundred cubic feet |
| CE | Comparable Earnings |
| CGS | City Gas Sales Service |
| CPI | Consumer Price Index |
| DCF | discounted cash flow |
| DIMP | Distribution Integrity Management Program |
| DPS | dividends per share |
| DSIC | Distribution System Improvement Charge |
| EB | energy burden |
| EBSC | Exelon Business Services Company |
| EE&C | Energy Efficiency and Conservation |
| EMV | evaluation, measurement, and verification |
| EPS | earnings per share |
| ERP | Emergency COVID-19 Relief Plan |
| FCO | Fixed Credit Option |
| FPFTY | fully projected future test year |
| FPL | Federal Poverty Level |
| FTE | full-time equivalent |
| FTY | future test year |
| GC | General Service - Commercial and Industrial |
| GPC | Gas Procurement Charge |
| GR | General Service -Residential |
| HTY | historical test year |
| I&E | Bureau of Investigation and Enforcement |
| IS | Interruptible Service |
| IVR | Interactive Voice Response |
| L | Large High Load Factor Service |
| LIHEAP | Low-Income Home Energy Assistance Program |
| LIURP | Low-Income Usage Reduction Program |
| LNG | Liquified Natural Gas |
| LPG | liquid propane gas |
| MEAF | Matching Energy Assistance Fund |
| MFC | Merchant Function Charge |
| MGP | Manufactured Gas Plant |
| MMcF | million cubic feet |
| MV - I | Motor Vehicle Service - Interruptible |
| MV-F | Motor Vehicle Service - Firm |
| NGDC | Natural Gas Distribution Company |
| NGPP | Neighborhood Gas Pilot Program |
| NGPR | Neighborhood Gas Pilot Rider |
| NGS | Negotiated Gas Service |
| NYSE | New York Stock Exchange |
| O&M | Operating and Maintenance |
| OALJ | Office of Administrative Law Judge |
| OCA | Office of Consumer Advocate |
| OL | Outdoor Lighting |
| OPEB | other post-employment benefits |
| OSBA | Office of Small Business Advocate |
| P&A | Peak and Average |
| PADEP | Pennsylvania Department of Environmental Protection |
| PAIEUG | Philadelphia Area Industrial Energy Users Group |
| PGC | Purchased Gas Cost |
| PIPP | Percentage of Income Payment Plan |
| PURTA | Public Utility Realty Tax |
| ROE | Return on Equity |
| RP | Risk Premium |
| SEHP | Safe and Efficient Heating Program |
| SFAS | Statement of Financial Accounting Standards |
| TCS | Temperature Controlled Service |
| TRC | Total Resource Cost |
| TS -F | Gas Transportation Service - Firm |
| TS -I | Gas Transportation Service - Interruptible |
| TUS | Bureau of Technical Utility Services |
| USCEP | Universal Service and Energy Conservation Plan |
| USP | Universal Service Program |
| WAP | Weatherization Assistance Program |

**Pennsylvania Public Utility Commission**

**v.**

**PECO Energy Company – Gas Division**

**Docket No. R-2020-3018939**

# 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**

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1. PAIEUG submitted a letter (Letter) on April 26, 2021 indicating that it would not be filing Exceptions and noted an Administrative issue in the Recommended Decision regarding an *errata* filed by I&E. This issue is discussed *infra.* [↑](#footnote-ref-2)
2. CAUSE-PA submitted a letter on May 3, 2021 indicating that it would not be filing Replies to Exceptions. [↑](#footnote-ref-3)
3. As noted below, PECO subsequently revised its proposed revenue increase to $65.967 million. [↑](#footnote-ref-4)
4. The future test year (FTY) ended June 30, 2021, and the historical test year (HTY) ended June 30, 2020. PECO M.B. at 2. [↑](#footnote-ref-5)
5. In its Main Briefs, PECO stated that its final revenue increase request was $66.2 million, representing an approximate $2.5 million reduction to the Company’s original request. PECO M.B. at 2. However, as discussed in Section VI.A of this Opinion and Order, Appendix A, Table I of the Company’s Main Briefs shows a final proposed revenue increase of $65,976,052. [↑](#footnote-ref-6)
6. PECO originally planned to seek rate relief in March 2020, but delayed filing this rate case until September 30, 2020, in light of the onset of the COVID-19 pandemic. PECO M.B. at 1. [↑](#footnote-ref-7)
7. 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 a 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-8)
8. As previously noted, PECO had initially requested a $68.7 million increase to its revenue requirement, but subsequently reduced it to $66.2 million. Additionally, as noted elsewhere in this Opinion and Order, Appendix A, Table I of the Company’s Main Briefs indicates the final proposed revenue increase requested by PECO was $65,976,052. [↑](#footnote-ref-9)
9. *Pa. PUC v. Columbia Gas*, Docket Nos. R-2020-3018835 *et al.* at 48‑51 (Order entered February 19, 2021) (*Columbia Gas*), *Pa. PUC v. Pennsylvania American Water Co.*, Docket Nos. R-2020-3019369 and R-2020-3019371 (Order entered February 25, 2021) (*PAWC*). [↑](#footnote-ref-10)
10. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989). [↑](#footnote-ref-11)
11. *Columbia Gas* at 44 (quoting *Popowsky v. Pa. PUC*, 683 A.2d 958, 961 (Pa. Cmwlth. 1996)). [↑](#footnote-ref-12)
12. These issues are discussed in the Customer Protections Section of this Order in Section X, *infra*. [↑](#footnote-ref-13)
13. CAUSE-PA’s Exception No. 1 also addresses various proposals it advanced to address COVID-19 impacts on low-income customers. Those aspects of CAUSE-PA’s Exceptions are addressed in a later portion of this Order. [↑](#footnote-ref-14)
14. These specific claims are addressed in a later portion of this Opinion and Order. [↑](#footnote-ref-15)
15. Section 1330(b)(1)(i)-(v) of the Code provides the following:

    **(b) *Alternative rate mechanisms.*—**

    (1) Notwithstanding any other provision of law, including, but not limited to, sections 2806.1(k)(2) (relating to energy efficiency and conservation program) and 2807(f)(4) (relating to duties of electric distribution companies), the commission may approve an application by a utility in a base rate proceeding to establish alternative rates and rate mechanisms, including, but not limited to, the following mechanisms:

    (i) decoupling mechanisms;

    (ii) performance-based rates;

    (iii) formula rates;

    (iv) multiyear rate plans; or

    (v) rates based on a combination of more than one of the mechanisms in subparagraphs (i), (ii), (iii) and (iv) or other ratemaking mechanisms as provided under this chapter. [↑](#footnote-ref-16)
16. *Popowsky II*, 683 A.2d at 961 (“[t[he PUC 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.”). [↑](#footnote-ref-17)
17. *See,* *e.g., Pa. PUC et al. v. PPL Electric Utilities Corporation*, Docket Nos. R-2015-2469275 *et al.* (Recommended Decision issued October 5, 2015) at 32-33. [↑](#footnote-ref-18)
18. The “polestar” of ratemaking concerns is the “cost of providing service.” *Lloyd v. Pa. PUC*, 904 A.2d 1010, 1019-21 (Pa. Cmwlth. 2006) (*Lloyd*). Inherent in this principle of ratemaking is the recognition that public utilities are natural monopolies and that the Commission’s oversight through cost-of-service ratemaking serves as a proxy for a competitive market in appropriately restraining, or exerting downward pressure on, the profit-maximizing prices a monopoly could otherwise charge in the absence of price regulation. *See, e.g*., OCA St. 1 at 4. With respect to a utility’s recovery of costs related to providing service, we have previously explained:

    It is our opinion that in exchange for the utility’s provision of safe, adequate and reasonable service, the ratepayers are obligated to pay rates which cover the cost of service which includes reasonable operation and maintenance expenses, depreciation, taxes and a fair rate of return for the utility’s investors. Thus, as the OCA contends, a quid pro quo relationship exists between the utility and its ratepayers. In return for providing safe and adequate service, the utility is entitled to recover, through rates, these enumerated costs. We find this principle to be consistent with the standards enunciated in [*Hope Natural Gas*] wherein it was stated that the “…fixing of ‘just and reasonable’ rates, involves a balancing of the investor and the consumer interests . . .”

    *Pa. PUC v. Pennsylvania Gas & Water Co.*,Docket No. R-850178 (Order entered April 24, 1986); 61 Pa. P.U.C. 409, 415-16; 1986 WL 1301279. [↑](#footnote-ref-19)
19. *See* 66 Pa. C.S. §§ 523, 526(a). [↑](#footnote-ref-20)
20. *See Lloyd*, 904 A.2d at1020 (explaining that gradualism is the principle under which utility rates are gradually increased in order to avoid rate shock, as part of what is overall considered a reasonable rate under the circumstances and is permitted in implementing large rate increases). [↑](#footnote-ref-21)
21. *See Pa. PUC et. al v. Twin Lakes Utilities, Inc*., Docket No. R‑2019‑3010958 (Order entered March 26, 2020) at 48, 80 (the ALJ did not err in considering evidence relating to the various quality of service and rate affordability issues in the proceeding and factoring in such evidence as part of her overall determination on which expert witnesses’ cost of equity to adopt for setting just and reasonable rates). [↑](#footnote-ref-22)
22. Categories of operating expenses may include operations, maintenance, administrative, and general. [↑](#footnote-ref-23)
23. *See* *Pa. PUC v. UGI Utilities, Inc. – Electric Division,* Docket No. R‑2017‑2640058 (Order entered October 25, 2018) (*UGI Electric*) at 26 (explaining that Section 315(e) of the Code requires a utility to provide data after the fact to substantiate the accuracy of its FPFTY estimates). [↑](#footnote-ref-24)
24. 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. *Pennsylvania Gas and Water Co. v. Pa. PUC*, 341 A.2d 239, 251 (Pa. Cmwlth. 1975) (citations omitted). [↑](#footnote-ref-25)
25. *See UGI Electric* at 26. [↑](#footnote-ref-26)
26. 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). [↑](#footnote-ref-27)
27. *See* *Popowsky II*, 683 A.2d at 961 (“[t[he PUC 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.”). [↑](#footnote-ref-28)
28. For example, any specific risks and uncertainties related to this pandemic affecting financial investments in similarly situated business undertakings may be considered by the experts when recommending a market-based return on equity for the utility (*e.g*., in such expert’s analysis of proxy groups, growth rates, and dividend yields). [↑](#footnote-ref-29)
29. It is well-established that a fair rate of return allows the utility the opportunity to recover those costs prudently incurred by all classes of capital used to finance the rate base during the prospective period in which its rates will be in effect. *See* *Bluefield*,292 U.S. at 692-93; *see also* *Hope Natural Gas Co.*,320 U.S. at 603. “When determining the cost of capital, the [Commission] must ‘give consideration to the utilities financial structure, credit standing, dividends, interests, risks, regulatory lag, wasting assets and any peculiar features of the utility involved.’” *West Penn Power v. Pa. PUC*, 607 A.2d 1132, 1135 (Pa. Cmwlth. 1992) (*West Penn*). [↑](#footnote-ref-30)
30. As previously noted, as will be discussed in Section VI of this Opinion and Order, *infra.*, Appendix A, Table I of the Company’s Main Briefs indicates a final proposed revenue increase for PECO of $65,976,052. [↑](#footnote-ref-31)
31. In its original filing, PECO utilized data for the 13-month period ending June 30, 2020. I&E witness Mr. Ethan Cline and OCA witness Mr. Lafayette Morgan proposed adjustments to the five items listed above based on more recent data through September 30, 2020. PECO did not object to updating these specific claims to reflect data for the 13-months ended September 30, 2020, as shown on Schedules C-4 to C-13 of PECO Exhibit MJT-1 Revised. [↑](#footnote-ref-32)
32. In addition, as explained in PECO’s response to Interrogatory OCA-II-8, the Company overstated the plant reserve balance as of June 30, 2022, recorded in Accounts 376 and 380 and is reducing its rate base claim for accumulated depreciation by approximately $1.1 million. *See* PECO Exh. MJT-1 Revised, Sch. C-3. [↑](#footnote-ref-33)
33. Due to the reduction in the Federal corporate tax rate that became effective on January 1, 2018, pursuant to the Tax Cuts and Jobs Act (TCJA), there is “excess” ADIT. Excess ADIT represents taxes that were deferred prior to January 1, 2018 at the then-applicable 35% tax rate but will be paid to the Federal government, after January 1, 2018, at the current 21% tax rate. The excess ADIT is to be returned to customers over periods that correspond to the periods over which the ADIT would have been paid to the government if the Federal corporate tax rate had not been reduced. To reflect that obligation, the Company has transferred its excess ADIT from the Company’s ADIT account to a new regulatory liability account. PECO St. 3 at 6-7. [↑](#footnote-ref-34)
34. As stated by PECO:

    [t]he credit balance of ADIT includes the liability for deferred Federal income taxes, net of an offset (debit) for the ADIT assets related to Federal income tax paid by the Company in advance of recognizing the associated tax determinants for financial reporting purposes, which consist principally of contributions‑in-aid-of-construction (CIAC) recognized as income for income tax purposes.

    PECO St. 3 at 6. [↑](#footnote-ref-35)
35. In rebuttal testimony, PECO’s witness Mr. Michael J. Trzaska indicated that Mr. Morgan failed to propose an adjustment to the tax repairs deduction that would be associated with the disallowance of incremental FPFTY plant additions. PECO St. 3‑R at 7. Mr. Morgan acknowledged this oversight in surrebuttal testimony and corrected the income tax calculation to reflect the FTY repairs deduction and reflected the FTY accelerated state and federal tax depreciation in his corrected income tax calculation. *See* OCA St. 2-SR, Sch. LKM-31. [↑](#footnote-ref-36)
36. In order to remain consistent with I&E’s proposed plant in service adjustment, I&E recommended that PECO’s accumulated depreciation claim be reduced by approximately $804,000. I&E St. 3 at 13; I&E St. 3-SR at 6-7. [↑](#footnote-ref-37)
37. Mr. Cline explained that dividing the $33,888,385 by 28% indicates that the total project costs is $121,029,946. Therefore, the remaining cost of the project is $87,141,561 ($121,029,946 - $33,888,385). I&E St. 3 at 11-12. [↑](#footnote-ref-38)
38. I&E Exhibit 3, Schedule 2 at 3 is a copy of the Company’s response to an interrogatory that details all the projects in the Company’s claim for FPFTY plant additions in this proceeding. [↑](#footnote-ref-39)
39. It should be noted that $38.5 million is the difference between the total cost of the Natural Gas Reliability project of $121,029,946, as calculated by I&E, and the amount of $82,481,428, which the Company claimed in its FPFTY plant additions for the project. [↑](#footnote-ref-40)
40. As Mr. Morgan testified, the budget preparation date is critical because the events, circumstances, and related data from that period reflect circumstances and projections that are no longer accurate. OCA St. 2 at 9-10. Since the LRP was developed, sales of existing homes dropped substantially at the onset of the pandemic, unemployment rates surged, and Company operations were restricted. Thus, the OCA submits that this volatility can be material as a large portion of PECO’s plant additions, for example, are based around new business connections, *i.e.*, 12.9 percent of PECO’s FPFTY plant projection activity. *Id*. [↑](#footnote-ref-41)
41. PECO indicates that the additional errors in the OCA’s reliance on *Columbia Gas* are addressed on page 10 of the Company’s Reply Brief. [↑](#footnote-ref-42)
42. The OSBA, CAUSE-PA and PAIEUG did not brief their positions on the Company’s claimed rate base before the ALJ. *See* R.D. at 46. [↑](#footnote-ref-43)
43. PECO asserted that it is only proposing to include Pension Asset in rate base to recover the associated carrying costs on a prospective basis. PECO is not seeking to recover prior carrying costs in this case. *See* PECO M.B. at 22-23; PECO R.B. at 13. [↑](#footnote-ref-44)
44. Formerly the Statement of Financial Accounting Standards 87 (SFAS 87). [↑](#footnote-ref-45)
45. Citing PECO St. 3-R at 19 (Referencing three consecutive Duquesne Light rate case “black box” settlements, in which the parties did not provide specific amounts attributable to every element of the calculation of the rate increase, which also approved recovery for a pension asset, similar to that claimed by PECO in the present case). [↑](#footnote-ref-46)
46. The NGPR is available to residential customers who will receive natural gas service under rate GR, including the CAP Rider. However, PECO explained that certain cost and customer interest thresholds must be met to qualify for the pilot (*e.g.*, the proposed extension must be greater than $15,000 and at least 20% of eligible customers must execute contracts for gas service). PECO St. 9 at 11. [↑](#footnote-ref-47)
47. The Company developed its claims for *pro forma* present rate revenue levels by using PECO’s budgeted revenue from gas sales for the FPFTY and, in accordance with well-established Commission practice which include: (1) removing revenues relating to PECO’s portion of off-system gas sales and the margin on sales under PECO Rate IS - Interruptible Service; (2) annualizing the effect of changes in the number of customers projected for the FPFTY; and (3) normalizing revenue to reflect 365.25 days. PECO M.B. at 26. [↑](#footnote-ref-48)
48. As previously noted, the Company stated in the body of its Main Briefs that its final revenue increase request was $66.2 million, representing an approximate $2.5 million reduction to the Company’s original request. PECO M.B. at 2. However, Appendix A, Table I of the Company’s Main Briefs shows a final proposed revenue increase of $65,976,052. [↑](#footnote-ref-49)
49. The OCA defines allocated employees as employees who spend all or a substantial portion of their time performing services for a subsidiary or an affiliated business. OCA R. Exc. at 7, n. 4. [↑](#footnote-ref-50)
50. The “cost to achieve” is related to PECO’s merger costs and will be explained in detail in Section VII.E: Costs to Achieve/PHI Merger, *infra.* [↑](#footnote-ref-51)
51. In making his recommendation, the ALJ inadvertently stated that “the Company’s actual FTY increase of $288,000 (16%) over the HTY level of expense substantiates the Company’s FTY claim of $2,197,000.” R.D. at 125. However, it is clear from the record that the Company’s FTY claim was $2,022,423 and that its FPFTY claim was $2,197,000.  *See* PECO M.B. at 39. [↑](#footnote-ref-52)
52. ($2,727,500 (allowance) - $2,008,000 (existing budget) = $719,500). OCA Exc. at 12, n.12. [↑](#footnote-ref-53)
53. It appears that the Recommended Decision inadvertently misstated that “the total allowable depreciation expense is $804,000,” rather than the total allowable reduction to depreciation expense is $804,000, consistent with the ALJ’s recommendation that PECO’s claimed FPFTY rate base be reduced by $46,820,803. *See* R.D. at 134. [↑](#footnote-ref-54)
54. As set forth in Table II: Adjustments in our Commission Tables Calculating Allowed Revenue increase, which is attached to this Opinion and Order, the $136,580 reduction is the net of: (1) an increase of $82,642 to Cash Working Capital – Interest and Dividends; (2) a decrease of $126,813 to Cash Working Capital – Taxes; and (3) a decrease of $92,409 to Cash Working Capital – O&M Expense. [($82,642 - $126,813 - $92,409) =  **–**$136,580]. [↑](#footnote-ref-55)
55. The Parties’ positions regarding the cost of common equity will be discussed in more detail in Section IX.D of this Opinion and Order, *infra.* [↑](#footnote-ref-56)
56. On this point, the OCA acknowledged that UGI, which the OCA included in its own proxy group, recently announced on December 30, 2020 that it plans to purchase Mountaineer Gas in West Virginia. However, the OCA submitted that because its direct testimony was filed on December 22, 2020, the data that it based its proxy group recommendation upon was sourced prior to UGI’s merger announcement. Therefore, the OCA submitted that it is not necessary to adjust its proxy group or the information included within its direct testimony for this proceeding given the dates that its analysis was performed, and that the testimony was filed. OCA St. 3-R at 8. [↑](#footnote-ref-57)
57. As noted above, the OCA examined Exelon separately from the rest of its proxy group. [↑](#footnote-ref-58)
58. As discussed above, PECO, like the OCA, included New Jersey Resources and Southwest Gas Holdings in its proposed Gas Group. [↑](#footnote-ref-59)
59. 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-60)
60. We note that there are additional rate issues pertaining to the elements in the proposed base rate increase addressed later in this Opinion and Order and not included here simply because the Order follows the structure of the Recommended Decision for ease of reference by the reader. [↑](#footnote-ref-61)
61. PECO filed this Petition on June 26, 2020. A Commission Order on the Petition has not yet been issued. [↑](#footnote-ref-62)
62. The CAP Policy Statement provides the following:

    (**B)** Generally, maximum payments for natural gas heating should not exceed the following maximums:

    **(I)** Household income between 0 - 50% of FPIG at 4% of income.

    **(II)** Household income between 51 - 100% of FPIG at 6% of income.

    **(III)** Household income between 101 - 150% of FPIG at 6% of income.

    52 Pa. Code § 69.265(2)(i)(B)(I)(II)(III). Under its proposed CAP PIPP, PECO proposes maximum energy burdens of 4% for customers with household income between 0-50% of FPIG; 6% for customers with household income between 51-100% of FPIG; and 10% for customers with household income between 101-150% of FPIG.  [↑](#footnote-ref-63)
63. *See PECO Energy Company Universal Service and Energy Conservation Plan for 2019-2024 Submitted in Compliance with 52 Pa. Code §§ 54.74 and 62.4*, Docket No. M-2018-3005795 (Tentative Order entered May 6, 2021) (*May 2021 Tentative Order*). The Company filed amendments to its proposed 2019-2024 USECP on November 26, 2019, January 16, 2020, July 8, 2020, and September 25, 2020. In the *May 2021 Tentative Order*, the Commission identified issues that require further attention on the record before approving PECO’s amended proposed 2019-2024 USECP. The *May 2021 Tentative Order* requires additional information from PECO and allows for comments and reply comments from stakeholders. [↑](#footnote-ref-64)
64. This proceeding was initiated as a complaint proceeding in which TURN sought a retroactive reduction of the electric and natural gas energy burdens used in PECO’s CAP. Parties to the *TURN* proceeding filed Exceptions and Replies to Exceptions, and a Commission Order on these filings is pending. [↑](#footnote-ref-65)
65. **[BEGIN CONFIDENTIAL]**

    **[END CONFIDENTIAL]** [↑](#footnote-ref-66)
66. **[BEGIN CONFIDENTIAL]**

    **[END CONFIDENTIAL]** [↑](#footnote-ref-67)
67. PECO also has Negotiated Gas Service (NGS) customers, whose rates are based on their competitive characteristics. The Company’s current tariff requires that NGS customers have a “viable, currently available competitive alternative to service under the Rates GC, L, TS-F, TS-I or CGS including any applicable riders.” It should be noted that PECO is proposing to eliminate rate CGS (City Gate Sales Service) and all references to CGS stated in the PECO Retail Gas Tariff based on its belief that the rate is now obsolete because large and small customers may now directly access the competitive gas supply market. *See* PECO Exh. JAB-2. The single customer that was on rate CGS agreed to switch to rate TS-I, effective November 2019. PECO St. 8 at 10-11. [↑](#footnote-ref-68)
68. Customers participating in PECO’s CAP are combined with rate class GR because their usage characteristics are the same as other rate class GR customers. [↑](#footnote-ref-69)
69. In PECO’s ACCOSS, the rate class in the Company’s current tariff titled OL – Outdoor Lighting is combined into rate class GC because the usage of rate class OL is very small. [↑](#footnote-ref-70)
70. The Company’s customer cost analysis is also included as part of the A&E ACCOSS. *See* PECO Exhs. JD-4-5, JD-4R-5R. As discussed later in this Opinion and Order, the result of PECO’s customer cost analysis for residential customers, shown on PECO Exhibit JD-5R, is a cost per customer of $28.07, which is used to support the Company’s proposed $4.25 increase to the monthly residential customer charge from $11.75 to $16.00. [↑](#footnote-ref-71)
71. As discussed *infra*, the Company had also modified its approach regarding the revenue allocation to the GC and L rate classes. [↑](#footnote-ref-72)
72. As previously noted, PECO stated in its Main Brief that its final revenue increase request is $66.2 million, representing an approximate $2.5 million reduction to the Company’s original request. PECO M.B. at 2. However, as discussed in Section VI.A of this Opinion and Order, Appendix A, Table I of the Company’s Main Brief shows a final proposed revenue increase of $65,976,052. [↑](#footnote-ref-73)
73. *Pa. PUC v. PECO Energy Company – Gas Division*, Docket No. R‑2010‑2161592 (Order entered December 29, 2010) (*2010 PECO Order*). [↑](#footnote-ref-74)
74. As noted earlier, after it submitted its supporting data in this case, the Company discovered that a model used to develop its ACCOSS included a formula error. Specifically, PECO clarified that “the revenue increase needed for each rate class to achieve its cost of service should have been calculated to produce the system average rate of return.” PECO M.B. at 98. The Company further clarified that the formula error related only to the equalized proposed rate of return at the proposed class revenue requirement, adding that the cost allocation methodology employed in the model was not affected and the calculation of class rate of return at present rates was unaffected. Consequently, accompanying her rebuttal testimony, Ms. Ding submitted a revised and corrected ACCOSS as PECO Exhibit JD-6R. PECO M.B. at 98-99. [↑](#footnote-ref-75)
75. *2007 PPL Gas Order* at 176-178; *2007 PGW Order*; *see generally 2010 PECO Order*; *Pa. PUC v. Philadelphia Gas Works*, Docket No. R-2020-3017206 (Order entered November 19, 2020) (*2020 PGW Order*); *Pa. PUC v. UGI Central Penn Gas, Inc.*, Docket No. R‑2010-2214415 (Order entered August 19, 2011) (*2010 UGI CPG Order*). [↑](#footnote-ref-76)
76. In determining proposed revenue allocations in this proceeding, the Parties had to consider the terms of the Commission-approved Joint Petition for Settlement of Rate Investigation from the Company’s 2008 base rate proceeding:

    PECO agrees that, over the course of its next two gas base rate filings, it will propose to move the Rate GC and L class rates of return to the system average rate of return by moving fifty percent (50%) towards that goal in the next such filing and removing all remaining difference through the following filing. All parties retain their rights, in such future rate proceedings, to challenge that proposal through the use of class rates of return obtained through alternative cost of service studies or other ratemaking principles.

    *Pa. PUC v. PECO Energy Company*, Docket No. R-2008-2028934 (2008 Settlement). The instant proceeding is PECO’s second base rate case since the 2008 Settlement. [↑](#footnote-ref-77)
77. The Company’s revised revenue allocation, as well as its revised revenue requirement, A&E ACCOSS, and proof of revenues additionally reflects its agreement to propose eliminating the disputed rate IS sharing mechanism on or before December 1, 2021, as part of its next annual Purchased Gas Cost (PGC) reconciliation filing. As discussed later in this Opinion and Order, PECO’s proposal satisfied the concerns raised by the OCA and the OSBA and no Party opposed PECO’s proposal. PECO St. 7-R at 17. [↑](#footnote-ref-78)
78. Note that the slight discrepancy between the revenue increase of $66,193,000 shown under column 2 in Table 5, above, and the amount of $66,194,000 shown in PECO’s ACCOSS and on its Schedule A-1 of PECO Exhibit MJT-1 Revised is possibly due to rounding. [↑](#footnote-ref-79)
79. CAUSE-PA did not take a position on revenue allocation, except on the allocation of universal service costs. [↑](#footnote-ref-80)
80. I&E explained that it should be noted that the revenue decrease shown for the MV-F rate class is due to the DSIC being set at 0%, the Tax Reform Base Rate Impact, and the GPC reduction, and is not due to a reduction in rates. I&E St. 3-SR at 20. Additionally, the revenue increases shown in I&E Exh. 3-SR, Sch. 4 include adjustments for the GPC and MFC reductions. [↑](#footnote-ref-81)
81. It should be noted that the OCA’s recommended revenue allocation does not appear to reflect all the revisions and corrections submitted through PECO’s various rebuttal testimonies, particularly the Company’s revision to its requested revenue requirement increase. [↑](#footnote-ref-82)
82. The OSBA noted its agreement with PECO’s proposal to align rate L revenues with allocated costs, pursuant to its commitments set forth in the 2008 Settlement. OSBA St. 1-S at 13. [↑](#footnote-ref-83)
83. PAIEUG noted that to comport with principles of gradualism, it capped the increase to all classes, except the L rate class, at no more than 1.5 times the system average increase. As it discussed in its Main Brief, PAIEUG did not apply the principles of gradualism to rate L because: (1) rate L is paying significantly below its cost of service; and (2) the 2008 Settlement required PECO to propose to move rate L to its cost of service in this proceeding. PAIEUG M.B. at 24-25. [↑](#footnote-ref-84)
84. *Energy Affordability for Low-Income Customers*,Docket No. M‑2017‑2587711; *Review of Universal Service and Energy Conservation Programs*,Docket No. M­2017­2596907*.*  [↑](#footnote-ref-85)
85. It should be noted that it appears the Company inadvertently misstated the residential customer-related costs identified in the Company’s ACCOSS as $30.26 per month, rather than $28.07 per month. *See* R.D. at 408; PECO M.B. at 116; PECO R.B. at 75; PECO Exhs. JD-4R at 4 and JD-5R at 1. [↑](#footnote-ref-86)
86. Mr. Colton found that “[t]he average arrearage for Confirmed Low-Income customers was from 100% to 118% higher than the average arrears for Residential customers.” OCA St. 5 at 35. The breadth of arrears is also greater for confirmed low‑income customers. He found that from 2015 through 2019, up to 75% more confirmed low-income customers have been in arrears and “the extent to which the percentage of Confirmed Low-Income customers is higher than the Residential percentage has increased each year 2015 through 2019.” *Id*. [↑](#footnote-ref-87)
87. In 2019, PECO’s percentage of confirmed low-income gas customers experiencing a non-payment disconnection was approximately four times higher than the percentage of residential customers experiencing a nonpayment disconnection. OCA St. 5 at 36. Nearly one-in-five of PECO’s confirmed low-income gas customers had their service terminated for non-payment. *Id.* [↑](#footnote-ref-88)
88. Mr. Colton explained that PECO’s current customer charge is $11.75, which makes up 14.7% of the current average residential bill, which is $80.10. If the proposed fixed charge is approved at $16.00, it would equal 20% of the current average residential bill, which is $80.10, or 18% of the average bill if PECO’s rate increase is approved as requested, which would be $87.17. CAUSE-PA St. 1 at 43. [↑](#footnote-ref-89)
89. The average monthly residential bill was estimated by utilizing the surcharges based on rates as of September 1, 2020, provided on PECO Attachment III‑E‑11(a), page 1, and PECO’s revised proposed distribution rates, shown on PECO JAB-4 Revised (Corrected). [↑](#footnote-ref-90)
90. MMcF stands for “Million Cubic Feet.” [↑](#footnote-ref-91)
91. PECO noted that Mr. Knecht agreed with the Company’s revised proposal for Rate TS-F but stated that the proposal set forth in PECO St. 7-R and PECO Exh. JAB-4 Revised did not incorporate the revision for Rate TS-I. Subsequently, PECO further updated Rate TS-I in PECO Exh. JAB-1 to completely incorporate Mr. Knecht’s recommendation. PECO M.B. at 120 (citing PECO Exh. JAB-4 Revised (Corrected)). [↑](#footnote-ref-92)
92. Specifically, PAIEUG requests that the language on page 7 of the OSBA’s Exceptions, beginning with, “[t]he [ALJ’s] reliance on this evidence in support of rate shock…” through the end of page 8, as well as Appendix A to the OSBA’s Exceptions, be stricken from the OSBA’s Exceptions. PAIEUG Motion at 2 (citing OSBA Exc. at 7‑8, Appendix A). [↑](#footnote-ref-93)
93. *Hess v. Pa. PUC*, 107 A.3d 246, 265-267 (Pa. Cmwlth. 2014) (*Hess*); *Pa. PUC v. Verizon Pa., Inc.*, Docket No. R-00994697 (Order entered June 3, 2001); *Application of Apollo Gas Company*, 1994 Pa. PUC Lexis 45 (*Apollo Gas*). [↑](#footnote-ref-94)
94. We note that, based upon our review, we find no reason to reopen the record at this stage, pursuant to 52 Pa. Code § 5.571(d)(2). [↑](#footnote-ref-95)
95. The current theft/fraud fee, under existing Rule 17.6, is $370. PECO R.B. at 84. [↑](#footnote-ref-96)