



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
COMMONWEALTH KEYSTONE BUILDING
400 NORTH STREET, HARRISBURG, PA 17120

BUREAU OF
INVESTIGATION
&
ENFORCEMENT

October 13, 2022

Via Electronic Filing

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

Re: Pennsylvania Public Utility Commission v.
Valley Energy, Inc.
Docket No.: R-2022-3032300

I&E Pre-Served Testimony, Exhibits, and Verification Statements

Enclosed for electronic filing please find the **Pre-Served Testimony, Exhibits, and Verification Statements** of the Bureau of Investigation & Enforcement's (I&E) witnesses in the above-captioned proceeding. The following documents were admitted into the record by Administrative Law Judges Vero's and Collins's Order Granting Stipulation for Admission of Testimony and Exhibits dated October 11, 2022:

Brian LaTorre	I&E Statement No. 1 I&E Exhibit No. 1 I&E Statement No. 1-SR
Christopher Keller	I&E Statement No. 2 I&E Exhibit No. 2 I&E Statement No. 2-SR
Esyon Sakaya	I&E Statement No. 3 I&E Exhibit No. 3 I&E Statement No 3-SR
Jessalyn Heydenreich	I&E Statement No. 4 I&E Exhibit No. 4 I&E Statement No. 4-SR

Witness Verification Statements

Copies of this letter are being served on parties of record per the attached Certificate of Service. Should you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Scott B. Granger".

Scott B. Granger
Prosecutor
Bureau of Investigation and Enforcement
PA Attorney ID No. 63641
(717) 425-7593
sgranger@pa.gov

SBG/ac
Enclosure

cc: Honorable Eranda Vero (*Cover Letter and Certificate of Service only - via email*)
Honorable Charece Z. Collins (*Cover Letter and Certificate of Service only - via email*)
Per Certificate of Service (*Cover Letter and Certificate of Service only - via email*)

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No.: R-2022-3032300
	:	
Valley Energy, Inc.	:	

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Letter Regarding Pre-Served Testimony, Exhibits, and Verification Statements** dated October 13, 2022, in the manner and upon the persons listed below:

Served via Electronic Mail Only

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Honorable Charece Z. Collins
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**I&E Statement No. 1
Witness: Brian LaTorre**

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Direct Testimony

of

Brian LaTorre

Bureau of Investigation & Enforcement

Concerning:

OPERATING AND MAINTENANCE EXPENSES

STATE INCOME TAX EXPENSE

CASH WORKING CAPITAL

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1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Brian LaTorre, and my business address is Pennsylvania Public Utility
4 Commission, Commonwealth Keystone Building, 400 North Street, Harrisburg,
5 PA 17120.

6
7 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

8 A. I am employed by the Pennsylvania Public Utility Commission (Commission) in
9 the Bureau of Investigation & Enforcement (I&E) as a Fixed Utility Financial
10 Analyst.

11

12 **Q. WHAT IS YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND?**

13 A. An outline of my education and employment background is set forth in the
14 attached Appendix A.

15

16 **Q. PLEASE DESCRIBE THE ROLE OF I&E IN RATE PROCEEDINGS.**

17 A. I&E is responsible for protecting the public interest in proceedings before the
18 Commission. I&E's analysis in the proceeding is based on its responsibility to
19 represent the public interest. This responsibility requires the balancing of the
20 interests of ratepayers, the regulated utility, and the regulated community as a
21 whole.

1 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

2 A. The purpose of my testimony is to review the base rate filing of Valley Energy,
3 Inc. (Valley or Company) and make recommended adjustments to the Company's
4 proposed operating and maintenance (O&M) expenses and cash working capital
5 claims for the fully projected future test year (FPFTY) ending December 31, 2023.

6
7 **Q. DOES YOUR TESTIMONY INCLUDE AN EXHIBIT?**

8 A. Yes. I&E Exhibit No. 1 contains schedules that support my direct testimony.

9
10 **Q. WHAT TEST YEARS IS VALLEY USING IN THIS PROCEEDING?**

11 A. Valley is using calendar year 2021 as the historic test year (HTY), calendar year
12 2022 as the future test year (FTY), and calendar year 2023 as the FPFTY in this
13 proceeding.¹

14
15 **Q. WHAT IS THE COMPANY'S REQUESTED REVENUE INCREASE?**

16 A. Valley is requesting an annual total revenue increase of \$999,631, however its rate
17 case filing supports a revenue increase of \$1,234,913.²

¹ Valley Statement No. 1, p. 2.

² Valley Statement No. 1 (CU), p. 2.

1 **Q. PLEASE SUMMARIZE YOUR ADJUSTMENTS.**

2 A. The following table summarizes my recommended adjustments:

	Company Claim	I&E Recommended Allowance	I&E Adjustment
O&M Expenses:			
Office Supplies and Expense	\$80,374	\$66,964	<u>(\$13,410)</u>
Total O&M Adjustments			<u>(\$13,410)</u>
Taxes:			
State Income Tax Expense	\$52,067	\$39,622	<u>(\$12,445)</u>
Total Tax Adjustments			<u>(\$12,445)</u>
Rate Base Adjustments:			
Cash Working Capital	\$433,234	\$431,558	<u>(\$1,676)</u>
Total Rate Base Adjustments			<u>(\$1,676)</u>

3

4

5 **OVERALL I&E POSITION**

6 **Q. WHAT IS I&E'S TOTAL RECOMMENDED REVENUE REQUIREMENT?**

7 A. I&E's total recommended revenue requirement for the Company is \$6,479,534.

8 This recommended revenue requirement represents an increase of \$958,359 to the

9 claimed present rate revenues of \$5,521,175. This total recommended allowance

10 incorporates my adjustments made in this testimony to O&M expenses and cash

11 working capital and the recommended adjustments made in the testimony of I&E

12 witness Christopher Keller.³

³ I&E Statement No. 2.

1 A calculation of the I&E recommended revenue requirement is shown
 2 below:

Valley Energy, Inc. R-2022-3032300	TABLE I INCOME SUMMARY				
	12/31/23 Proforma	INVESTIGATION & ENFORCEMENT			
	Present Rates	Adjustments	Present Rates	Allowances	Proposed
	\$	\$	\$	\$	\$
Operating Revenue	5,521,175	0	5,521,175	958,359	6,479,534
Deductions:					
O&M Expenses	3,623,229	-13,410	3,609,819	6,469	3,616,288
Depreciation	1,178,428	0	1,178,428		1,178,428
Taxes, Other	34,169	0	34,169	0	34,169
Income Taxes:					
Current State	-47,126	1,173	-45,953	85,575	39,622
Current Federal	37,749	2,492	40,241	181,926	222,167
Deferred Taxes	-9,148	0	-9,148		-9,148
ITC	0	0	0		0
Total Deductions	4,817,301	-9,745	4,807,556	273,970	5,081,526
Income Available	703,874	9,745	713,619	684,389	1,398,008
Rate Base	19,775,484	-1,676	19,773,808	0	19,773,808
Rate of Return	3.56%		3.61%		7.07%

3
4

5 **OFFICE SUPPLIES AND EXPENSE**

6 **Q. WHAT IS THE COMPANY’S TOTAL CLAIM FOR OFFICE SUPPLIES**
 7 **AND EXPENSES?**

8 **A. The Company’s claim for office supplies and expenses (account 921) is \$80,374.⁴**

⁴ Valley Exhibit HSG-1 Schedule C1-1 (CU) p. 2.

1 **Q. WHAT IS THE BASIS FOR THE COMPANY’S CLAIM?**

2 A. In response to I&E-RE-14-D,⁵ the Company provided a table that detailed the
3 expenses for office supplies and expenses. From the HTY to the FTY, the
4 Company’s office supplies and expenses are projected to increase by \$22,066
5 (\$66,964 - \$44,898) due to relaxed travel restrictions as well as the initial training
6 of the new employee that is expected to be hired in August 2022. The Company is
7 projecting an additional \$13,410 (\$80,374 - \$66,964) increase in the FPFTY for an
8 increase in travel, training, and associated meals in 2023.

9

10 **Q. DO YOU AGREE WITH THE COMPANY’S CLAIM?**

11 A. No.

12

13 **Q. WHAT IS YOUR RECOMMENDATION FOR OFFICE SUPPLIES AND**
14 **EXPENSES?**

15 A. I recommend a total expense of \$66,964, or a reduction of \$13,410 (\$80,374 –
16 \$66,964) to the Company’s claim.

17

18 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?**

19 A. In response to OCA-II-36, the Company stated that it expects to hire an additional
20 employee for the new Training and Compliance Coordinator position starting on
21 August 22, 2022.⁶ The Company has not indicated any additional hires in the

⁵ I&E Exhibit No. 1, Schedule 1, p. 1.

⁶ I&E Exhibit No. 1, Schedule 1, p. 2.

1 FPFTY ending December 31, 2023. The Company stated that the \$13,410
2 increase from the FTY to FPFTY is due to increases in travel, training, and
3 associated meals, however the Company has not provided justification for an
4 increase in training expenses when there are no new employees to train in the
5 FPFTY.

6
7 **COVID-19 RELATED EXTRAORDINARY COSTS**

8 **Q. WHAT EXPENSES ARE INCLUDED IN THE COMPANY'S CLAIM FOR**
9 **COVID-19 RELATED EXTRAORDINARY COSTS?**

10 A. The Company's claim for COVID-19 related extraordinary costs includes carrying
11 costs on higher-than-normal uncollectible accounts expense and out-of-pocket
12 costs directly related to the pandemic.⁷

13
14 **Q. WHAT IS UNCOLLECTIBLE ACCOUNTS EXPENSE?**

15 A. Uncollectible accounts expense consists of specific receivables that are determined
16 to be uncollectible, in whole or in part, either because the debtors do not pay or
17 because the creditor finds it impracticable to enforce payment. Those accounts
18 deemed uncollectible are charged against income as uncollectible accounts
19 expense.

⁷ Valley Statement No. 1, pp. 13-14.

1 **Q. HOW DO UTILITIES RECOGNIZE UNCOLLECTIBLE EXPENSE FOR**
2 **RATEMAKING PURPOSES?**

3 A. Generally, for ratemaking purposes, utilities compute uncollectible expense on an
4 annual prospective basis. While the uncollectible expense is a prospective claim,
5 the proper calculation begins with a historic analysis of actual net write-offs to
6 gross revenues to develop a historic write-off ratio. Thus, net write-offs are gross
7 write-offs less recoveries of amounts previously written off. This ratio is applied
8 to projected revenues to determine the proper prospective allowance. Normally,
9 the historic analysis is based on several years of data.

10

11 **Q. WHAT CLAIM ARE YOU ADDRESSING HEREIN?**

12 A. I am addressing the recovery of the COVID-19 related extraordinary costs
13 associated with uncollectible accounts expense and other COVID-19 related
14 expense deferrals.

15

16 **Q. WHAT IS THE COMPANY'S CLAIM FOR COVID-19**
17 **EXTRAORDINARY COSTS?**

18 A. The Company's total claim for COVID-19 related extraordinary cost recovery is
19 \$32,277 (\$10,859⁸ x 3 years). The Company has not indicated if it will continue
20 regulatory asset treatment going forward for incremental uncollectible costs above
21 what is included in this proceeding to be recovered in the next base rate
22 proceeding.

⁸ Valley Exhibit HSG-1, Schedule C1-7 (CU), line 7.

1 **Q. WHAT IS THE BASIS FOR THE COMPANY’S COVID-19 RELATED**
2 **UNCOLLECTIBLE ACCOUNTS EXPENSE CLAIM?**

3 A. The Company followed the Commission’s guidance in the May 13, 2020
4 Secretarial Letter regarding *COVID-19 Cost Tracking and Creation of Regulatory*
5 *Asset, Docket No. M-2020-3019775* (May 13, 2020 Secretarial Letter), taking the
6 difference between the amount of uncollectible expense experienced in the fiscal
7 year ended December 31, 2019 and the average amount experienced in the fiscal
8 years ended December 31, 2020 and December 31, 2021.⁹ The Company has not
9 indicated that COVID-19 related uncollectible deferrals should cease upon the
10 effective date of new rates in the instant proceeding. The Company has not stated
11 if it should be able to continue to accumulate and defer costs above the normalized
12 level as approved within the Company’s new rates as a regulatory asset citing
13 higher than normal accounts receivable balances.

14
15 **Q. WHAT IS THE BASIS FOR THE COMPANY’S OTHER COVID-19**
16 **RELATED DEFERRALS?**

17 A. This portion of the claim relates to the purchase of masks, hand sanitizer, etc.¹⁰

18
19 **Q. DO YOU AGREE WITH THE COMPANY’S CLAIM?**

20 A. No.

⁹ Valley Exhibit HSG-1, Schedule C1-7 (CU).
¹⁰ Valley Statement No. 1, p. 14.

1 **Q. WHAT IS YOUR RECOMMENDATION FOR THE CONTINUED**
2 **DEFERRAL OF COVID-19 RELATED EXTRAORDINARY COSTS?**

3 A. I accept the Company’s total deferral claim of \$32,277 for the 2020 and 2021
4 COVID-19 related extraordinary costs, as well as the three-year amortization
5 period proposed by the Company resulting in an annual recovery amount of
6 \$10,859.¹¹ The Company should not be allowed to continue recording a
7 regulatory asset for ongoing COVID-19 related incremental uncollectible accounts
8 costs and for other COVID-19 related expenses after the effective date of new
9 rates for the instant proceeding. Upon the effective date of new rates for this
10 proceeding, the Company will have a new uncollectible accounts expense
11 percentage built into rates that accounts for the increased delinquency rates and
12 higher customer balances. Additionally, any other COVID-19 related expenses
13 such as masks, hand sanitizer, etc. should be built into routine expenses and are
14 likely not material in nature.

15
16 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?**

17 A. While the Commission did not specify when utilities should discontinue tracking
18 COVID-19 related expenses, the May 13, 2020 Secretarial Letter states, “[the
19 creation of] a regulatory asset [is] for any incremental expenses incurred above
20 those embedded in rates...”.¹² In my opinion, the regulatory asset is intended so

¹¹ Valley Exhibit HSG-1, Schedule C1-7 (CU).

¹² May 13, 2020 Secretarial Letter, p. 2.

1 that utilities can defer extraordinary costs, not previously embedded in rates at the
2 time of the March 13 Emergency Order, so that those extraordinary costs could be
3 recovered in the next proceeding following the March 13 Emergency Order and
4 the regulatory asset should only be tracked until the rate case is filed. The future
5 rates in the instant proceeding will allow for recovery of the incremental COVID-
6 19 related extraordinary expenses incurred since the issuance of the March 13
7 Emergency Order. Therefore, upon the effective date of new rates for this
8 proceeding, the Company will have a new uncollectible accounts expense
9 percentage built into rates that accounts for the increased delinquency rates and
10 higher customer balances. Furthermore, as stated above, any other COVID-19
11 related expenses should already be included in routine expense accounts and likely
12 immaterial in nature thus not requiring continued deferral treatment.

13 Additionally, in the current inflationary environment, many ratepayers will
14 likely struggle to pay utility bills for reasons unrelated to the COVID-19
15 pandemic. To include future uncollectibles that exceed a now stale historic factor
16 in the COVID-19 regulatory asset would be inappropriate and not reflective of
17 how historic uncollectibles are routinely recovered. It is unreasonable to expect
18 that all future uncollectibles that exceed a rate established in 2019 are related to
19 the COVID-19 pandemic and, therefore, should be afforded regulatory asset
20 treatment.

1 **STATE INCOME TAX EXPENSE**

2 **Q. WHAT IS THE COMPANY'S CLAIM FOR STATE INCOME TAX**
3 **EXPENSE?**

4 A. The Company's claim for state income tax expense is \$52,067.¹³

5
6 **Q. WHAT IS THE BASIS FOR THE COMPANY'S CLAIM?**

7 A. The Company's state income tax expense claim is based on the existing corporate
8 net income tax rate of 9.99%.¹⁴

9
10 **Q. DO YOU AGREE WITH THE COMPANY'S CLAIM?**

11 A. No.

12
13 **Q. WHAT DO YOU RECOMMEND FOR STATE INCOME TAX EXPENSE?**

14 A. I recommend an allowance of \$39,622 or a reduction of \$12,445 (\$52,067 -
15 \$39,622) to the Company's claim.

16
17 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?**

18 A. On July 8, 2022, Pennsylvania House Bill 1342 was signed into law as Act 53 of
19 2022. Act 53 will lower the current 9.99% corporate net income tax rate to 8.99%
20 in 2023 (the Company's claimed FPFTY) and will decrease the tax rate by 0.5%
21 each year until 2031, when the tax rate will be 4.99%.¹⁵ Therefore, I recommend a

¹³ Valley Exhibit __ (HSG-1) Schedule C1-4 (CU).

¹⁴ Valley Exhibit __ (HSG-1) Schedule C1-4 (CU).

¹⁵ I&E Exhibit No. 1, Schedule 2, p. 1.

1 Pennsylvania income tax rate of 8.99% to reflect the Pennsylvania corporate
2 income tax rate that will be in effect for the FPFTY. This recommended allowance
3 also incorporates the state income tax effect of my other recommended
4 adjustments and those of I&E witnesses Keller.¹⁶

5
6 **CASH WORKING CAPITAL**

7 **Q. WHAT IS A CASH WORKING CAPITAL (CWC) ALLOWANCE FOR**
8 **RATEMAKING PURPOSES?**

9 A. CWC includes the amount of funds necessary to operate a utility during the
10 interim period between the rendition of service, including the payment of related
11 expenses, and the receipt of revenue in payment for services rendered by the
12 utility.

13
14 **Q. WHAT IS THE COMPANY'S CWC CLAIM**

15 A. The Company's claim for CWC is \$433,234.¹⁷

16
17 **Q. HOW DID THE COMPANY CALCULATE ITS CWC CLAIM?**

18 A. The Company used the 1/8 Method, also known as the 45-Day Method. The
19 Company's claim was determined by adding all cash based operating expenses to
20 arrive at a total of \$3,465,870. This total was multiplied by 1/8 to arrive at a CWC
21 amount of \$433,234 ($\$3,465,870 \times (1/8)$).¹⁸

¹⁶ I&E Statement No. 2.

¹⁷ Valley Exhibit HSG-1 Schedule C1-6 (CU), p. 1.

¹⁸ Valley Exhibit HSG-1 Schedule C1-6 (CU), p. 2.

1 **Q. DO YOU AGREE WITH THE COMPANY’S USE OF THE ONE-EIGHTH**
2 **METHOD?**

3 A. Yes. I accept the Company’s use of the 1/8 Method since the requested increase in
4 rates is less than \$1,000,000 in this proceeding.

5

6 **Q. DO YOU AGREE WITH THE COMPANY’S CLAIM?**

7 A. No. I disagree with the Company’s CWC claim. The claim needs to be adjusted
8 to reflect my O&M adjustment for office supplies and expense as discussed above.

9

10 **Q. WHAT IS YOUR RECOMMENDED ALLOWANCE FOR CWC?**

11 A. I recommend an allowance of \$431,558 or a reduction of \$1,676 (\$433,234 –
12 \$431,558).

13

14 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?**

15 A. My recommendation is based on my adjustments to O&M expenses as discussed
16 above. My recommendation is calculated below:

Company’s CWC Claim		\$433,234
I&E Recommended O&M Adjustments:		
Total O&M Adjustments (Office Supplies & Expenses)	<u>(\$13,410)</u>	
1/8 of Total O&M Adjustments		<u>(\$1,676)</u>
I&E Recommended CWC Allowance		<u>\$431,558</u>

17

1 **Q. IS YOUR RECOMMENDED CWC ALLOWANCE A FINAL**
2 **RECOMMENDATION?**

3 A. No. All adjustments to the Company's claims for revenues, expenses, taxes, and
4 rate base must be continually brought together in the Administrative Law Judge's
5 Recommended Decision and again in the Commission's Final Order. This
6 process, known as iteration, effectively prevents the determination of a precise
7 calculation until all adjustments have been made to the Company's claim.

8

9 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

10 A. Yes.

Brian LaTorre

Professional and Educational Background

Professional Experience

Pennsylvania Public Utility Commission, Harrisburg, Pennsylvania

November 2021 to Present

Fixed Utility Financial Analyst, Bureau of Investigation and Enforcement

Pennsylvania House of Representatives, Lansdale, Pennsylvania

December 2018 to October 2021

Constituent Services Advisor

Organized meetings with local officials and stakeholders on issues impacting the community. Assisted residents and business owners with issues relating to state government, including LIHEAP and Unemployment Compensation.

SimiTree Healthcare Consulting, Conshohocken, Pennsylvania

June 2016 to March 2018

Analyst

Tracked and analyzed revenue cycle accounts receivable trends for home healthcare and hospice clients. Identified and corrected Medicare, Medicaid, and Private Insurance billing issues. Maintained external dashboards that displayed key performance indicators for clients.

Education and Training

Pennsylvania State University – Smeal College of Business

Bachelor of Science, Finance, 2016

Minor in Economics

Pennsylvania PUC Rate School, January 18 through February 8, 2022

Testimony Submitted

- R-2022-3031113 – PECO Energy Company – Gas Division
- R-2022-3030235 – National Fuel Gas Distribution Corporation (§ 1307(f))
- R-2021-3030218 – UGI Utilities, Inc. – Gas Division

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Exhibit to Accompany

the

Direct Testimony

of

Brian LaTorre

Bureau of Investigation & Enforcement

Concerning:

OPERATING AND MAINTENANCE EXPENSES

STATE INCOME TAX EXPENSE

CASH WORKING CAPITAL

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

I&E-RE-14-D Reference Company Exhibit HSG-1, Schedule C1-1, p. 2 concerning Office Supp & Exp (Account 921), explain the following adjustments in detail:

- A. Expense increase from \$30,312 in 2020 to \$44,898 in the HTY 2021;
- B. Expense increase from \$44,898 in the HTY 2021 to \$66,964 in the FTY 2022; and
- C. Expense increase from \$66,964 in the FTY 2022 to \$80,374 in the FPFTY 2023.

Response:

A- C. The table below presents the detail requested, for the amounts in Exhibit HSG-1, Schedule C1-1, page 2.

ACCOUNT 921	2020	2021	2022	2023
GENERAL OFFICE SUPPLIES (00)	11,548	12,122	10,973	11,192
MEAL EXPENSES (40)	1,693	2,511	4,502	5,919
TRAVEL AND TRAINING (45)	12,087	18,552	35,914	47,688
COMMUNICATION EQUIPMENT (50)	4,984	11,714	15,575	15,575
TOTAL	30,312	44,898	66,964	80,374

- A. The increase from \$30,312 in 2020 to \$44,898 in HTY 2021 is due to following factors:
 - increase in travel, training, and associated meals in 2021 due to relaxed COVID restrictions
 - added additional internet provider for redundancy to enhance reliability of critical communications systems
 - upgrade of phone management system started in third quarter of 2021
- B. The increase from \$44,898 in HTY 2021 to \$66,964 in FTY 2022 is due to following factors:
 - increase in travel, training, and associated meals in 2022 due to further relaxed COVID restrictions as well as initial training for new employee discussed in our testimony
 - upgrade of phone management system fully deployed
- C. The increase from \$66,964 in FTY 2022 to \$80,374 in FPFTY 2023 is due to following factors:
 - increase in travel, training, and associated meals in 2023

All training including associated travel and meals are to stay abreast of regulatory requirements, technological advances in industry, best practices, and maintaining industry certifications and licensing.

**Response Provided by: Jamie Levering, Vice President/Treasurer
Valley Energy, Inc.**

Date: June 7, 2022

**VALLEY ENERGY, INC. RESPONSE TO
OFFICE OF CONSUMER ADVOCATE INTERROGATORIES
DOCKET NO. R-2022-3032300**

OCA-II-36 Refer to Statement No. 5 page 4 (Mr. Levering's Testimony). Please provide a timeline of additional employees expected to be hired by Valley Energy, the starting salary, the expected hire date and the responsibilities.

Response:

Valley expects to hire an additional employee for the new Training and Compliance Coordinator position starting on August 22, 2002, with a starting salary of \$64,000.

The Training and Compliance Coordinator will be responsible for the development, implementation, oversight, and monitoring of pipeline safety and compliance programs. These duties encompass all construction, operation, maintenance, service, and emergency response activities and ensure compliance with all federal, state, and local regulations as well as applicable industry codes, practices, and standards. The position is responsible for the development, implementation, and administration of the companies training and qualification programs. The position as interfaces with regulators, insurers, industry associations, and other external entities on matters pertaining to gas regulatory compliance. This employee provides technical leadership as the Company's primary point of contact for compliance matters and administers the intake, review, investigation, and resolution of non-compliance allegations.

**Response Provided by: Edward E. Rogers, President and Chief Executive Officer
Valley Energy, Inc.**

Date: July 11, 2022



TaxNewsFlash

United States



No. 2022-193
July 11, 2022

I&E Exhibit No. 1
Schedule 2
Page 1 of 3

Pennsylvania: Changes to corporate net income tax laws, other tax changes

House Bill 1342 was signed into law in Pennsylvania on July 8, 2022. The bill makes significant changes to the Commonwealth's corporate net income tax laws, as discussed below.

Corporate net income tax rate reduction

The Commonwealth's current corporate net income tax rate is 9.99%, which is one of the highest in the country. House Bill 1342 reduces that rate incrementally to 4.99%. These rate reductions are scheduled to occur automatically and are not contingent on state tax revenues meeting or exceeding specific thresholds.

The rate is first reduced to 8.99% for the 2023 tax year—the tax year beginning on or after January 1, 2023 through December 31, 2023. The rate is further reduced as follows:

- 8.49% for tax year 2024
- 7.99% for tax year 2025
- 7.49% for tax year 2026
- 6.99% for tax year 2027
- 6.49% for tax year 2028
- 5.99% for tax year 2029
- 5.49% for tax year 2030
- 4.99% for tax years beginning January 1, 2031 and thereafter

KPMG observation

Previous corporate net income rate reductions were included in bills that would also have adopted unitary combined reporting. However, unitary combined reporting is not included in this legislation.

Sales factor changes

Under current law, specific sourcing rules apply to receipts from sales of services and receipts from sales of tangible personal property. All other receipts are sourced under the statutory income-producing activity test and

are included in the Pennsylvania sales factor numerator if the income-producing activity is performed in Pennsylvania, or if a greater proportion of the income-producing activity is performed in Pennsylvania, based on costs of performance. House Bill 1342 adopts comprehensive customer-based sourcing rules for a number of “other” types of receipts, including:

- Gross receipts from the lease or license of intangible property
- Gross receipts from sales of intangibles
- Gross receipts from the sale, redemption, maturity or exchange of securities held by a taxpayer primarily for sale to customers
- Gross receipts related to lending activities involving real property and tangible personal property
- Gross receipts received from interest, fees, and penalties from credit card holders
- Gross receipts received from interest not otherwise addressed in the revised law

Any gross receipts associated with intangible property that are not specifically addressed will be excluded from both the numerator and denominator of the sales factor. The state tax authority is directed to promulgate rules and regulations to implement the new sourcing rules, which are effective for tax years beginning after December 31, 2022.

KPMG observation

There is ongoing litigation in Pennsylvania over the application of the income-producing activity test as applied to service receipts. The *Synthes* case, currently pending before the Pennsylvania Supreme Court, involves the interpretation of the statutory income-producing activity test in years prior to 2014 before the legislature revised the law to provide that service receipts are sourced to the location where the services are delivered. In *Synthes*, the state tax authority and the taxpayer were on the same side and argued that the tax authority’s market-based interpretation of the income-producing activity test, which resulted in a refund for Pennsylvania-based taxpayer, was entitled to deference. The Attorney General, however, disagreed that the tax authority’s interpretation was entitled to deference. The Commonwealth Court held in favor of the taxpayer and the tax authority, the Attorney General appealed to the Pennsylvania Supreme Court, and oral arguments were held in March 2022. Although *Synthes* involves service receipts, the outcome may be instructive as to application of the income-producing activity test to other types of receipts for years prior to 2023.

Codification of economic nexus standards

House Bill 1342 codifies Corporation Tax Bulletin 2019-04, issued post-*Wayfair*, in which the state tax authority announced that for tax years beginning on or after January 1, 2020, corporations meeting an economic nexus standard would be required to file corporate net income tax returns (unless protected under Public Law 86-272). The bulletin set forth a rebuttable presumption that a corporate taxpayer without a physical presence in Pennsylvania that had \$500,000 or more of direct or indirect gross receipts sourced to Pennsylvania from any combination of (1) gross receipts from the sale, rental, lease, or licensing of tangible personal property; (2) gross receipts from the sale of services; or (3) gross receipts from the sale or licensing of intangibles, including franchise agreements, would have a filing responsibility.

Effective for tax years beginning after December 31, 2022, House Bill 1342 codifies the rebuttable presumption that a corporation with \$500,000 or more of receipts sourced to Pennsylvania will have substantial nexus with the Commonwealth, despite the lack of a physical presence. However, an exception applies to affiliated entities domiciled in foreign nations that have entered into comprehensive income tax treaties with the United States. The treaties must provide “for the allocation of all categories of income subject to taxation, or the withholding of tax, on royalties, licenses, fees and interest for the prevention of double taxation of the respective nations’ residents and the sharing of information.”

KPMG observation

It is important to consider the economic nexus standard in conjunction with the revised sourcing rules that apply beginning with the 2023 tax year. A taxpayer that previously sourced receipts under the income-producing

activity test may not have had the requisite level of receipts sourced to the Commonwealth. However, that may no longer be the case when those receipts are sourced using the new customer-based rules.

Sales and use tax and other tax changes

Effective January 1, 2023, House Bill 1342 requires peer-to-peer car sharing marketplace facilitators (as defined) to collect sales and use tax on facilitated shared vehicle rentals. The up-to-\$2 per day fee that applies to vehicle rentals is extended to vehicles rented as part of a peer-to-peer car sharing program. However, the Commonwealth's 2% vehicle rental tax does not apply to a shared vehicle that is rented through a peer-to-peer car sharing program. The bill also extends the computer data center sales tax exemption qualification period from 15 years to 25 years for qualified purchases of equipment installed in the computer data center.

For individual (personal) income tax purposes, effective for tax years beginning after December 31, 2022, the bill conforms the Commonwealth to the section 179 expensing provisions and the section 1031 deferral provisions. A new refundable tax credit is adopted for eligible taxpayers who receive the federal child and dependent care tax credit. Finally, the bill increases the annual cap for the research and development and film production tax credits and makes certain changes to the keystone opportunity zone provisions.

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I&E Statement No. 2
Witness: Christopher Keller

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Direct Testimony

of

Christopher Keller

Bureau of Investigation & Enforcement

Concerning:

Rate of Return

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1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Christopher Keller. My business address is Pennsylvania Public
4 Utility Commission, Commonwealth Keystone Building, 400 North Street,
5 Harrisburg, PA 17120.

6

7 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

8 A. I am employed by the Pennsylvania Public Utility Commission (Commission) in
9 the Bureau of Investigation & Enforcement (I&E) as a Fixed Utility Financial
10 Analyst.

11

12 **Q. WHAT IS YOUR EDUCATION AND EMPLOYMENT BACKGROUND?**

13 A. An outline of my education and employment history is attached as Appendix A.

14

15 **Q. PLEASE DESCRIBE THE ROLE OF I&E IN RATE PROCEEDINGS.**

16 A. I&E is responsible for protecting the public interest in proceedings before the
17 Commission. I&E's analysis in this proceeding is based on its responsibility to
18 represent the public interest. This responsibility requires balancing the interests of
19 ratepayers, the regulated utility, and the regulated community as a whole.

20

21 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

22 A. The purpose of my testimony is to review the base rate filing of Valley Energy,

1 Inc. (Valley or Company), and make recommendations regarding Valley's rate of
2 return, including capital structure, cost of long-term debt, the cost of equity, and
3 the overall fair rate of return for the fully projected future test year (FPFTY)
4 ending December 31, 2023.

5

6 **Q. DOES YOUR TESTIMONY INCLUDE AN EXHIBIT?**

7 A. Yes. I&E Exhibit No. 2 contains schedules that support my direct testimony.

8

9 **BACKGROUND**

10 **Q. WHAT IS THE GENERAL DEFINITION OF RATE OF RETURN IN THE**
11 **CONTEXT OF A RATE CASE?**

12 A. Rate of return is one of the components of the revenue requirement formula. Rate
13 of return is the amount of revenue an investment generates in the form of net
14 income and is usually expressed as a percentage of the amount of capital invested
15 over a given period of time.

16

17 **Q. WHAT IS THE REVENUE REQUIREMENT FORMULA?**

18 A. The revenue requirement formula used in base rate cases is as follows:

19
$$RR = E + D + T + (RB \times ROR)$$

20 Where:

21 RR = Revenue Requirement

22 E = Operating Expenses

- 1 D = Depreciation Expense
- 2 T = Taxes
- 3 RB = Rate Base
- 4 ROR = Overall Rate of Return

5 In the above formula, the rate of return is expressed as a percentage. The
6 calculation of that percentage is independent of the determination of the
7 appropriate rate base value for ratemaking purposes. As such, the appropriate total
8 dollar return is dependent upon the proper computation of the rate of return and
9 the proper valuation of the Company’s rate base.

10

11 **Q. WHAT CONSTITUTES A FAIR AND REASONABLE OVERALL RATE**
12 **OF RETURN?**

13 A. A fair and reasonable overall rate of return is one that will allow the utility an
14 opportunity to recover those costs prudently incurred by all classes of capital used
15 to finance the rate base during the prospective period in which its rates will be in
16 effect.

17 The *Bluefield Water Works & Improvements Co. v. Public Service Comm.*
18 *of West Virginia*, 262 U.S. 679, 692-93 (1923), and the *FPC v. Hope Natural Gas*
19 *Co.*, 320 U.S. 591, 603 (1944) cases set forth the principles that are generally
20 accepted by regulators throughout the country as the appropriate criteria for
21 measuring a fair rate of return:

- 1 1. A utility is entitled to a return similar to that being earned by other
2 enterprises with corresponding risks and uncertainties, but not as high as
3 those earned by highly profitable or speculative ventures.
- 4 2. A utility is entitled to a return level reasonably sufficient to assure financial
5 soundness.
- 6 3. A utility is entitled to a return sufficient to maintain and support its credit
7 and raise necessary capital.
- 8 4. A fair return can change (increase or decrease) along with economic
9 conditions and capital markets.

10
11 **Q. EXPLAIN HOW THE OVERALL RATE OF RETURN IS**
12 **TRADITIONALLY CALCULATED IN BASE RATE PROCEEDINGS.**

13 A. In base rate proceedings, the overall rate of return is traditionally calculated using
14 the weighted average cost of capital method. To calculate the weighted average
15 cost of capital, a company's capital structure must first be determined by
16 comparing the percentage of each capitalization component, which has financed
17 rate base, to total capital. Next, the effective cost rate of each capital structure
18 component must be determined. The historical component of the cost rate of debt
19 can be computed accurately, and any future debt issuances are based on estimates.
20 The cost rate of common equity is not fixed and is more difficult to measure.
21 Because of this difficulty, a proxy group is used as discussed later in this
22 testimony. Next, each capital structure component percentage is multiplied by its

1 corresponding effective cost rate to determine the weighted capital component cost
2 rate. The table in the “*I&E Position*” section below demonstrates the interaction
3 of each capital structure component and its corresponding effective cost rate.
4 Finally, the sum of the weighted cost rates produces the overall rate of return.
5 This overall rate of return is multiplied by the rate base to determine the return
6 portion of a company’s revenue requirement.
7

8 **COMPANY’S RATE OF RETURN CLAIM**

9 **Q. WHO IS THE COMPANY’S RATE OF RETURN WITNESS?**

10 A. Valley witness Dylan W. D’Ascendis is the primary witness addressing rate of
11 return (Valley Statement No. 2). Mr. D’Ascendis provided analysis for the
12 claimed capital structures, long-term debt, and cost of common equity for Valley.
13

14 **Q. PLEASE SUMMARIZE THE COMPANY’S RATE OF RETURN CLAIM.**

15 A. Although the Company has claimed it can justify a higher rate of return, it is
16 requesting a lower 7.13% rate of return (corrected and updated position as of
17 July 11, 2022) (Valley Exhibit (HSG-1), Schedule C1 (CU)) to keep its requested
18 revenue increase under \$1,000,000 (Valley Statement No. 1 (CU), p. 2, lines 13-
19 19). However, Mr. D’Ascendis has recommended the following rate of return for
20 Valley based on its FPFTY ending December 31, 2023 (Valley Schedule DWD-1,
21 p. 1):

Type of Capital	Ratio	Cost Rate	Weighted Cost Rate
Long-Term Debt	50.47%	4.49%	2.27%
Common Equity	49.53%	11.50%	5.70%
Total	100.00%		7.97%

1

2

3 **I&E POSITION**

4 **Q. PLEASE SUMMARIZE YOUR RATE OF RETURN**

5 **RECOMMENDATION.**

6 A. I recommend the following rate of return for the Company (I&E Exhibit No. 2,
7 Schedule 1):

Type of Capital	Ratio	Cost Rate	Weighted Cost Rate
Long-Term Debt	50.47%	4.49%	2.27%
Common Equity	49.53%	9.70%	4.80%
Total	100.00%		7.07%

8

9

10 **PROXY GROUP**

11 **Q. WHAT IS A PROXY GROUP AS USED IN BASE RATE CASES?**

12 A. A proxy group is a set of companies that have similar traits of risk in comparison
13 to the subject utility. This group of companies acts as a benchmark for
14 determining the subject utility's rate of return in a base rate case.

15

16 **Q. WHAT ARE THE REASONS FOR USING A PROXY GROUP?**

17 A. A proxy group's cost of equity is used as a benchmark to satisfy the long-
18 established guideline of utility regulation that seeks to provide the subject utility

1 with the opportunity to earn a return similar to that of enterprises with
2 corresponding risks and uncertainties.

3 A proxy group is typically utilized since the use of data exclusively from
4 one company may be less reliable. The lower reliability occurs because the data
5 for one company may be subject to events that can cause short-term anomalies in
6 the marketplace. The rate of return on common equity for a single company could
7 become distorted in these circumstances and would therefore not be representative
8 of similarly situated companies. Therefore, a proxy group has the effect of
9 smoothing out potential anomalies associated with a single company.

10
11 **Q. WHAT CRITERIA DID YOU USE IN SELECTING YOUR GAS**
12 **INDUSTRY PROXY GROUP?**

13 A. The criteria for my proxy group was designed to select companies that are most
14 like the natural gas distribution company subject in this proceeding. I applied the
15 following criteria to Value Line's Natural Gas Utility company group:

- 16 1. Fifty percent or more of the company's revenues must be generated from
17 the regulated gas utility industry;
- 18 2. The company's stock must be publicly traded;
- 19 3. Investment information for the company must be available from more than
20 one source, which includes Value Line;
- 21 4. The company must not be currently involved/targeted in an announced
22 merger or acquisition;

- 1 5. The company must have four consecutive years of historic earnings data;
2 and
3 6. The company must be operating in a state that has a deregulated gas utility
4 market.

5
6 **Q. WHAT CRITERIA DID MR. D’ASCENDIS USE IN SELECTING HIS GAS**
7 **PROXY GROUP COMPANIES?**

8 A. Mr. D’Ascendis determined his proxy group of six gas companies by using the
9 following criteria (Valley Statement No. 2, p. 14, line 13 through p. 15, line 8):

- 10 1. The company is included in the Natural Gas Utility Group of Value Line’s
11 Standard Edition;
- 12 2. The company has 60% or greater of 2021 total operating income and 60%
13 or greater of 2021 total assets attributable to regulated gas distribution
14 operations;
- 15 3. At the time of the preparation of Mr. D’Ascendis’ testimony, the company
16 must not have publicly announced they were involved in any major merger
17 or acquisition activity;
- 18 4. The company must not have cut or omitted its common dividends during
19 the five years ended 2021 or through the time of the preparation of Mr.
20 D’Ascendis’ testimony;
- 21 5. The company must have Value Line and Bloomberg Professional Services
22 (Bloomberg) adjusted betas;

- 1 6. The company must have a positive Value Line five-year dividends per
 2 share (DPS) growth rate projection; and
- 3 7. The company must have Value Line, Reuters, Zacks, or Yahoo! Finance
 4 consensus five-year earnings per share (EPS) growth rate projections.

5

6 **Q. WHAT PROXY GROUP DID YOU USE IN YOUR ANALYSIS?**

7 A. I included the following six companies in my proxy group (I&E Exhibit No. 2,
 8 Schedule 2):

Atmos Energy Corp.	ATO
Chesapeake Utilities Corp.	CPK
NiSource Inc.	NI
Northwest Natural Holding Co.	NWN
ONE Gas, Inc.	OGS
Spire Inc.	SR

9

10

11 **Q. WHAT PROXY GROUP DID MR. D’ASCENDIS USE IN HIS ANALYSIS?**

12 A. Mr. D’Ascendis utilized the following six companies in his Gas Utility Proxy
 13 Group (Valley Schedule DWD-2, p. 3):

Atmos Energy Corp.	ATO
New Jersey Resources Corp.	NJR
NiSource Inc.	NI
Northwest Natural Holding Co.	NWN
ONE Gas, Inc.	OGS
Spire, Inc.	SR

14

1 **Q. DO YOU AGREE WITH MR. D’ASCENDIS’ GAS PROXY GROUP?**

2 A. Not entirely. While we do have five companies that match, I use one company
3 that Mr. D’Ascendis does not, and he uses one company that I do not.

4

5 **Q. STATE THE COMPANY MR. D’ASCENDIS INCLUDED THAT YOU DID**
6 **NOT AND EXPLAIN WHY YOU HAVE EXCLUDED THAT COMPANY**
7 **FROM YOUR PROXY GROUP.**

8 A. Mr. D’Ascendis included New Jersey Resources Corp. in his Gas Group, and I
9 have excluded this company from my proxy group. I excluded New Jersey
10 Resources Corp. as it did not meet my first criterion that fifty percent or more of
11 the company’s revenues must be generated from the regulated gas utility industry.
12 This is important because revenues represent the percentage of cash flow a
13 company receives from each business line related to providing a good or service.
14 If less than fifty percent of revenues come from the regulated gas sector, the
15 company is not comparable to the subject utility as they do not provide a similar
16 level of regulated business.

17

18 **Q. STATE THE COMPANY YOU INCLUDED THAT MR. D’ASCENDIS**
19 **DOES NOT AND EXPLAIN WHY HE HAS EXCLUDED THAT**
20 **COMPANY FROM HIS GAS GROUP.**

21 A. I included Chesapeake Utilities, Corp. in my proxy group, and Mr. D’Ascendis did
22 not include this company in his Gas Group. Mr. D’Ascendis excluded Chesapeake
23 Utilities, Corp. as it violated his second criterion that the company has 60% or

1 greater of 2021 total operating income and 60% or greater of 2021 total assets
2 attributable to regulated gas distribution operations (I&E Exhibit No. 2, Schedule
3 3).
4

5 **CAPITAL STRUCTURE**

6 **Q. WHAT IS A CAPITAL STRUCTURE?**

7 A. A capital structure represents how a firm has financed its rate base with different
8 sources of funds. The primary funding sources are long-term debt and common
9 equity. A capital structure may also include preferred stock and/or short-term
10 debt.
11

12 **Q. WHAT IS THE COMPANY'S CLAIMED CAPITAL STRUCTURE?**

13 A. The Company's claimed *hypothetical* capital structure is summarized in the table
14 below (Valley Statement No. 2, p. 17, lines 8-10 and Valley Schedule DWD-1,
15 p. 1):

Type of Capital	Ratio
Long-Term Debt	50.47%
Common Equity	49.53%
Total	100.00%

16

1 **Q. WHAT IS THE BASIS FOR THE COMPANY’S CLAIMED CAPITAL**
2 **STRUCTURE?**

3 A. Mr. D’Ascendis stated that he utilized the capital structure of the Company’s
4 parent organization, C&T Enterprises. Mr. D’Ascendis stated that the Company’s
5 actual capital structure, which contained 63.89% common equity, is inappropriate
6 for ratemaking purposes as it contained a higher than necessary common equity
7 ratio which would result in a higher cost of capital that would need to be paid by
8 ratepayers. Mr. D’Ascendis also stated that his hypothetical capital structure is
9 reasonable, consistent, and within the range of capital structures in his Gas Utility
10 Proxy Group (Valley Statement No. 2, p. 17, line 5 through p. 18, line 5).

11

12 **Q. WHAT IS YOUR RECOMMENDATION REGARDING THE COMPANY’S**
13 **CAPITAL STRUCTURE?**

14 A. I recommend using the Company’s claimed hypothetical capital structure as
15 presented in the table above.

16

17 **Q. WHY ARE YOU ACCEPTING THE COMPANY’S RECOMMENDED**
18 **HYPOTHETICAL CAPITAL STRUCTURE?**

19 A. I agree with using the Company’s claimed capital structure as it falls within the
20 range of my proxy group’s 2021 capital structures, and I concur with Mr.
21 D’Ascendis that the Company’s actual capital structure would represent an
22 unreasonable burden to ratepayers. The 2021 range that I observed consists of

1 long-term debt ratios ranging from 35.93% to 60.71%, short-term debt ratios
2 ranging from 0.00% to 15.91%, and equity ratios ranging from 35.60% to 60.67%,
3 with a 2021 average of 47.95% for long-term debt, 8.74% for short-term debt, and
4 43.31% for common equity (I&E Exhibit No. 2, Schedule 2).

5
6 **COST OF LONG-TERM DEBT**

7 **Q. WHAT IS THE COMPANY'S CLAIMED COST RATE OF LONG-TERM**
8 **DEBT?**

9 A. The Company's claimed long-term debt cost rate is 4.49% for the FPFTY (Valley
10 Statement No. 2, p. 18, lines 8-9).

11
12 **Q. WHAT IS YOUR RECOMMENDATION REGARDING THE**
13 **COMPANY'S COST RATE OF LONG-TERM DEBT?**

14 A. I recommend using the Company's long-term debt cost rate of 4.49%.

15
16 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION TO USE THE**
17 **COMPANY'S COST RATE OF LONG-TERM DEBT?**

18 A. Although this falls outside my proxy group's implied long-term debt cost range of
19 1.74% to 3.96%, with an average implied long-term debt cost of 3.09% for 2021
20 (I&E Exhibit No. 2, Schedule 4), I recommend the Company's cost rate of long-
21 term debt be used as the data used to determine the long-term debt cost range does
22 not consider the current environment of increasing interest rates.

1 **COST OF COMMON EQUITY**

2 **COMMON METHODS**

3 **Q. WHAT METHODS ARE COMMONLY PRESENTED BY UTILITIES IN**
4 **DETERMINING THE COST OF COMMON EQUITY?**

5 A. Four methods commonly presented to estimate the cost of common equity are the
6 Discounted Cash Flow (DCF), the Capital Asset Pricing Model (CAPM), the Risk
7 Premium (RP) Method, and the Comparable Earnings (CE) Method.

8
9 **Q. WHAT IS THE THEORETICAL BASIS FOR THE DCF METHOD?**

10 A. The DCF method is the “dividend discount model” of financial theory, which
11 maintains that the value (price) of any security or commodity is the discounted
12 present value of all future cash flows. The DCF method assumes that investors
13 evaluate stocks in the classical economic framework, which maintains that the
14 value of a financial asset is determined by its earning power, or its ability to
15 generate future cash flows.

16
17 **Q. WHAT IS THE THEORETICAL BASIS FOR THE CAPM?**

18 A. The CAPM describes the relationship of a stock’s investment risk and its market
19 rate of return. It identifies the rate of return investors expect so that it is
20 comparable with returns of other stocks of similar risk. This method hypothesizes
21 that the investor-required return on a company’s stock is equal to the return on a
22 “risk free” asset plus an equity premium reflecting the company’s investment risk.

1 In the CAPM, two types of risk are associated with a stock: (1) firm-specific risk
2 (unsystematic risk); and (2) market risk (systematic risk), which is measured by a
3 firm's beta. The CAPM allows for investors to receive a return only for bearing
4 systematic risk. Unsystematic risk is assumed to be diversified away, and
5 therefore, does not earn a return.

6
7 **Q. WHAT IS THE THEORETICAL BASIS FOR THE RP METHOD?**

8 A. The theoretical basis for the RP method is a simplified version of the CAPM. The
9 RP method's theory is that common stock is riskier than debt, and thus, investors
10 require a higher expected return on stocks than bonds. In the RP approach, the
11 cost of equity is made up of the cost of debt and a risk premium. While the
12 CAPM uses the market risk premium, it also directly measures the systematic risk
13 of a company group through the use of beta. The RP method does not measure the
14 specific risk of a company.

15
16 **Q. WHAT IS THE THEORETICAL BASIS FOR THE CE METHOD?**

17 A. The CE method utilizes the concept of "opportunity cost." This means that
18 investors will likely dedicate their capital to the investment offering the highest
19 return with similar risk to alternative investments. Unlike the DCF, CAPM, and
20 the RP methods, the CE method is not market-based and relies upon historic
21 accounting data. The most problematic issue with the CE method is determining
22 what constitutes comparable companies.

1 **Q. WHAT METHOD DO YOU RECOMMEND USING TO DETERMINE AN**
2 **APPROPRIATE COST OF COMMON EQUITY FOR THE COMPANY?**

3 A. I recommend using the DCF method as the primary method to determine the cost
4 of common equity. I provide the results of my CAPM as a comparison and not as
5 a check to the DCF results. Although no one method can capture every factor that
6 influences an investor, including the results of methods that are less reliable than
7 the DCF does not make the end result more reliable or more accurate. My
8 recommendation is also consistent with the methodology historically used by the
9 Commission in base rate proceedings, even as recently as 2017, 2018, 2020, and
10 2021.¹

11
12 **Q. PLEASE EXPLAIN WHY YOU CHOSE TO USE THE DCF AND CAPM IN**
13 **YOUR ANALYSIS.**

14 A. I have used the DCF as the primary method for several reasons. First, the DCF is
15 appealing to investors as it is based upon the concept that the receipt of dividends
16 in addition to expected appreciation is the total return requirement determined by
17 the market.² Second, the use of a growth rate and expected dividend yield are also

¹ *Pa. PUC v. City of DuBois – Bureau of Water*; Docket No. R-2016-2554150 (Order Entered March 28, 2017). *See generally* Disposition of Cost Rate Models, pp. 96-97; *Pa. PUC v. UGI Utilities, Inc. – Electric Division*; Docket No. R-2017-2640058 (Order Entered October 25, 2018). *See generally* Disposition of Cost of Common Equity, p. 119; *Pa. PUC v. Wellsboro Electric Company*; Docket No. R-2019-3008208 (Order Entered April 29, 2020). *See generally* Disposition of Primary Methodology to Determine ROE, pp. 80-81; *Pa. PUC v. Citizens Electric Company of Lewisburg, PA*; Docket No. R-2019-3008212 (Order Entered April 29, 2020). *See generally* Disposition of Cost of Common Equity, pp. 91-92. *Pa. PUC v. Columbia Gas of Pennsylvania, Inc.*; Docket No. R-2020-3018835 (Order Entered February 19, 2021). *See generally* Disposition of Cost of Common Equity, p. 131.

² David C. Parcell, “The Cost of Capital – A Practitioner’s Guide,” 2010 Edition, p. 151.

1 strengths of the DCF, as this recognizes the time value of money and is forward-
2 looking. Third, the use of the utilities' own, or in this case, the proxy group's
3 stock prices and growth rates directly in the calculation also causes the DCF to be
4 industry and company specific. Fourth, the DCF method is the superior method
5 for determining the rate of return for the current economic market because it
6 measures the cost of equity directly. Finally, the DCF, through the use of a spot
7 stock price when determining the dividend yield and analysts who generate
8 forecasted earnings growth rates, almost certainly takes current inflationary trends
9 into consideration, therefore, it contains the most up-to-date projected information
10 of any model. Therefore, the DCF method is the superior method for determining
11 the rate of return for the current economic market because it measures the cost of
12 equity directly.

13
14 **Q. PLEASE EXPLAIN WHY YOU CHOSE TO USE THE CAPM AS A**
15 **COMPARISON IN YOUR ANALYSIS.**

16 A. I have included a CAPM analysis only as a comparison and not as a
17 recommendation because while both the CAPM and the DCF include inputs that
18 allow the results to be specific to the utility industry, the CAPM is far less
19 responsive to changes in the industry than the DCF. The CAPM is based on the
20 performance of U.S. Treasury bonds and the performance of the market as
21 measured through the S&P 500 and is company-specific only through the use of
22 beta. Beta reflects a stock's volatility relative to the overall market, thereby

1 incorporating an industry-specific aspect to the CAPM, but only as a measure of
2 how reactive the industry is compared to the market as a whole. Although
3 changes in the utility industry are more likely to be accurately reflected in the
4 DCF, which uses the companies' actual prices, dividends, and growth rates, I have
5 included the results of my CAPM analysis because changes in the market, whether
6 as a whole or specific to the utility industry, affect the outcome of each method in
7 different ways. Although I have provided the results of CAPM as a comparison
8 and not as a check, it does have several disadvantages and should not be given
9 comparable weight to the DCF method.

10
11 **Q. EXPLAIN THE DISADVANTAGES OF THE CAPM.**

12 A. The CAPM, and the RP method by virtue of its similarities to the CAPM, give
13 results that indicate to an investor what the equity cost rate should be if current
14 economic and regulatory conditions are the same as those present during the
15 historical period in which the risk premiums were determined. This is because
16 beta, which is the only company-specific variable in the CAPM model, measures
17 the *historical* volatility of a stock compared to the *historical* overall market return.
18 Reliance on historical values is especially problematic now given the recent
19 impact of the coronavirus on economic conditions. Although the CAPM and RP
20 results can be useful to investors in making rational buy and sell decisions within
21 their portfolios, the DCF method is the superior method for determining the rate of
22 return for the current economic market and measuring the cost of equity directly.

1 The CAPM and the RP methods are less reliable indicators because they measure
2 the cost of equity indirectly and risk premiums vary depending on the debt and
3 equity being compared. Also, regulators can never be certain that economic and
4 regulatory conditions underlying the historical period during which the risk
5 premiums were calculated are the same today or will be the same in the future.
6

7 **Q. IS THERE ANY ACADEMIC EVIDENCE THAT QUESTIONS THE**
8 **CREDIBILITY OF THE CAPM MODEL?**

9 A. Yes. An article, “Market Place; A Study Shakes Confidence in the Volatile-Stock
10 Theory,” which appeared in the *New York Times* on February 18, 1992,
11 summarized a CAPM study conducted by professors Eugene F. Fama and
12 Kenneth R. French.³ Their study examined the importance of beta, CAPM’s risk
13 factor, in explaining returns on common stock. In CAPM theory a stock with a
14 higher beta should have a higher expected return. However, they found that the
15 model did not do well in predicting actual returns and suggested the use of more
16 elaborate multi-factor models.

17 A more recent article, “The Capital Asset Pricing Model: Theory and
18 Evidence,” which appeared in the *Journal of Economic Perspectives*, states that
19 “the attraction of the CAPM is that it offers powerful and intuitively pleasing
20 predictions about how to measure risk and the relation between expected return

³ Berg, Eric N. “Market Place; A Study Shakes Confidence in the Volatile-Stock Theory” *The New York Times*, 18 Feb 1992: *nytimes.com* Web. 23 Mar 2016.

1 and risk. Unfortunately, the empirical record of the model is poor - poor enough
2 to invalidate the way it is used in applications.”⁴ As a result, I conclude that the
3 CAPM’s relevance to the investment decision making process does not carry over
4 into the regulatory rate setting process.

5
6 **Q. PLEASE EXPLAIN WHY YOU HAVE CHOSEN TO EXCLUDE THE RP**
7 **METHOD FROM YOUR ANALYSIS.**

8 A. The RP method is excluded because it is a simplified version of the CAPM and is
9 subject to the same faults listed above. Additionally, unlike the CAPM, the RP
10 method does not recognize company-specific risk through beta.

11
12 **Q. EXPLAIN WHY YOU HAVE CHOSEN TO EXCLUDE THE CE METHOD**
13 **FROM YOUR ANALYSIS.**

14 A. The CE method is excluded because the choice of which companies are
15 comparable is highly subjective, and it is debatable whether historic accounting
16 values are representative of the future. Moreover, its historical usage in this
17 regulatory forum has been minimal.

⁴ Fama, Eugene F. and French, Kenneth R., “The Capital Asset Pricing Model: Theory and Evidence.” *Journal of Economic Perspectives* (2004): Volume 18, Number 3, pp. 25-46.

1 **Q. ARE THERE ANY RECENT COMMISSION ORDERS THAT DEVIATE**
2 **FROM THE USE OF THE DCF AS THE PRIMARY METHOD IN**
3 **DETERMINING A COMPANY’S RETURN ON EQUITY?**

4 A. Yes. The Commission indicated in the most recent Aqua Pennsylvania, Inc.
5 (Aqua) base rate case order that its method “for determining Aqua’s ROE shall
6 utilize both I&E’s DCF and CAPM methodologies”⁵ and that “I&E’s DCF and
7 CAPM produce a range of reasonableness for the ROE...”⁶, which deviates from
8 prior Commission practice of primarily relying on the DCF.

9

10 **Q. SHOULD THE COMMISSION’S USE OF THE CAPM AS A CEILING**
11 **FOR A “RANGE OF REASONABLENESS” APPLY IN THIS**
12 **PROCEEDING?**

13 A. No. In a report issued by Regulatory Research Associates, a group within S&P
14 Global Market Intelligence,⁷ Aqua’s return on equity of 10.00% is stated as being
15 above the national average for water utility base rate cases and above the
16 Distribution System Improvement Charge (DSIC) authorized by the Commission
17 of 9.80%⁸ for water and wastewater utilities based on the year ended
18 September 30, 2021, issued at the Public Meeting held January 13, 2022. It should

⁵ *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket Nos. R-2021-3027385 & R-2021-3027386, pp. 154 (Order entered May 16, 2022).

⁶ *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket Nos. R-2021-3027385 & R-2021-3027386, pp. 178 (Order entered May 16, 2022).

⁷ Regulatory Research Associates, “Commission authorizes management performance bonus for Aqua Pennsylvania,” *S&P Global Market Intelligence*, May 16, 2022.

⁸ PA Public Utility Commission, Bureau of Technical Utility Services Report on the Quarterly Earnings of Jurisdictional Utilities for the Year Ended September 30, 2021, p. 27, approved at Public Meeting on January 13, 2022 at Docket No. M-2021-3030045.

1 be noted that since this above referenced report, the DSIC rate has remained
2 unchanged with the most recent report being issued by the Commission for water
3 and wastewater based on the year ended December 31, 2021, issued at the Public
4 Meeting held June 16, 2022.⁹ The above referenced Regulatory Research
5 Associates report also states that the average return on equity for water utility base
6 rate cases that have been completed during the first four months of 2022 was
7 9.63%, and for the last twelve months ended April 30, 2022 it was 9.53%, which
8 are well below the 10.00% return on equity authorized by the Commission for
9 Aqua. This demonstrates the problem associated with using the CAPM as a
10 ceiling for determining a utility's return on equity.

11 Additionally, as explained above, the CAPM should not be used as a
12 primary method, and it should only be used as a comparison (not as a check of the
13 DCF). Also, as demonstrated below, the use of the CAPM in this proceeding
14 would result in a significant burden to ratepayers during a time of increasing levels
15 of inflation and economic decline. Therefore, I disagree with providing the
16 CAPM comparable weight to the DCF method.

⁹ PA Public Utility Commission, Bureau of Technical Utility Services Report on the Quarterly Earnings of Jurisdictional Utilities for the Year Ended December 31, 2021, p. 27, approved at Public Meeting on June 16, 2022 at Docket No. M-2022-3032405.

1 **SUMMARY OF THE COMPANY’S RESULTS**

2 **Q. WHAT ARE THE RESULTS OF THE COMPANY’S COST OF EQUITY**
3 **ANALYSES?**

4 A. Mr. D’Ascendis used the DCF, CAPM, and the RP methods in analyzing Valley’s
5 cost of equity. Mr. D’Ascendis also used the Predictive Risk Premium Method
6 (PRPM) and the Empirical Capital Asset Pricing Model (ECAPM) in forming his
7 recommendations under the RP and the CAPM methods, respectively. Mr.
8 D’Ascendis applied these methods using his proxy group of regulated gas utilities
9 and averaged the results of the methods for his non-price regulated proxy group.
10 Mr. D’Ascendis then listed the results for each method for the regulated utility
11 group and the average of the median and mean of the results of the methods for the
12 non-price regulated group. Finally, he recommended that the cost of equity be
13 increased by 90 basis points due to Valley’s small size and five basis points for
14 management performance. Ultimately, Mr. D’Ascendis opined that a cost of
15 equity of 11.50% is warranted (Valley Statement No. 2, p. 3, line 5 through p. 6,
16 line 14 and Valley Schedule DWD-1, p. 2).

17
18 **I&E RECOMMENDATION**

19 **Q. WHAT IS YOUR RECOMMENDED COST OF COMMON EQUITY FOR**
20 **THE COMPANY?**

21 A. Based upon my analysis, I recommend a cost of common equity of 9.70% (I&E
22 Exhibit No. 2, Schedule 1).

1 **Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?**

2 A. My recommendation is based on the use of the DCF method. As explained above,
3 I used my CAPM result only to present to the Commission a comparison and not
4 as a check to my DCF results. My DCF analysis uses a spot dividend yield, a 52-
5 week dividend yield, and earnings growth forecasts.

6

7 **DISCOUNTED CASH FLOW**

8 **Q. PLEASE EXPLAIN YOUR DCF ANALYSIS.**

9 A. My analysis employs the constant growth DCF model as portrayed in the
10 following formula:

11
$$K = D_1/P_0 + g$$

12 Where:

13 K = Cost of equity

14 D₁ = Dividend expected during the year

15 P₀ = Current price of the stock

16 g = Expected growth rate

17 When a forecast of D₁ is not available, D₀ (the current dividend) must be adjusted
18 by one half of the expected growth rate to account for changes in the dividend paid
19 in period one. As forecasts for each company in my proxy group were available
20 from Value Line, no dividends were adjusted for the purpose of my analysis.

1 **Q. PLEASE EXPLAIN HOW YOU DEVELOPED THE DIVIDEND YIELDS**
2 **USED IN YOUR DCF ANALYSIS.**

3 A. A representative dividend yield must be calculated over a time frame that avoids
4 the problems of both short-term anomalies and stale data series. For my DCF
5 analysis, the dividend yield calculation places equal emphasis on the most recent
6 spot and the 52-week average dividend yields. The following table summarizes
7 my dividend yield computations for the proxy group (I&E Exhibit No. 2,
8 Schedule 5):

Six-Company Proxy Group	Dividend Yield
Spot	3.01%
52-week average	3.22%
Average	3.12%

9
10

11 **Q. WHAT INFORMATION DID YOU RELY UPON TO DETERMINE YOUR**
12 **EXPECTED GROWTH RATE?**

13 A. I have used five-year projected growth rate estimates from Value Line, Yahoo!
14 Finance, Zacks, and Morningstar.

15

16 **Q. WHAT WERE THE RESULTS OF YOUR FORECASTED EARNINGS**
17 **GROWTH RATES?**

18 A. The expected average growth rates for the six-company proxy group ranged

1 from 3.70% to 10.50% with an overall average of 6.58% (I&E Exhibit No. 2,
2 Schedule 6).

3

4 **Q. WHAT IS THE RESULT OF YOUR DCF ANALYSIS BASED ON YOUR**
5 **RECOMMENDED DIVIDEND YIELD AND GROWTH RATE?**

6 A. The results of my DCF analysis are calculated as follows (I&E Exhibit No. 2,
7 Schedule 7):

$$\begin{array}{rcccl} K & = & D_1/P_0 & + & g \\ 9.70\% & = & 3.12\% & + & 6.58\% \end{array}$$

8

9

10 **Q. DOES THE DCF ADEQUATELY FACTOR IN RECENT INFLATIONARY**
11 **TRENDS?**

12 A. Yes. My DCF calculation includes a spot stock price when determining the
13 dividend yield and analysts who generate forecasted earnings growth rates almost
14 certainly take inflation into consideration as well; therefore, it contains the most
15 up-to-date projected information of any model. Thus, any potential concerns that
16 the Commission should consider the overall economic climate and related inflation
17 when deciding the merits of the Company's requested base rate increase are
18 adequately covered by use of the DCF as a primary model for determining an
19 appropriate return on equity.

1 **CAPITAL ASSET PRICING MODEL**

2 **Q. PLEASE EXPLAIN YOUR CAPM ANALYSIS.**

3 A. My analysis employs the traditional CAPM as portrayed in the following formula:

4 $K = R_f + \beta(R_m - R_f)$

5 Where:

6 K = Cost of equity

7 R_f = Risk-free rate of return

8 R_m = Expected rate of return on the overall stock market

9 β = Beta measures the systematic risk of an asset

10
11 **Q. WHAT IS BETA AS EMPLOYED IN YOUR CAPM ANALYSIS?**

12 A. Beta is a measure of the systematic risk of a stock in relation to the rest of the
13 stock market. A stock's beta is estimated by calculating the linear regression of a
14 stock's return against the return on the overall stock market. The beta of a stock
15 with a price pattern identical to that of the overall stock market will equal one. A
16 stock with a price movement that is greater than the overall stock market will have
17 a beta that is greater than one and would be described as having more investment
18 risk than the market. Conversely, a stock with a price movement that is less than
19 the overall stock market will have a beta of less than one and would be described
20 as having less investment risk than the market.

1 **Q. HOW DID YOU DETERMINE BETA FOR YOUR CAPM ANALYSIS?**

2 A. In estimating an equity cost rate for my proxy group of six gas companies, I used
3 the average of the betas for the companies as provided in the Value Line
4 Investment Survey. The average beta for my proxy group is 0.82 (I&E Exhibit
5 No. 2, Schedule 8).

6
7 **Q. WHAT RISK-FREE RATE OF RETURN HAVE YOU USED FOR YOUR**
8 **FORECASTED CAPM ANALYSIS?**

9 A. I used the risk-free rate of return (R_f) from the projected yield on 10-year Treasury
10 Notes. While the yield on the short-term T-Bill is a more theoretically correct
11 parameter to represent a risk-free rate of return, it can be extremely volatile. The
12 volatility of short-term T-Bills is directly influenced by Federal Reserve policy.
13 At the other extreme, the 30-year Treasury Bond exhibits more stability but is not
14 risk-free. Long-term Treasury Bonds have substantial maturity risk associated
15 with market risk and the risk of unexpected inflation. Long-term treasuries
16 normally offer higher yields to compensate investors for these risks. As a result, I
17 used the yield on the 10-year Treasury Note because it mitigates the shortcomings
18 of the other two alternatives. Additionally, the Commission has recognized the
19 10-year Treasury Note as the superior measure of the risk-free rate of return.¹⁰

¹⁰ *Pa. PUC v. UGI Utilities, Inc. – Electric Division*; Docket No. R-2017-2640058 (Order Entered October 25, 2018).
See generally Disposition of Capital Asset Pricing Model (CAPM), p. 99.

1 The forecasted yield on the 10-year Treasury Note, as can be seen in Blue
2 Chip Financial Forecasts, is expected to be between 3.00% and 3.30% from the
3 third quarter of 2022 through the third quarter of 2023, and it is forecasted to be
4 2.90% from 2023-2027. For my forecasted CAPM analysis, I used 3.15%, which
5 is the average of all the yield forecasts I observed (I&E Exhibit No. 2,
6 Schedule 9).

7
8 **Q. HOW DID YOU DETERMINE THE RETURN ON THE OVERALL**
9 **STOCK MARKET IN YOUR FORECASTED CAPM ANALYSIS?**

10 A. To arrive at a representative expected return on the overall stock market, I
11 observed Value Line's 1700 stocks and the S&P 500. Value Line expects its
12 universe of 1700 stocks to have an average yearly return of 16.29% over the next
13 three to five years based on a forecasted dividend yield of 2.10% and a yearly
14 index appreciation of 70%. The S&P 500 index is expected to have an average
15 yearly return of 15.33% over the next five years based upon Barron's forecasted
16 dividend yield of 1.53% and Morningstar's average expected increase in the S&P
17 500 index of 13.70% (I&E Exhibit No. 2, Schedule 10).

18
19 **Q. WHAT IS THE EXPECTED RETURN ON THE OVERALL STOCK**
20 **MARKET BASED ON YOUR FORECASTED ANALYSIS?**

21 A. The expected return on the overall market is 15.81% for my forecasted analysis
22 (I&E Exhibit No. 2, Schedule 10).

1 **Q. WHAT IS THE COST OF EQUITY RESULT FROM YOUR CAPM**
2 **ANALYSIS?**

3 A. The result of my analysis is as follows (I&E Exhibit No. 2, Schedule 11):

$$4 \quad K = R_f + \beta(R_m - R_f)$$
$$5 \quad 13.53\% = 3.15\% + 0.82(15.81\% - 3.15\%)$$

6
7 **Q. DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING YOUR**
8 **CAPM ANALYSIS?**

9 A. Yes. As discussed earlier in my testimony, my recommended cost of equity is
10 based upon my DCF analysis. I only present a CAPM analysis to the Commission
11 as a comparison and not for recommendation purposes as the inputs are highly
12 subjective, and other than beta, not company or industry specific. Again, it has
13 been the historical preference of the Commission to view both the DCF and
14 CAPM analysis in base rate proceedings.

15
16 **Q. IS IT NECESSARY OR APPROPRIATE TO APPLY THE CAPM WITH**
17 **SIMILAR WEIGHT TO THE DCF WHEN DETERMINING A SPECIFIC**
18 **RETURN ON EQUITY DUE TO RECENT INFLATIONARY TRENDS?**

19 A. No. My use of the DCF as a primary method in determining an appropriate return
20 on equity sufficiently takes this into consideration. As mentioned above, the DCF
21 includes a spot stock price in the dividend yield calculation and analysts who
22 generate forecasted earnings growth almost certainly take inflation into

1 consideration as well, so it contains the most up-to-date projected information of
 2 any model. In other words, the inputs of the DCF capture all known economic
 3 factors, including inflation.

4
 5 **Q. BASED ON THE COMPANY'S AS-FILED RATE BASE AND CLAIMED**
 6 **CAPITAL STRUCTURE, WHAT IS THE VALUE OF AN ADDITIONAL**
 7 **383 BASIS POINTS TO THE COST OF EQUITY BASED ON THE**
 8 **DIFFERENCE IN RESULTS BETWEEN YOUR CAPM ANALYSIS**
 9 **(13.53%) AND YOUR DCF ANALYSIS (9.70%)?**

10 A. The example below illustrates the impact of 383 additional basis points to Valley's
 11 cost of equity if the results of my CAPM analysis, rather than my DCF results
 12 were applied to Valley's as-filed rate base:

Valley Energy, Inc.	
Claimed Equity Percentage of Capital Structure	49.53%
Difference in Return on Equity between I&E CAPM and DCF Analysis (13.53% - 9.70% = 3.83%)	383
Claimed Rate Base*	\$19,775,484
Impact Prior to Gross Revenue Conversion Factor (0.4953 x 0.0383 x \$19,775,484)	\$375,141
Gross Revenue Conversation Factor**	1.41587063
Total Impact (1.41587063 x \$375,141)	\$531,151
*(Valley Exhibit (HSG-1), Schedule C1 (CU))	
**(I&E Exhibit No. 2, Schedule 12)	

1 In this example, an addition of 383 basis points to the cost of equity would burden
2 ratepayers to fund an additional amount of \$531,151. In short, I believe it is
3 inappropriate to use the CAPM as the top end of a range as was done by the
4 Commission in the recent Aqua rate case in determining a return on equity.
5 Contrary to the 383-basis point spread in this proceeding as illustrated above, the
6 spread between the DCF and the CAPM in the Aqua case was much less
7 substantial at 99 basis points.¹¹ Any amount granted above the DCF (9.70% based
8 on my recommendation) places an inappropriate burden on ratepayers.

9
10 **CRITIQUE OF MR. D’ASCENDIS’ PROPOSED COST OF EQUITY**

11 **Q. DO YOU AGREE WITH MR. D’ASCENDIS’ PROPOSED COST OF**
12 **EQUITY?**

13 A. No. Several factors cause Mr. D’Ascendis’ claimed cost of equity to be
14 overstated. First, I disagree with the weight given to his CAPM and RP methods.
15 Within his RP analysis, Mr. D’Ascendis relies upon proprietary software that is
16 not commonly used by investors making investment decisions. Additionally, Mr.
17 D’Ascendis relies upon a proxy group comprised of companies that are not
18 regulated gas utilities. Finally, Mr. D’Ascendis makes unsupported size and
19 performance factor adjustments to the results of his analyses, both of which serve
20 to inflate his recommendation.

¹¹ *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket Nos. R-2021-3027385 & R-2021-3027386, pp. 178 (Order entered May 16, 2022).

1 Notably, although Mr. D’Ascendis and I have different implementations of
2 our DCF and CAPM methods. The results of his DCF and CAPM are 9.76% and
3 11.75% respectively, while the results of my DCF and CAPM are 9.70% and
4 13.53% respectively. While I don’t necessarily agree with the specific variables or
5 applications of these methods, such as his use of a 30-year Treasury Bond and
6 ECAPM, any specific critiques of his DCF and CAPM analyses are unnecessary in
7 this proceeding. The above CAPM analysis by Mr. D’Ascendis and myself
8 demonstrate that the CAPM is unreliable, highly subjective, easy to manipulate
9 based on the time frames chosen and sources used, and other than beta, the CAPM
10 is not company or industry specific. Whereas our DCF results demonstrate the
11 DCF method’s consistency and reliability.

12
13 **WEIGHTS GIVEN TO THE CAPM AND RP METHODS**

14 **Q. DO YOU AGREE WITH MR. D’ASCENDIS’ RELIANCE ON THE CAPM**
15 **AND RP MODELS?**

16 A. No. While I am not opposed to providing the Commission the results of the
17 CAPM for a point of comparison to the results of the DCF calculation, I am
18 opposed to giving the CAPM and RP considerable weight. For the reasons
19 discussed above, including my reference to recent Commission orders, it is not
20 appropriate to give the CAPM and RP models similar weight to the DCF as Mr.
21 D’Ascendis has done in creating his recommended cost of equity range (Valley
22 Statement No. 2, p. 5, line 11). As discussed above, the CAPM measures the cost

1 of equity indirectly and can be manipulated by the time period chosen. Since the
2 RP is a simplified version of the CAPM, it suffers these same flaws. Also, the
3 results of the lesser-used ECAPM and PRPM models should also be rejected. I
4 have not used the ECAPM because it only weights the results of the CAPM in
5 order to flatten the Security Market Line, but it does not correct the previously
6 discussed problems with the CAPM. Finally, as discussed in more detail below, I
7 have not used Mr. D'Ascendis' Predicative Risk Premium Model, because it is not
8 a widely accepted method and investors must have a statistical software package
9 to use the PRPM.

11 **PREDICTIVE RISK PREMIUM MODEL**

12 **Q. WHAT IS THE PREDICTIVE RISK PREMIUM MODEL?**

13 A. The PRPM is a method published in August 2011 by Pauline M. Ahern, Frank J.
14 Hanley, and Richard A. Michelfelder in the article *New Approach to Estimating*
15 *the Cost of Common Equity Capital for Public Utilities*.¹² Mr. D'Ascendis' PRPM
16 requires Eviews[®] statistical software to compute (Valley Statement No. 2, pp. 24-
17 26).

19 **Q. DO YOU AGREE WITH MR. D'ASCENDIS' USE OF THE PRPM?**

20 A. No. Mr. D'Ascendis' PRPM is not a commonly used method and cannot be

¹² Ahern, Pauline M., Hanley, Frank J., Michelfelder, Richard A. (December 2011, Volume 40, Issue 3). *New Approach to Estimating the Cost of Common Equity Capital for Public Utilities*. Journal of Regulatory Economics, pp. 261-278.

1 evaluated or recreated without the software. I am also unaware of any state that
2 has accepted the use of the PRPM. Finally, the PRPM does not solve the problem
3 of the RP method because it is still an indirect measure of the cost of equity, and
4 the PRPM complicates the RP method with the introduction of a measurement that
5 requires the use of specialized software.

6
7 **DOMESTIC NON-PRICE REGULATED COMPANIES**

8 **Q. DOES MR. D'ASCENDIS RELY ON ANY MARKET DATA INPUTS**
9 **SPECIFIC TO COMPANIES THAT ARE NOT REGULATED UTILITIES?**

10 A. Yes. Mr. D'Ascendis asserted that in the *Hope* and *Bluefield* cases, the U.S.
11 Supreme Court did not specify that comparable risk companies had to be utilities.
12 Consequently, he assembled a proxy group consisting of 38 non-price regulated
13 firms which he asserts are comparable in terms of total risk to the Gas Utility
14 Proxy Group (Valley Statement No. 2, pp. 45-49). After forming his proxy group
15 of 38 non-price regulated firms, Mr. D'Ascendis calculated common equity costs
16 with data inputs specific to these companies using the DCF, RP, and CAPM
17 methods (Valley Schedule DWD-7). The average of the mean and median results
18 of these analyses of 12.04% was incorporated into Mr. D'Ascendis' final
19 calculation of the Company's return on equity of 11.50% (Valley Schedule DWD-
20 1, p. 2).

1 **Q. DO YOU AGREE WITH MR. D’ASCENDIS’ APPROACH OF USING THE**
2 **MARKET DATA OF NON-UTILITY COMPANIES TO CALCULATE**
3 **VALLEY’S RETURN ON EQUITY?**

4 A. No. The process of choosing a proxy group of non-utility companies similar in
5 risk to Valley is highly speculative and subjective. In effect, Mr. D’Ascendis
6 blends the CE approach into the DCF, RP, and CAPM models. As stated earlier,
7 the Commission has ruled on the use of the CE approach, specifically, the use of
8 non-utility companies in comparable groups, and stated,

9 The use of nonregulated companies as a comparable group for
10 regulated firms requires numerous unsupportable assumptions
11 which results in a highly speculative finding.¹³

12 Additionally, in the UGI Electric case, the Commission made the following
13 comments regarding the CE method, specifically, the use of non-utility companies
14 in comparable groups, and stated,¹⁴

15 With respect to the CE method, as noted above, this cost of
16 equity method utilizes data for non-regulated firms. Thus, by
17 its very nature, determining which companies are comparable
18 is entirely subjective. In addition, the record indicates that the
19 companies UGI utilized in its CE group results in the selection
20 of companies such as Coca-Cola Company, Kellogg Company,
21 and Walmart Stores, Inc....Each of these companies operate in
22 industries that are very different from a utility company and
23 have significantly more competition, which would require a
24 higher return for the associated additional risk.

¹³ *Pennsylvania Public Utility Commission v. Philadelphia Electric Co.* 33 PUR 4th 319, 341 (Pa PUC 1980).

¹⁴ *Pa. PUC v. UGI Utilities, Inc. – Electric Division*; Docket No. R-2017-2640058 (Order entered October 25, 2018), p. 105. The Commission has also ruled “[t]he use of nonregulated companies as a comparable group for regulated firms requires numerous unsupportable assumptions which results in a highly speculative finding.” *Pennsylvania Public Utility Commission v. Philadelphia Electric Co.* 33 PUR 4th 319, 341 (Pa PUC 1980).

1 If the non-price regulated company proxy group is truly similar in total risk to
2 Valley, I would expect to see similar results in the calculation of the DCF, RP, and
3 CAPM between the Gas Utility and Non-Price Regulated Company proxy groups
4 used by Mr. D’Ascendis. However, two of the three Non-Price Regulated
5 Company proxy groups results were significantly higher. This clearly
6 demonstrates the Commission’s ruling that “the use of non-regulated companies as
7 a comparable group for regulated firms results in a highly speculative finding.”
8

9 **SIZE ADJUSTMENT**

10 **Q. WHAT SIZE ADJUSTMENT HAS MR. D’ASCENDIS PROPOSED?**

11 A. Mr. D’Ascendis added 90 basis points to his cost of common equity because he
12 opined that smaller companies are less able to cope with significant events
13 affecting sales, revenues, or earnings. He further stated that the loss of revenue
14 from a few larger customers would have a greater effect on a small company. Mr.
15 D’Ascendis relied upon technical literature, including Duff & Phelps’ 2020
16 Valuation Handbook – U.S. Guide to Cost of Capital (D&P – 2020), a Fama and
17 French study entitled “The Capital Asset Pricing Model: Theory & Evidence” and
18 Professor Eugene Brigham’s textbook entitled “Fundamentals of Finance
19 Management.” Mr. D’Ascendis quantified his size adjustment based on size
20 premiums for portfolios of New York Stock Exchange, American Stock Exchange,
21 and NASDAQ listed companies ranked by deciles for the 1926 to 2020 period.
22 While Mr. D’Ascendis’ gas proxy group companies fell in the 4th decile, he

1 asserted that Valley fell in the 10th decile for size. He stated that while this
 2 indicates an upward equity risk premium adjustment of 426 basis points, he chose
 3 an upward adjustment of 90 basis points. Finally, Mr. D’Ascendis points to a
 4 2019 Commission order where the Commission considered a size adjustment
 5 (Valley Statement No. 2, pp. 51-56).

6
 7 **Q. BASED ON THE COMPANY’S FILED RATE BASE AND CLAIMED**
 8 **CAPITAL STRUCTURE, WHAT IS THE VALUE OF AN ADDITIONAL 90**
 9 **BASIS POINTS TO THE COST OF EQUITY?**

10 A. The example below illustrates the impact of 90 additional basis points to the
 11 Company’s cost of equity:

Valley Energy, Inc.	
Claimed Equity Percentage of Capital Structure	49.53%
Additional Points to Calculated Cost of Equity	90
Claimed Rate Base*	\$19,775,484
Impact Prior to Gross Revenue Conversion Factor (0.4953 x 0.0090 x \$19,775,484)	\$88,153
Gross Revenue Conversation Factor**	1.41587063
Total Impact (1.41587063 x \$88,153)	\$124,813
** (Valley Exhibit (HSG-1), Schedule C1 (CU))	
** (I&E Exhibit No. 2, Schedule 12)	

12

1 In this example, an addition of 90 basis points to the cost of equity would force
2 ratepayers to fund an unwarranted additional amount of \$124,813. Furthermore,
3 Valley is requesting an increase in revenue of \$999,631 (Valley Schedule B4
4 (CU)) in this proceeding and Mr. D'Ascendis' size adjustment represents
5 approximately 12.5% ($\$124,813 \div \$999,631$) of Valley's requested increase in
6 revenue.

7
8 **Q. DO YOU AGREE WITH MR. D'ASCENDIS' SIZE ADJUSTMENT?**

9 A. No. Mr. D'Ascendis' proposed size adjustment is unnecessary because the
10 technical literature he cited supporting investment adjustments related to the size
11 of a company is not specific to the utility industry; therefore, it has no relevance in
12 this proceeding.

13
14 **Q. IS THERE ACADEMIC EVIDENCE THAT SUPPORTS YOUR**
15 **CONCLUSION THAT THE SIZE ADJUSTMENT FOR RISK IS NOT**
16 **APPLICABLE TO UTILITY COMPANIES?**

17 A. Yes. In the article "Utility Stocks and the Size Effect: An Empirical Analysis,"
18 Dr. Annie Wong concludes,

19 The objective of this study is to examine if the size effect exists
20 in the utility industry. After controlling for equity values, there
21 is some weak evidence that firm size is a missing factor from
22 the CAPM for the industrial but not for utility stocks. This
23 implies that although the size phenomenon has been strongly

1 documented for the industriales, the findings suggest that there
2 is no need to adjust for the firm size in utility rate regulation.¹⁵

3 Valley has presented no evidence to support application of a non-utility study
4 regarding a size adjustment for risk to a utility setting. Absent any credible article
5 to refute Dr. Wong’s findings, Mr. D’Ascendis’ size adjustment to his cost of
6 common equity results should be rejected. Furthermore, the Commission has
7 rejected the application of a size adjustment to the cost of equity calculation.¹⁶

8
9 **Q. DID THE COMMISSION AWARD A SIZE ADJUSTMENT IN THE**
10 **REFERENCED COMMISSION ORDER FOR CITIZENS’ ELECTRIC**
11 **COMPANY?**

12 A. No. The Commission did not, in fact, award an explicit 100-basis point size
13 adjustment as the Commission determined that there was not enough evidence as
14 to whether size is specifically a risk for utilities,

15 Consistent with the foregoing discussion, like the ALJs, we
16 shall not specify an exact size adjustment. Instead, we shall
17 adopt the ALJs’ recommendation that Citizens’ be awarded a
18 DCF cost of common equity of 9.49%. In our view, this cost
19 of equity is reasonable and strikes an appropriate balance by
20 recognizing the general inverse relationship between a
21 company’s size and its risk, while acknowledging that there is
22 not substantial evidence in the record to prove that an explicit
23 size basis point adjustment is warranted in this case.¹⁷

¹⁵ Dr. Annie Wong, “Utility Stocks and the Size Effect: An Empirical Analysis,” *Journal of Midwest Finance Association* 1993, pp. 95-101.

¹⁶ *Pa. PUC v. UGI Utilities, Inc. – Electric Division*; Docket No. R-2017-2640058 (Order Entered October 25, 2018). *See generally* Disposition of Capital Asset Pricing Model (CAPM), p. 100.

¹⁷ *Pa. PUC v. Citizens Electric Company of Lewisburg, PA*; Docket No. R-2019-3008212 (Order Entered April 29, 2020). *See generally* Disposition of Cost of Common Equity, pp. 103-104.

1 **MANAGEMENT PERFORMANCE**

2 **Q. WHAT IS THE COMPANY’S CLAIM REGARDING MANAGEMENT**
3 **PERFORMANCE.**

4 A. Mr. D’Ascendis explains that his 11.50% cost of equity recommendation includes
5 5 basis points in consideration of the Company’s exemplary management
6 performance. Mr. D’Ascendis also points to two 2019 Commission orders where
7 the Commission considered management performance adjustment (Valley
8 Statement No. 2, p. 56, lines 3-18). To support this claim, the Company states that
9 Valley’s management performance is demonstrated through. among other things,
10 replacing all cast-iron, bare-steel and the majority of its vintage plastic mains
11 without assessing a DSIC, low customer complaints, its emergency response,
12 favorable customer feedback, its adoption of Smarthub, its Pipeline Investment
13 Program grant for its East Athens expansion, low lost and unaccounted for gas,
14 and its customer service representative efforts to assist payment troubled accounts
15 during the COVID-19 pandemic (Valley Statement No. 2, pp. 8-11)

16
17 **Q. BASED ON THE COMPANY’S FILED RATE BASE AND CLAIMED**
18 **CAPITAL STRUCTURE, WHAT IS THE VALUE OF AN ADDITIONAL**
19 **5 BASIS POINTS TO THE COST OF EQUITY?**

20 A. The example below illustrates the impact of 5 additional basis points to the
21 Company’s cost of equity:

1

Valley Energy, Inc.

Claimed Equity Percentage of Capital Structure	49.53%
Additional Points to Calculated Cost of Equity	5
Claimed Rate Base*	\$19,775,484

Impact Prior to Gross Revenue Conversion Factor (0.4953 x 0.0005 x \$19,775,484)	\$4,897
---	----------------

Gross Revenue Conversation Factor**	1.41587063
-------------------------------------	------------

Total Impact (1.41587063 x \$4,897)	\$6,934
--	----------------

* (Valley Exhibit (HSG-1), Schedule C1 (CU))

** (I&E Exhibit No. 2, Schedule 12)

2 In this example, an addition of 5 basis points to the cost of equity would force
3 ratepayers to fund an unwarranted additional amount of \$6,934.

4

5 **Q. DO YOU AGREE WITH THE COMPANY’S CLAIMS REGARDING**
6 **MANAGEMENT PERFORMANCE?**

7 A. No. By awarding the Company management performance points, it will cost the
8 customer money for the Company to provide the adequate, efficient, safe, and
9 reasonable service that they are required to do. Any savings from effective
10 operating and maintenance cost measures should flow through to ratepayers and/or
11 investors. These claimed savings would likely be offset by the addition of basis
12 points for management performance as ratepayers would have to fund the

1 additional costs. This defeats the purpose of cutting expenses to benefit
2 ratepayers.

3
4 **Q. ARE YOU AWARE OF ANY OTHER COMPANIES THAT HAVE**
5 **RECEIVED ADDITIONAL BASIS POINTS IN RECOGNITION OF**
6 **MANAGEMENT PERFORMANCE?**

7 A. Yes. In the most recent litigated Aqua base rate case, the Commission awarded
8 Aqua an addition of 25 basis points for its management performance efforts.¹⁸
9 However, it is important to recognize that this addition was based specifically on
10 Aqua rescuing troubled water and wastewater systems at the Commission's
11 request. In this proceeding, the Commission stated the following:¹⁹

12 We specifically recognize Aqua's efforts and willingness to
13 quickly provide emergency aid to various water and
14 wastewater systems that needed substantial improvement.
15 Aqua has often provided this emergency aid on short notice
16 and at the request of the Commission or other parties to protect
17 the public from egregious health and safety threats and to
18 protect the Commonwealth's drinking water resources from
19 catastrophic damage.

¹⁸ *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket Nos. R-2021-3027385 & R-2021-3027386, pp. 168-173 (Order entered May 16, 2022).

¹⁹ *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket Nos. R-2021-3027385 & R-2021-3027386, p. 169 (Order entered May 16, 2022).

1 **Q. DOES THE COMMISSION’S RECENT AWARD OF ADDITIONAL**
2 **EQUITY POINTS TO RECOGNIZE MANAGEMENT PERFORMANCE**
3 **MEAN THAT VALLEY SHOULD ALSO RECEIVE AN ADJUSTED**
4 **RETURN ON EQUITY?**

5 A. No. The issuance of equity points to recognize management performance must
6 always be done on a case-by-case basis. The situation in the Aqua case was very
7 specific to the company rescuing troubled water and wastewater systems and
8 preventing health and safety concerns regarding drinking water. This scenario
9 does not apply to Valley. Management performance is something that is very
10 specific to each individual utility. Therefore, what the Commission has
11 historically decided in this regard, and the management performance of other
12 utilities, has no bearing on whether Valley should receive a higher return on equity
13 to recognize its management performance.

14
15 **Q. WHAT IS YOUR RECOMMENDATION REGARDING THE**
16 **CONSIDERATION OF 5 ADDITIONAL BASIS POINTS FOR THE**
17 **COMPANY’S MANAGEMENT PERFORMANCE?**

18 A. Ultimately, for any company, true management performance is earning a higher
19 return through its efficient use of resources and cost cutting measures. The greater
20 net income resulting from cost savings and true efficiency in management and
21 operations is available to be passed on to shareholders. Valley, or any utility,
22 should not be awarded additional basis points for doing what they are required to
23 do in order to provide adequate, efficient, safe, and reasonable service under 66 Pa

1 C.S.A. §1501 especially when compared to the reasons stated above by the
2 Commission for awarding Aqua management performance points.

3
4 **OVERALL RATE OF RETURN RECOMMENDATION**

5 **Q. WHAT IS THE COMPANY’S PROPOSED OVERALL RATE OF**
6 **RETURN?**

7 A. The Company’s proposed overall rate of return is 7.97% (Valley Statement No. 2,
8 p. 4, line 2).

9
10 **Q. WHAT IS I&E’S RECOMMENDED OVERALL RATE OF RETURN?**

11 A. I recommend an overall rate of return for the Company of 7.07% (I&E Exhibit
12 No. 2, Schedule 1).

13
14 **Q. DO YOU HAVE ANY FINAL COMMENTS REGARDING THE**
15 **COMPANY’S PROPOSED RETURN ON EQUITY?**

16 A. Yes. First, a report issued by Regulatory Research Associates, a group within
17 S&P Global Market Intelligence,²⁰ illustrates that Valley Energy, Inc.’s 11.50%
18 requested return on equity is a significant 112 basis points higher than the average
19 return on equity request of 10.38% of all pending nationwide gas utility rate cases

²⁰ Regulatory Research Associates, “Major energy utility cases in progress in the US, Quarterly update on pending rate cases,” *S&P Global Market Intelligence*, June 16, 2022.

1 as of June 9, 2022. It is also important to note here that Pennsylvania is a
2 deregulated state, which would indicate less risk.

3 Second, when asked, Mr. D’Ascendis indicated he was unaware if any
4 natural gas distribution utilities throughout the United States were granted a
5 Commission authorized return of 11.50% or higher cost of common equity in the
6 past two years (I&E Exhibit No. 2, Schedule 13).

7 Third, as discussed earlier in my testimony, Valley’s requested return on
8 common equity is 135 basis points higher than the Commission’s approved DSIC
9 rate of 10.15%²¹ for gas distribution companies. My understanding is that the
10 DSIC rate is designed to encourage its use and to incentivize accelerated pipeline
11 replacement and infrastructure upgrades to bring the existing aging infrastructure
12 closer to meeting safety and reliability requirements in between base rate filings.
13 Additionally, the DSIC rate establishes a benchmark above which a utility
14 company is considered “overearning.” To recommend a cost of equity that is
15 above the DSIC rate in this base rate proceeding is inappropriate and not in the
16 public interest.

17 Finally, while I am aware of the rising costs of capital due to the after-
18 effects of the pandemic and increasing levels of inflation, I believe it is important
19 not to overburden ratepayers. While the economy is in decline, Valley is
20 requesting a record return on equity to apply to its capital structure. As detailed in

²¹ PA Public Utility Commission, Bureau of Technical Utility Services Report on the Quarterly Earnings of Jurisdictional Utilities for the Year Ended December 31, 2021, p. 23, approved at Public Meeting on June 16, 2022 at Docket No. M-2022-3032405.

1 the various charts above, the effect of Mr. D'Ascendis' adjustments to the market-
2 determined cost of common equity are an enormous burden to ratepayers and are
3 completely unwarranted and unnecessary. Although they are not cumulative, the
4 impact to ratepayers of each of the disputed adjustments is summarized as follows:

Adjustment	Total Impact
Size Adjustment	\$124,813
Management Adjustment	\$6,934

5

6

7 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

8 A. Yes.

Professional and Educational Experience
Christopher Keller

Professional Experience

January 2014 to Present
Fixed Utility Financial Analyst
Pennsylvania Public Utility Commission, Harrisburg, Pennsylvania
Bureau of Investigation & Enforcement

September 2008 to January 2014
Insurance Company Financial Analyst
Pennsylvania Insurance Department, Harrisburg, Pennsylvania
Bureau of Licensing & Financial Analysis

Education and Training

FAI Utility Finance and Accounting for Financial Professionals, Boston, MA
May 21-23, 2014

York College of Pennsylvania, York, Pennsylvania
Master of Business Administration, Finance Concentration, 2008
Bachelor of Science, Accounting, 2006

Testimony Submitted

I have testified and/or submitted testimony in the following proceedings:

- Docket No. R-2022-3031704 – Borough of Ambler – Water Department (ROR)
- Docket No. R-2022-3032242 – UGI Utilities, Inc. – Gas Division (1307(f))
- Docket No. R-2022-3031211 – Columbia Gas of Pennsylvania, Inc. (ROR)
- Docket No. A-2021-3026132 – Aqua Pennsylvania Wastewater, Inc. – Acquisition of the Wastewater Collection and Conveyance System Assets of East Whiteland Township (1329)
- Docket No. P-2021-3030012 – Metropolitan Edison Company (DSP)
- Docket No. P-2021-3030013 – Pennsylvania Electric Company (DSP)
- Docket No. P-2021-3030014 – Pennsylvania Power Company (DSP)
- Docket No. P-2021-3030021 – West Penn Power Company (DSP)
- Docket No. R-2021-3026116 – Borough of Hanover – Water (ROR)
- Docket No. R-2021-3025206 – Community Utilities of Pennsylvania – Water Division (ROR)
- Docket No. R-2021-3025207 – Community Utilities of Pennsylvania – Wastewater Division (ROR)
- Docket No. R-2021-3025652 – UGI Utilities, Inc. – Gas Division (1307(f))
- Docket No. R-2021-3024750 – Duquesne Light Company (O&M and ROR)

**Professional and Educational Experience
Christopher Keller**

Testimony Submitted (Continued)

I have testified and/or submitted testimony in the following proceedings:

- Docket No. R-2021-3024296 – Columbia Gas of Pennsylvania, Inc. (ROR)
- Docket No. R-2020-3018929 – PECO Energy Company – Gas Division (ROR)
- Docket No. P-2020-3020914 – Twin Lakes Utilities, Inc. (529 Proceeding)
- Docket No. R-2020-3018835 – Columbia Gas of Pennsylvania, Inc. (ROR)
- Docket No. R-2020-3019680 – UGI Utilities, Inc. (1307(f))
- Docket No. P-2020-3019356 – PPL Electric Utilities Corporation (DSP)
- Docket No. R-2019-3015162 – UGI Utilities, Inc. – Gas Division (ROR)
- Docket No. R-2019-3010955 – City of Lancaster – Sewer Fund (O&M)
- Docket No. R-2019-3009647 – UGI Utilities, Inc. – Gas Division (1307(f))
- Docket No. R-2018-3006818 – Peoples Natural Gas Company LLC (O&M)
- Docket No. R-2018-3000124 – Duquesne Light Company (O&M)
- Docket No. R-2018-3001631 – UGI Central Penn Gas, Inc. (1307(f))
- Docket No. R-2018-3001632 – UGI Penn Natural Gas, Inc. (1307(f))
- Docket No. R-2018-3001633 – UGI Utilities, Inc. (1307(f))
- Docket No. R-2018-2645938 – Philadelphia Gas Works (1307(f))
- Docket No. P-2017-2637855 – Metropolitan Edison Company (DSP)
- Docket No. P-2017-2637857 – Pennsylvania Electric Company (DSP)
- Docket No. P-2017-2637858 – Pennsylvania Power Company (DSP)
- Docket No. P-2017-2637866 – West Penn Power Company (DSP)
- Docket No. R-2017-2602627 – UGI Central Penn Gas, Inc. (1307(f))
- Docket No. R-2017-2602638 – UGI Utilities, Inc. (1307(f))
- Docket No. R-2017-2586783 – Philadelphia Gas Works (O&M)
- Docket No. R-2017-2587526 – Philadelphia Gas Works (1307(f))
- Docket No. I-2016-2526085 – Delaware Sewer Company (529 Proceeding)
- Docket No. R-2016-2531550 – Citizens’ Electric Company (O&M)
- Docket No. R-2016-2531551 – Wellsboro Electric Company (O&M)
- Docket No. R-2016-2537349 – Metropolitan Edison Company (CWC and CAP)
- Docket No. R-2016-2537352 – Pennsylvania Electric Company (CWC and CAP)
- Docket No. R-2016-2537355 – Pennsylvania Power Company (CWC and CAP)
- Docket No. R-2016-2537359 – West Penn Power Company (CWC and CAP)
- Docket No. R-2016-2543311 – UGI Central Penn Gas, Inc. (1307(f))
- Docket No. R-2015-2518438 – UGI Utilities, Inc. – Gas Division (CWC and USP)
- Docket No. P-2015-2511333 – Metropolitan Edison Company (DSP)
- Docket No. P-2015-2511351 – Pennsylvania Electric Company (DSP)
- Docket No. P-2015-2511355 – Pennsylvania Power Company (DSP)
- Docket No. P-2015-2511356 – West Penn Power Company (DSP)

Professional and Educational Experience
Christopher Keller

Testimony Submitted (Continued)

- Docket No. R-2015-2468056 – Columbia Gas of Pennsylvania, Inc. (O&M)
- Docket No. P-2014-2404341 – Delaware Sewer Company (529 Investigation)
- Docket No. R-2014-2452705 – Delaware Sewer Company (O&M)
- Docket No. R-2014-2428304 – Borough of Hanover – Water (O&M)
- Docket No. R-2014-2419774 – Wellsboro Electric Company (Customer Choice Support Charge)
- Docket No. R-2014-2420279 – UGI Central Penn Gas, Inc. (1307(f))

Assisted with the Following Cases

- Docket No. R-2017-2631441 – Reynolds Water Company (ROR)
- Docket No. R-2016-2580030 – UGI Penn Natural Gas, Inc. (ROR)
- Docket No. R-2014-2462723 – United Water Pennsylvania (CWC)
- Docket No. R-2014-2428742 – West Penn Power Company (CWC)
- Docket No. R-2014-2428743 – Pennsylvania Electric Company (CWC)
- Docket No. R-2014-2428744 – Pennsylvania Power Company (CWC)
- Docket No. R-2014-2428745 – Metropolitan Edison Company (CWC)
- Docket No. R-2013-2397353 – Pike County Light & Power Company (Gas) (O&M)
- Docket No. R-2013-2397237 – Pike County Light & Power Company (Electric) (O&M)

I&E Exhibit No. 2
Witness: Christopher Keller

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Exhibit to Accompany

the

Direct Testimony

of

Christopher Keller

Bureau of Investigation and Enforcement

Concerning:

Rate of Return

I&E			
Summary of Cost of Capital			
Type of Capital	Ratio	Cost Rate	Weighted Cost
Valley Energy, Inc.			
Long Term Debt	50.47%	4.49%	2.27%
Common Equity	49.53%	9.70%	4.80%
Total	<u>100.00%</u>		<u><u>7.07%</u></u>

Proxy Group Capital Structure

	2021		2020		2019		2018		2017		Average
Atmos Energy Corp											
Long-term Debt	\$ 5,124.950	39.33%	\$ 4,732.850	41.07%	\$ 3,529.452	36.22%	\$ 2,493.665	31.81%	\$ 3,067.045	41.37%	37.96%
Short-term Debt	-	0.00%	-	0.00%	464.915	4.77%	575.780	7.34%	447.745	6.04%	3.63%
Common Equity	7,906.889	60.67%	6,791.203	58.93%	5,750.223	59.01%	4,769.950	60.85%	3,898.666	52.59%	58.41%
	13,031.839	100.00%	11,524.053	100.00%	9,744.590	100.00%	7,839.395	100.00%	7,413.456	100.00%	100.00%
Chesapeake Utilities											
Long-term Debt	558.474	35.93%	518.371	37.26%	450.064	35.75%	316.020	27.99%	197.395	21.12%	31.61%
Short-term Debt	221.634	14.26%	175.644	12.63%	247.371	19.65%	294.458	26.08%	250.969	26.85%	19.89%
Common Equity	774.130	49.81%	697.085	50.11%	561.577	44.60%	518.439	45.92%	486.294	52.03%	48.50%
	1,554.238	100.00%	1,391.100	100.00%	1,259.012	100.00%	1,128.917	100.00%	934.658	100.00%	100.00%
Nisource Inc.											
Long-term Debt	9,211.300	60.71%	9,249.700	63.25%	7,907.800	53.48%	7,105.400	50.92%	7,512.200	57.62%	57.19%
Short-term Debt	560.000	3.69%	503.000	3.44%	1,773.200	11.99%	1,977.200	14.17%	1,205.700	9.25%	8.51%
Common Equity	5,400.800	35.60%	4,872.200	33.31%	5,106.700	34.53%	4,870.900	34.91%	4,320.100	33.13%	34.30%
	15,172.100	100.00%	14,624.900	100.00%	14,787.700	100.00%	13,953.500	100.00%	13,038.000	100.00%	100.00%
Northwest Natural Holding Co.											
Long-term Debt	1,124.055	45.90%	940.702	44.08%	806.796	44.28%	706.247	41.88%	683.184	46.16%	44.46%
Short-term Debt	389.500	15.91%	304.525	14.27%	149.100	8.18%	217.620	12.90%	54.200	3.66%	10.99%
Common Equity	935.146	38.19%	888.733	41.65%	865.999	47.53%	762.634	45.22%	742.776	50.18%	44.55%
	2,448.701	100.00%	2,133.960	100.00%	1,821.895	100.00%	1,686.501	100.00%	1,480.160	100.00%	100.00%
One Gas Inc.											
Long-term Debt	3,707.778	56.60%	1,613.228	37.83%	1,314.064	33.18%	1,285.483	35.44%	1,193.257	33.99%	39.41%
Short-term Debt	494.000	7.54%	418.225	9.81%	516.500	13.04%	299.500	8.26%	357.215	10.18%	9.76%
Common Equity	2,349.532	35.86%	2,233.311	52.37%	2,129.390	53.77%	2,042.656	56.31%	1,960.209	55.84%	50.83%
	6,551.310	100.00%	4,264.764	100.00%	3,959.954	100.00%	3,627.639	100.00%	3,510.681	100.00%	100.00%
Spire Inc.											
Long-term Debt	2,992.800	49.22%	2,482.100	45.88%	2,082.600	40.62%	1,900.100	40.35%	1,995.000	44.69%	44.15%
Short-term Debt	672.000	11.05%	648.000	11.98%	743.200	14.50%	553.600	11.76%	477.300	10.69%	11.99%
Common Equity	2,416.200	39.73%	2,280.300	42.15%	2,301.000	44.88%	2,255.400	47.89%	1,991.300	44.61%	43.85%
	6,081.000	100.00%	5,410.400	100.00%	5,126.800	100.00%	4,709.100	100.00%	4,463.600	100.00%	100.00%
2021 Average Capital Structure											
Long-term Debt		47.95%									
Short-term Debt		8.74%									
Common Equity		43.31%									
		100.00%									

Source:
Compustat (S&P Global Market Intelligence - Data Management Solutions)
Yearly data updates typically provided late April of each year
(data in millions)

Accessed on May 19, 2022

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

I&E-RR-9-D Reference Valley Statement No. 2, p. 14, line 11 through p. 15, line 11. Identify each company from Value Line's Natural Gas Utility Group that were excluded from Mr. D'Ascendis' gas utility proxy group. Specifically, state which of Mr. D'Ascendis' criteria each company violated in order to be excluded.

Response:

The following companies are included in the Value Line Natural Gas Utility Group:

Company	Ticker
Atmos Energy Corporation	ATO
Chesapeake Utilities Corporation	CPK
New Jersey Resources Corporation	NJR
NiSource, Inc.	NI
Northwest Natural Holding Co.	NWN
ONE Gas, Inc.	OGS
South Jersey Industries, Inc.	SJI
Southwest Gas Holdings, Inc.	SWX
Spire, Inc.	SR
UGI Corporation	UGI

Of these companies, CPK, SJI, SWX, and UGI were eliminated. CPK and UGI failed criterion (ii) regarding the total net operating income and assets attributable to regulated natural gas distribution operations. SJI and SWX failed criterion (iii) regarding merger speculation. Mr. D'Ascendis' selection criteria for his Gas Utility Proxy Group is stated on Valley Statement No. 2, page 14 and 15.

**Response Provided by: Dylan W. D'Ascendis, CRRA, CVA, Director
ScottMadden, Inc.**

Date: July 7, 2022

	2021		
	Interest Charges	Long-term Debt	Debt Cost
Atmos Energy Corp	94.97	5,124.95	1.85%
Chesapeake Utilities	19.57	558.47	3.50%
Nisource Inc.	345.70	9,211.30	3.75%
Northwest Natural Holding Co.	44.49	1,124.06	3.96%
One Gas Inc.	64.50	3,707.78	1.74%
Spire Inc.	111.00	2,992.80	3.71%
	Range:	Low High	1.74% 3.96%
		Average	3.09%

Source:

Compustat (S&P Global Market Intelligence - Data Management Solutions)
 Yearly data updates typically provided late April of each year
 (data in millions)

Accessed on May 19, 2022

Dividend Yields of Six Company Proxy Group

Company	Atmos Energy Corp	Chesapeake Utilities	Nisource Inc.	Northwest Natural Holding Co.	One Gas Inc.	Spire Inc.
<i>Symbol</i>	<i>ATO</i>	<i>CPK</i>	<i>NI</i>	<i>NWN</i>	<i>OGS</i>	<i>SR</i>
Div	2.92	2.16	0.98	1.94	2.64	2.86
52-wk low	85.80	113.49	23.65	43.07	62.52	59.60
52-wk high	122.96	146.30	32.59	57.63	92.26	79.24
Spot Price	111.85	128.47	30.56	51.07	87.37	76.72
Spot Div Yield	2.61%	1.68%	3.21%	3.80%	3.02%	3.73%
52-wk Div Yield	2.80%	1.66%	3.49%	3.85%	3.41%	4.12%
Average	2.70%	1.67%	3.35%	3.83%	3.22%	3.92%

	<u>Average</u>
Spot Div Yield	<u>3.01%</u>
52-wk Div Yield	<u>3.22%</u>
Average	<u><u>3.12%</u></u>

Source: Barrons Value Line May 19, 2022 February 25, 2022

Five-Year Growth Estimate Forecast for Proxy Group (Actual)

<u>Company</u>	<u>Symbol</u>	Yahoo	Zacks	Morningstar	Value Line	Average
		Source				
Atmos Energy Corp	ATO	7.74%	7.30%	8.00%	7.50%	7.64%
Chesapeake Utilities	CPK	7.00%	NA	8.10%	8.00%	7.70%
Nisource Inc.	NI	7.18%	7.20%	7.50%	10.50%	8.10%
Northwest Natural Holding Co.	NWN	3.70%	4.50%	5.00%	6.00%	4.80%
One Gas Inc.	OGS	5.00%	5.00%	NA	6.00%	5.33%
Spire Inc.	SR	4.30%	5.00%	5.40%	9.00%	5.93%

Average

6.58%

Source:

(From Internet)

May 19, 2022

Expected Market Cost Rate of Equity
Using Data for the Proxy Group of Six Natural Gas Companies
5-Year Forecasted Growth Rates

<u>Time Period</u>	<u>Adjusted Dividend Yield</u> (1)	<u>Growth Rate</u> (2)	<u>Expected Return on Equity</u> (3=1+2)
(1) 52-Week Average Ending: May 19, 2022	3.22%	6.58%	9.80%
(2) Spot Price Ending: May 19, 2022	<u>3.01%</u>	<u>6.58%</u>	<u>9.59%</u>
(3) Average:	<u>3.12%</u>	<u>6.58%</u>	<u>9.70%</u>

Sources: Value Line February 25, 2022
 Barrons May 19, 2022

<u>Company</u>	<u>Beta</u>
Atmos Energy Corp	0.80
Chesapeake Utilities	0.80
Nisource Inc.	0.85
Northwest Natural Holding Co.	0.80
One Gas Inc.	0.80
Spire Inc.	0.85
Average beta for CAPM	<u>0.82</u>

Source:
Value Line
February 25, 2022

Risk-Free Rate	
<u>Treasury note 10-yr Note</u>	<u>Yield</u>
3Q 2022	3.00
4Q 2022	3.10
1Q 2023	3.30
2Q 2023	3.30
3Q 2023	3.30
2023-2027	2.90
Average	<u><u>3.15</u></u>

Source:
Blue Chip
April 29, 2022 and December 1, 2021

Required Rate of Return on Market as a Whole Forecasted

	<u>Dividend Yield</u>	+	<u>Growth Rate</u>	=	<u>Expected Market Return</u>
Value Line Estimate	2.10%		14.19%	(a)	16.29%
S&P 500	1.63%	(b)	13.70%		15.33%
Average Expected Market Return				=	<u>15.81%</u>

(a) $((1+70\%)^{.25}) - 1$ Value Line forecast for the 3 to 5 year index appreciation is 70%

(b) S&P 500 multiplied by half the growth rate

(b) $1.53\% * ((1+13.70\%/2)) = 1.63\%$

Sources:

S&P 500 Growth Rate (Morningstar)	5/19/2022	13.70%
S&P 500 Dividend Yield (Barrons)	5/13/2022	1.53%
Value Line Dividend Yield	5/20/2022	2.10%
Value Line Appreciation Yield	5/20/2022	70%

CAPM with Forecasted Return

Re Required return on individual equity security
Rf Risk-free rate
Rm Required return on the market as a whole
Be Beta on individual equity security

$$\text{Re} = \text{Rf} + \text{Be}(\text{Rm} - \text{Rf})$$

$$\text{Rf} = 3.15$$

$$\text{Rm} = 15.81$$

$$\text{Be} = 0.82$$

$$\text{Re} = \underline{\underline{13.53}}$$

Sources: Value Line February 25, 2022
Blue Chip April 29, 2022 and December 1, 2021

Valley Energy, Inc.

Gross Revenue Conversion Factor

		<u>Filing</u>
1	Operating Revenue	1.00000000
2	Less: Uncollectibles	0.00675000 Schedule C1-8
3	Income Before State Taxes	0.99325000 Line 1 - Line 2
4	State Income Tax Effect Rate	0.09990000 Schedule C1-4
5	Less: State Income Tax	0.09922568 Line 3 x Line 4
6	Income Before Federal Taxes	0.89402433 Line 3 - Line 5
7	Federal Income Tax Effect Rate	0.21000000 Schedule C1-4
8	Less: Federal Tax @ 21%	0.18774511 Line 6 x Line 7
9	Adjusted Operating Income	0.70627922 Line 1 - (Line 2 + Line 5 + Line 8)
10		
11	Gross Revenue Conversion Factor	<u>1.41587063</u> $1 + ((1 - \text{Line 9}) / \text{Line 9})$

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

I&E-RR-4-D Reference Valley Statement No. 2, page 57, lines 9-11:

- A. State whether Mr. D'Ascendis is aware of any natural gas distribution utilities throughout the United States that have been granted a Commission authorized 11.50% or higher cost of common equity in the past two years.
- B. If the response to Part A is yes, identify which company/companies have been authorized such cost of common equity, in what jurisdiction, and docket numbers associated with each instance.

Response:

- A. Mr. D'Ascendis is not aware of any natural gas distribution utilities throughout the United States that have been granted a Commission authorized 11.50% or higher cost of common equity in the past two years; however, his analysis is based on current market conditions and the circumstances of this proceeding. Mr. D'Ascendis limited his review to decisions provided by Regulatory Research Associates which only covers rate cases in which the company has requested a rate change of at least \$5 million or has authorized a rate change of at least \$3 million.
- B. NA.

**Response Provided by: Dylan W. D'Ascendis, CRRA, CVA, Partner
ScottMadden, Inc.**

**Howard S. Gorman, President
HSG Group, Inc.**

Date: May 31, 2022

I&E Statement No. 3
Witness: Esyan A. Sakaya

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Direct Testimony

of

Esyan A. Sakaya

Bureau of Investigation and Enforcement

Concerning:

Rate Base
Fully Projected Future Test Year Reporting Requirements
Forfeited Discount Revenue
Scale Back of Rates

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SCALE BACK OF RATES 10

1 **INTRODUCTION**

2 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS**
3 **ADDRESS?**

4 A. My name is Esyan A. Sakaya. My business address is Pennsylvania Public Utility
5 Commission, Commonwealth Keystone Building, 400 North Street, Harrisburg,
6 Pennsylvania 17120.

7

8 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

9 A. I am employed as a Fixed Utility Valuation Engineer in the Pennsylvania Public
10 Utility Commission's ("Commission") Bureau of Investigation and Enforcement
11 ("I&E").

12

13 **Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL**
14 **BACKGROUND?**

15 A. My educational and professional background are set forth in Appendix A, which is
16 attached.

17

18 **Q. PLEASE DESCRIBE THE ROLE OF I&E IN RATE PROCEEDINGS.**

19 A. I&E is responsible for protecting the public interest in proceedings before the
20 Commission. The I&E analysis in this proceeding is based on its responsibility to
21 represent the public interest. This responsibility requires the balancing of the
22 interests of ratepayers, the regulated utility, and the regulated community as a
23 whole.

1 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

2 A. My direct testimony relates to Valley Energy, Inc.’s (“Valley” or “Company”)
3 request for a base rate revenue increase of \$999,631. My testimony specifically
4 addresses the following issues:

- 5 • Test Year;
- 6 • Rate Base;
- 7 • Fully Projected Future Test Year Reporting Requirements; and
- 8 • Scale back of rates.

9

10 **TEST YEAR**

11 **Q. WHAT IS A TEST YEAR AND HOW IS IT USED BY A COMPANY IN A**
12 **RATE PROCEEDING?**

13 A. A test year is the twelve-month period over which a utility’s costs and revenues
14 are measured as the basis for setting prospective base rates. In order to meet its
15 burden of proof, a utility has the option of selecting to use a historic test year
16 (“HTY”), a future test year (“FTY”), or a Fully Projected Future Test Year
17 (“FPFTY”). An HTY is a twelve-month period selected by a company that
18 represents the most recent full year of actual data. An FTY begins the day after
19 the HTY ends and is determined using a combination of actual data and a
20 projection of annualized and normalized estimates of future revenues and expenses
21 and a corresponding measure of value at the end of that period. The FPFTY is
22 defined as the twelve-month period that begins with the first month that the new
23 rates will be placed into effect, after the application of the full suspension period

1 permitted under Section 1308(d). The FPFTY is a shift from the fundamental
2 ratemaking principle that a public utility should only be permitted to include
3 projects in rate base and earn a reasonable return on its investments after they
4 become “used and useful” for the utility’s public service.
5

6 **Q. WHAT TEST YEARS HAS THE COMPANY USED IN THIS**
7 **PROCEEDING?**

8 A. Valley has selected the year ended December 31, 2021 as the HTY, the year
9 ending December 31, 2022 as the FTY, and the year ending December 31, 2023 as
10 the FPFTY (Valley St. No. 1, p. 16).
11

12 **Q. WHAT TEST YEAR HAS THE COMPANY BASED ITS REVENUE**
13 **REQUIREMENT ON IN THIS PROCEEDING?**

14 A. Valley based its requested revenue requirement on the FPFTY ending December
15 31, 2023 (Valley St. No. 1, p. 2).
16

17 **Q. HAS THE COMPANY REVISED ITS INITIAL FILING?**

18 A. Yes. On July 11, 2022, Valley provided a revised rate study that included changes
19 to expenses and rate base. However, the Company did not change proposed rates
20 or revenue.

1 **RATE BASE**

2 **Q. WHAT IS RATE BASE?**

3 A. Rate base is the depreciated original cost of a utility's investment in plant a utility
4 has in place to serve customers plus other additions and deductions that the
5 Commission determines to be necessary in order to keep the utility operating and
6 providing safe and reliable service to its customers.

7
8 **Q. HOW IS RATE BASE USED WITHIN THE RATEMAKING FORMULA?**

9 A. Rate base is one part of the financial equation used by the Commission to
10 determine the appropriate revenue that a utility is granted in a rate proceeding.
11 The revenue determination allows the utility to meet its expense obligations and
12 gives it the opportunity to earn the rate of return established by the Commission in
13 a rate proceeding. The equation used to determine the proper revenue requirement
14 level is:

15
$$\text{Revenue Requirement} = (\text{Rate Base} \times \text{Rate of Return}) + \text{Operating}$$

16
$$\text{Expenses} + \text{Depreciation Expenses} + \text{Taxes}.$$

17
18 **Q. HOW IS THE DEPRECIATED ORIGINAL COST OF PLANT-IN-**
19 **SERVICE AT THE END OF THE TEST YEAR DETERMINED?**

20 A. The depreciated original cost is equal to the original cost of the plant-in-service
21 that is used and useful in the provision of utility service to the customers less the
22 depreciation reserve as adjusted by other items such as salvage value and removal
23 costs. By using a FPPTY, the depreciated original cost of the plant in service is

1 computed by taking a “snapshot” look at the depreciated original cost value of
2 used and useful utility plant estimated to be in service at the end of the FPFTY.

3
4 **Q. WHAT OTHER ADDITIONS AND DEDUCTIONS TO THE**
5 **DEPRECIATED ORIGINAL COST OF UTILITY PLANT ARE**
6 **ALLOWED?**

7 A. Some of the additions to the depreciated original cost of a company’s investment
8 in utility include materials and supplies, gas in storage, prepayments, and cash
9 working capital. Some of the deductions include accumulated depreciation,
10 deferred income taxes, and customer deposits. Some additions are applicable to a
11 specific utility or utility type.

12
13 **Q. WHAT RATE BASE IS THE COMPANY CLAIMING FOR THE FPFTY**
14 **ENDING DECEMBER 31, 2023?**

15 A. The Company’s proposed revised rate base for the FPFTY ending December 31,
16 2023 is \$19,775,484 (Valley Ex._(HSG-1), Sch. C1-6, (CU), line 15).

17
18 **Q. IS I&E RECOMMENDING ANY ADJUSTMENTS TO THE REVISED**
19 **RATE BASE OR THE ADDITIONS AND DEDUCTIONS LISTED ABOVE?**

20 A. No.

1 **REPORTING REQUIREMENTS**

2 **Q. WHAT AMOUNT OF PLANT IN SERVICE HAS THE COMPANY**
3 **PROPOSED FOR THE FTY AND FPFTY?**

4 A. The Company is proposing \$39,011,655 of total plant in service for the FTY, and
5 \$40,520,766 for the FPFTY (Valley Ex._(HSG-1), Sch. C1-6 (CU), line 2, p. 1).

6
7 **Q. HOW MUCH ADDITIONAL PLANT IN SERVICE DOES THIS**
8 **REFLECT?**

9 A. Valley had \$2,449,750 in plant additions for the HTY. The Company has
10 projected \$1,887,910 in plant additions and \$25,145 of retirements in the FTY,
11 and \$1,576,484 of plant additions and \$67,373 of retirements in the FPFTY
12 (Valley Ex._(HSG-1), Sch. C3-CU, pp. 2-3, line 39).

13
14 **Q. DO YOU HAVE ANY RECOMMENDATIONS REGARDING PLANT**
15 **ADDITIONS THAT THE COMPANY PROJECTS TO BE IN SERVICE**
16 **DURING THE FTY ENDING DECEMBER 31, 2022, AND THE FPFTY**
17 **ENDING DECEMBER 31, 2023?**

18 A. Yes. I recommend that the Company provide the Commission Bureau of
19 Investigation and Enforcement and the Office of Consumer Advocate with an
20 update to Valley Exhibit_(HSG-1), Schedule C3-CU no later than April 1, 2023,
21 under this docket number, which should include actual plant additions and
22 retirements by month for the twelve months ending December 31, 2022. And an

1 additional update should be provided for actual plant additions and retirements by
2 month through December 31, 2023, no later than April 1, 2024.

3
4 **Q. WHY DO YOU RECOMMEND THAT VALLEY PROVIDE THESE**
5 **UPDATES?**

6 A. I&E believes that there is value in determining how closely Valley's projected
7 investments in future facility comport with the actual investments that are made by
8 the end of the FTY and FPFTY. Determining the correlation between Valley's
9 projected and actual results will help inform the Commission and the parties in
10 future rate cases.

11 The updates are important because, as previously explained, through the
12 use of the FPFTY, Valley is requiring ratepayers to pay a return on its projected
13 investment in future facilities that are not in place and providing service at the
14 time the new rates take effect, but also are not subject to any guarantee of being
15 completed and placed into service. While the FPFTY provides for such
16 projections, there should be verification of the projections. Therefore, requiring
17 the Company to provide updates demonstrating that actual investments comport
18 with projections used in setting rates in the FPFTY provides the Commission with
19 actual data to gauge the accuracy of Valley's projected investments in future
20 proceedings as has become common practice among Pennsylvania utilities as the
21 use of the FPFTY has gained prevalence.

1 **FORFEITED DISCOUNTS**

2 **Q. WHAT ARE FORFEITED DISCOUNTS?**

3 A. A public utility can assess a separate charge to customers who do not pay their bill
4 on time. The term forfeited discounts revenue, also referred to as late payment
5 charges, refers to the revenue received by the utility as a result of this charge.

6

7 **Q. HOW MUCH REVENUE FROM FORFEITED DISCOUNTS DID THE**
8 **COMPANY ACTUALLY RECEIVE IN THE HTY AT PRESENT RATES?**

9 A. As shown on Valley Ex. HSG-1, Sch. B (CU), line 6, the Company received
10 \$14,197 in forfeited discounts revenue for the HTY ended December 31, 2021.

11

12 **Q. WHAT LEVEL OF FORFEITED DISCOUNTS REVENUE IS THE**
13 **COMPANY CLAIMING AT PROPOSED RATES FOR THE FPFTY**
14 **ENDING DECEMBER 31, 2023?**

15 A. Valley is projecting the same \$14,197 of forfeited discounts under proposed rates
16 for the FPFTY ending December 31, 2023 (Valley Ex. HSG-1, Sch. B (CU), line
17 6).

18

19 **Q. WHAT DO YOU RECOMMEND REGARDING FORFEITED DISCOUNTS**
20 **REVENUE AT PROPOSED RATES FOR THE FPFTY ENDING IN 2023?**

21 A. I recommend that the forfeited discount revenue be increased by \$1,617, from
22 \$14,197 to \$15,814 (I&E Ex. No. 3, Sch. 2, col G, lines 17-20).

1 **Q. HOW DID YOU DETERMINE THE INCREASE OF \$1,617?**

2 A. I began by summarizing base and gas revenue under present and proposed rates
3 excluding contract revenue (I&E Ex. No. 3, Sch. 1, line 15). Then I determined
4 the percent of total revenue and gas cost revenue to calculate the amount of
5 present late payment revenue attributable to base rate revenue and the amount of
6 late payment revenue attributable to gas costs. Using this calculation, I
7 determined that \$7,522 of late payment revenue is attributable to base rates (I&E
8 Ex. No. Sch. 1, lines 16-17). The \$1,617 was determined by multiplying this
9 \$7,522 of base rate late payment revenue times the 21.5% increase in base rates
10 (less contract revenue) to arrive at the \$1,617. The total late payment revenue
11 under proposed rates of \$15,814 (\$1,617 + \$14,197) is shown on (I&E Ex. No. 3,
12 Sch. 1, line 20).

13

14 **Q. WHY DID YOU EXCLUDE CONTRACT REVENUE IN YOUR**
15 **ANALYSIS?**

16 A. The revenue is received from customers under the discounted contract terms.
17 Therefore there should be no late payment revenue associated with these accounts.

18

19 **Q. WHY DID YOU EXCLUDE THE PORTION OF LATE PAYMENT**
20 **REVENUE ASSOCIATED WITH GAS COSTS?**

21 A. Gas costs remain the same under present and proposed rates. Since 47.0% of total
22 company revenue is from gas costs, it is reasonable to assume 47.0% of late

1 payment revenue is associated with gas costs. Since gas costs are not being
2 increased in this base rate case, 47.0% of total late payment revenue should be
3 excluded from the determination of late payment revenue at proposed rates.
4

5 **Q. SHOULD THE \$1,617 BE REDUCED IF THE COMMISSION GRANTS**
6 **LESS THAN THE FULL INCREASE?**

7 A. Yes. I recommend that the Company include revenue under proposed rates from
8 forfeited discounts equal to the percent increase in base rates (less contract
9 revenue) upon determination of the total revenue granted by the Commission.
10

11 **SCALE BACK OF RATES**

12 **Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED INCREASE BY**
13 **CLASS?**

14 A. For Retail customers, the Company proposed to increase Residential class revenue
15 by \$580,142 (21.5%), the Commercial class revenue by \$167,202 (20.8%), the
16 Interruptible class revenue by \$9,398 (20.9%), and the Small Industrial class revenue
17 by \$2,211 (18.1%). For Transportation customers, the Company is proposing the
18 following increases: \$91,442 (21.6%) for Firm customers, \$53,351 (24.0%) for
19 Firm-DDQ customers, and \$95,887 (21.6%) for Firm-Interruptible customers. For
20 contract customers, the Company is not proposing rate increases for the Firm-Fixed and
21 Firm-Volumetric (Contract) classes (Valley Ex. HSG-1, Sch. B4 (CU)).

1 **Q. DO THESE CLASS INCREASES INCLUDE INCREASES TO THE**
2 **CUSTOMER CHARGES?**

3 A. Yes. For Retail customers, the Company proposed a Residential customer charge
4 increase of \$1.11 per month or 9.4%. For Commercial and Transport Firm-DDQ
5 class customers, the Company is proposing a customer charge increase of \$1.74 per
6 month or 8.6%. For Interruptible, Interruptible Service, Small Industrial and
7 Transport Firm, The Company is proposing an increase is \$6.77 or 9.00%. The
8 Company is not proposing rate increases for the Firm-Fixed and Firm-Volumetric
9 (Contract) classes (Valley Ex. HSG-1, Sch. B5 (CU)).

10

11 **Q. WHAT IS A COST OF SERVICE STUDY (COSS)?**

12 A. A COSS is an analyses of a Company's revenue, expenses, return and taxes. In the
13 analysis, these items are assigned or allocated to various rate classes such as
14 Residential, Commercial, Industrial to determine if the revenue received from each
15 class is equal to, more than, or less than the corresponding cost of providing service
16 to that class. It can include a customer cost analysis that determines the monthly cost
17 incurred to provide service to the various classes.

18

19 **Q. DID THE COMPANY PROVIDE A COST OF SERVICE STUDY?**

20 A. No.

1 **Q. WHAT SCALE BACK DO YOU RECOMMEND IF THE COMMISSION**
2 **GRANTS LESS THAN THE FULL INCREASE?**

3 A. If the Commission grants an increase less than the amount Valley requested, I
4 recommend that the percentage increase for each class be adjusted so each class
5 other than the Contract classes receive the same percentage increase.

6
7 **Q. WHY DO YOU RECOMMEND THAT EACH CLASS OTHER THAN THE**
8 **CONTRACT CLASSES RECEIVE THE SAME PERCENTAGE INCREASE?**

9 A. The Company did not provide a COSS to compare the revenue received to the
10 expenses incurred to provide service to each class. Thus, there is no justification
11 for proposing a different percentage increase for the classes receiving an increase.
12 Therefore, scaling back the rates so each class receives the same percentage
13 increase is the most reasonable approach to establish rates if the Commission
14 grants less than the full increase.

15
16 **Q. DOES YOUR RECOMMENDATION TO SCALE BACK EACH CLASS SO**
17 **THAT THE PERCENTAGE INCREASE FOR EACH CLASS IS THE**
18 **SAME INCLUDE THE CUSTOMER CHARGES IN THOSE CLASSES?**

19 A. Yes, I recommend that the scale back include the customer charges for several
20 reasons. In order to limit the increase in the customer charge that is applicable to
21 zero and low usage customers, the customer charges should be included in the
22 scale back. Second, this recommendation promotes conservation because it causes

1 a larger portion of the customer's bill to be recovered in volumetric rates, thus
2 giving customers more of an incentive to reduce usage. Finally, in the last Valley
3 Energy case, the Commission affirmed the ALJ's recommendation that the
4 Company's rates be scaled back so that the percentage increase in the rates is the
5 same regardless of the increase ultimately allowed by the Commission (Valley
6 Energy R-2019-3008209, Order entered April 27, 2020, p. 132).

7

8 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

9 A. Yes.

Esyan A. Sakaya

THE PENNSYLVANIA PUBLIC UTILITY COMMISSION
400 North Street
HARRISBURG, PA 17120

Education:

National Association of Regulatory Utility Commissioners, Clearwater, FL
Utility Rate School; Utility Rate Making Basics, October 2019

Society of Depreciation Professionals, Philadelphia, PA
Introduction to Depreciation; Depreciation Fundamentals, September 2019

Temple University, Philadelphia, PA
Bachelor of Science; Major in Engineering Technology, 2015

Community College of Philadelphia, Philadelphia, PA
Associate of Applied Science; Major in Construction Management Technology, 2011

Island School of Building Arts, Gabriola Island, BC-Canada
Certificate Graduate: Heavy Timber Construction Aug 2002-Nov 2002

Solar Energy International, Carbondale, CO
Certificate Graduate: Basic and Advanced Photovoltaic Design, April 2002-May 2002

Experience:

12/2018-Present

Pennsylvania Public Utility Commission-Harrisburg, PA

Fixed Utility Valuation Engineer- Assist in engineering related studies related to valuation, depreciation, cost of service, quality of service as they apply to regulated utilities. Contribute in evaluating, contrasting and conducting performance analyses in distinctive sections of valuation engineering and rate structure involving valuation concepts, original cost, rate base, fixed capital costs, inventory processing, excess capacity, cost of service, and rate design. Provide expert testimony in rate related utility cases.

4/2018-12/2018

Pennsylvania Department of Transportation-Harrisburg, PA

Photogrammetry Technician I- Created three-dimensional mapping layouts of natural and man-made features from stereoscopic images on a computer workstation. Assisted in the field placement of ground based surveyed control-points prior to aerial photography acquisition. Provided field support in the use of laser scans for comprehensive digital surveying data. Operated global positioning satellite surveying equipment to obtain accurate geodetic coordinates of pre-established benchmarks.

8/2017-4/2018

Pennoni and Associates. Consulting Engineers-King of Prussia, PA

Construction Inspector-Provided quality assurance in the onsite material testing of concrete, soils, and asphalt. Read and interpreted construction drawings and specifications of materials and components. Completed daily reports regarding project progress to engineers, project managers/superintendents, contractors and clients.

TESTIMONY SUBMITTED:

I have assisted and/or submitted testimony in the following proceedings:

NO. Case

1. UGI Gas Utilities - Gas Division, Docket Number: R-2018-3006814
2. Newtown Artesian Water Company, Docket Number: R-2018-3006904
3. Pittsburgh Wastewater, Docket Number: M-2018-2640803
4. PAWC Purchase of Steelton, Docket Number: A-2019-3006814
5. Philadelphia Gas Works, Docket Number: R-2019-3009016 - 3007636
6. Community Utilities Water, Docket Number: R-2019-3008947
7. Aqua Purchase of Cheltenham, Docket Number: A-2019-3008491
8. UGI NORTH, Docket Number: R-2019-3009647
9. UGI CENTRAL, Docket Number: R-2019-3009647
10. UGI SOUTH, Docket Number: R-2019-3009647
11. Twin Lakes Utilities, Docket Number: R-2019-3010958
12. Penn Power Company, Docket: P-2019-3012628
13. UGI Gas Utilities, Docket Number: R-2019-3015162
14. National Fuel and Gas Distribution, Docket Number: R-2020-3015251
15. Columbia Gas of Pennsylvania, Docket: R-2020-3018993 -3018835

16. Duquesne Light Company, Docket Number: P-2020-3019522
17. PA American Water Company, Docket R-2020-3019369 – 310937
18. Bethlehem Water Company, Docket R-2020-3020256
19. Audubon Water Company, Docket: R-2020-3020919
20. Twin Lakes Utilities, Docket: P-2020-3020914
21. Pike County Light and Power-Gas, Docket: R-2020-3022134
22. Pike County Light and Power-Electric, Docket: R-2020-3022135
23. Duquesne Light Company, Docket Number: R-2021-3024750
24. Community Utilities Water, Docket Number: R-2021-3025206
25. Community Utilities Wastewater, Docket Number: R-2021-3025206
26. Hanover Municipal Water Works, Docket Number: R-2021-3026116
27. Aqua Pennsylvania, Inc, Docket R-2021-3027385 – 3027386
28. Aqua Purchase of Willistown, Docket Number: A-2021-3027268
29. National Fuel and Gas Distribution, Docket Number: R-2022-3030235
30. UGI Gas Utilities, Docket Number: R-2021-3030218
31. PECO Energy Company – Gas, Docket Number: R-2022-3031113

I&E Exhibit No. 3
Witness: Esyan A. Sakaya

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

**Exhibits to Accompany
the
Direct Testimony**

of

Esyan A. Sakaya

Bureau of Investigation and Enforcement

Concerning:

**Rate Base
Fully Projected Future Test Year Reporting Requirements
Forfeited Discount Revenue
Scale Back of Rates**

Valley Energy Company (PA)
Rate Case with FPFTY Ending December 31, 2023
R-2022-3032300

Line	Rate Class	2021 Present Revenue	Remove Contract Revenue	Present Revenue	Gas Costs	Total Revenue
	(A)	(B)	(C)	(D)	(E)	(F)
1	<u>Residential Sales Customers</u>					
2	Rate R- Residential	\$2,500,218	\$0	\$2,500,218	\$2,549,441	\$5,049,659
3	<u>Commercial and Industrial Sales Customers</u>					
4	Rate C- Commercial	\$764,429	\$0	\$764,429	\$1,104,762	\$1,869,191
5	Rate IS- Interruptible Service	\$52,983	\$0	\$52,983	\$245,445	\$298,428
6	Rate SI- Small Industrial	\$14,863	\$0	\$14,863	\$23,204	\$38,067
7		<u>\$832,275</u>	<u>\$0</u>	<u>\$832,275</u>	<u>\$1,373,411</u>	<u>\$2,205,686</u>
8	<u>Transportation Customers</u>					
9	Transport. Firm	\$407,143	\$0	\$407,143	\$0	\$407,143
10	Transport. Firm- Fixed	\$460,887	-\$460,887	\$0		
11	Transport. Firm- Volumetric	\$337,072	-\$337,072	\$0		
12	Transport. Firm- DDQ	\$227,303	\$0	\$227,303	\$0	\$227,303
13	Transport. Interruptible	\$454,241	\$0	\$454,241	\$0	\$454,241
14		<u>\$1,886,646</u>	<u>-\$797,959</u>	<u>\$1,088,687</u>	<u>\$0</u>	<u>\$1,088,687</u>
15	Total Revenue (Less Contracts)	<u>\$5,219,139</u>	<u>-\$797,959</u>	<u>\$4,421,180</u>	<u>\$3,922,852</u>	<u>\$8,344,032</u>
16	Percent of Base Rates, Gas Costs and Total Revenue (Less Contracts)			52.99%	47.01%	100.00%
17	Late Payment Revenue under Present Rates (Less Contracts)			\$7,522	\$6,675	\$14,197
18	Percent Increase in Rates (Less Contracts)			21.50%	0.0%	
19	Increase in Late Payment Revenue Under Proposed Rates			<u>\$1,617</u>	<u>\$0</u>	<u>\$1,617</u>
20	Late Payment Revenue Under Proposed Rates			<u>\$9,140</u>	<u>\$6,675</u>	<u>\$15,814</u>

I&E Statement No. 4
Witness: Jessalynn Heydenreich

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Direct Testimony

of

Jessalynn Heydenreich

Bureau of Investigation & Enforcement

Concerning:

PIPELINE ASSET REPLACEMENT PRIORITIES
DIMP RISK REDUCTION

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
2 **ADDRESS.**

3 A. My name is Jessalynn Heydenreich. I am a Fixed Utility Valuation Engineer in
4 the Pipeline Safety Division of the Pennsylvania Public Utility Commission's
5 (Commission) Bureau of Investigation and Enforcement (I&E). My business
6 address is Pennsylvania Public Utility Commission, 400 North Street, Harrisburg,
7 PA 17120.

8
9 **Q. WHAT IS YOUR EDUCATIONAL AND EMPLOYMENT EXPERIENCE?**

10 A. I attended the Pennsylvania State University and earned a Bachelor of Science
11 Degree in Mechanical Engineering in 2003. I joined the Pennsylvania Public
12 Utility Commission's Pipeline Safety Division in October 2015.

13
14 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

15 A. The purpose of my testimony is to address Valley Energy, Inc. - Supplement No.
16 59 to Tariff Gas – Pa. P.U.C. No. 2's (Valley or Company) pipeline replacement
17 costs, system replacement priority, specifically spending on regulator station
18 upgrades over higher risk system assets.

19
20 **Q. DOES YOUR TESTIMONY INCLUDE AN EXHIBIT?**

21 A. Yes. I&E Exhibit No. 4 contains schedules relating to my testimony.

1 **Q. PLEASE DESCRIBE THE ROLE OF I&E IN RATE PROCEEDINGS.**

2 A. I&E is responsible for protecting the public interest in proceedings before the
3 Commission. The I&E analysis in this proceeding is based on its responsibility to
4 represent the public interest. This responsibility requires the balancing of the
5 interests of ratepayers, the regulated utility, and the regulated community as a
6 whole.

7
8 **Q. WHAT FEDERAL AND STATE REGULATIONS ARE CONTROLLING,**
9 **REGARDING VALLEY’S PIPELINE REPLACEMENT?**

10 A. Valley is mandated to implement a Distribution Integrity Management Plan
11 (DIMP) under Chapter 49 CFR 192 Subpart P – Gas Distribution Pipeline
12 Integrity Management (IM) of the Code of Federal Regulations.

13
14 **Q. WHY MUST A NATURAL GAS DISTRIBUTION COMPANY COMPLY**
15 **WITH THE DIMP REGULATIONS?**

16 A. The Pipeline and Hazardous Material Safety Administration (PHMSA) created
17 DIMP regulations to reduce the number of U.S. Department of Transportation
18 (U.S. DOT) Reportable Incidents.¹ DIMP is a performance based regulatory

¹ A PHMSA Reportable Incident is defined by the following events: (1) An event that involves a release of gas from a pipeline, or of liquefied natural gas, liquefied petroleum gas, refrigerant gas, or gas from an LNG facility, and that results in one or more of the following consequences:(i) A death, or personal injury necessitating in-patient hospitalization;(ii) Estimated property damage of \$129,300 or more, including loss to the operator and others, or both, but excluding cost of gas lost;(iii) Unintentional estimated gas loss of three million cubic feet or more;(2) An event that results in an emergency shutdown of an LNG facility. Activation of an emergency shutdown system for reasons other than an actual emergency does not constitute an incident;(3) An event that is significant in the judgment of the operator, even though it did not meet the criteria of paragraphs (1) or (2) of this definition.

1 program required of gas distribution operators and is driven by risk management.

2

3 **Q. WHAT ARE THE REQUIREMENTS OF A DIMP?**

4 A. DIMP requires gas distribution pipeline operators to:

- 5 1. Demonstrate knowledge of the gas distribution system;
- 6 2. Identify threats;
- 7 3. Evaluate and rank risks;
- 8 4. Identify and implement measures to address risk;
- 9 5. Measure performance, monitor results and evaluate effectiveness;
- 10 6. Evaluate and improve the DIMP;
- 11 7. Report results.

12 DIMP requirements include the identification of threats to pipeline facilities and
13 the requirement for operators to create plans to mitigate and reduce the risks
14 caused by those threats. Valley uses a risk-based prioritization process to select
15 pipelines for replacement. Valley determines pipeline replacements by managing
16 the risk ranking of the different aspects of the pipeline and then replacing the pipe
17 based on the highest risk ranking.

18

19 **Q. WHAT ARE THE COMMON MITIGATION MEASURES TO REDUCE**
20 **PIPELINE RISK?**

21 A. The industry's common mitigation measure to reduce pipeline risk is to replace the
22 highest risk pipelines first. As a company replaces the pipelines calculated to be at

1 the highest risk, the total system risk should be reduced. The overall risk of the
2 asset group will reduce as the riskiest pipeline is replaced, if enough pipe is
3 replaced in that asset group annually to overcome the increasing risks on other
4 segments within that group.

5
6 **Q. SHOULD PIPELINE IMPROVEMENT MEASURES BE BASED ON**
7 **DIMP?**

8 A. Yes, the purpose of DIMP is to expose and replace the most at risk pipeline system
9 elements and mitigate as much risk to the distribution system as possible.

10
11 **Q. DO YOU HAVE ANY RECOMMENDATIONS WITH RESPECT TO HOW**
12 **THE COMPANY RANKS RISK?**

13 A. Yes. As discussed more fully below, I have a recommendation with respect to the
14 new regulators/reliefs asset category and the prioritization of vintage pipeline
15 replacement.

16
17 **Q. PLEASE EXPLAIN THE CONCERN WITH THE**
18 **“REGULATORS/RELIEFS” ASSET CATEGORY.**

19 A. Valley computes risk rankings in three years increments and the most recent
20 increment (2021-2023) includes district regulator stations and their needed
21 upgrades as the riskiest asset in the distribution system. However, district
22 regulator stations are not listed as an asset category in the 2015-2017 and 2018-

1 2020 DIMP models as provided in response to I&E-PS-10-
2 D.²“Regulators/Reliefs” were not a specified as an asset category prior to the 2021
3 revision of the DIMP.

4
5 **Q. WHY DID THE COMPANY INCLUDE “REGULATORS/RELIEFS” AS**
6 **AN ASSET CATEGORY IN THE 2021 DIMP?**

7 A. The Merrimack Valley incident and subsequent PHMSA advisory bulletin ADB-
8 20-02³ were taken into consideration when developing “Regulators/Reliefs” as a
9 specified asset category in DIMP as stated by Mr. Chapman in response to I&E-
10 PS-II-2.⁴ For further clarification, the Merrimack Valley incident occurred
11 September 13, 2018 when high pressure gas entered a low pressure distribution
12 system which resulted in a series of structure fires and explosions. Additionally,
13 PHMSA advisory bulletin ADB-20-02 provides that the Merrimack Valley
14 incident highlights the need for operators of low pressure systems to review
15 thoroughly their current DIMP for the threat of overpressurization and to make
16 any necessary changes or modifications to become fully compliant with the
17 Federal Pipeline Safety Regulations. While escalating a new asset category to the
18 highest risk score is not typical, it demonstrates Valley’s evolving
19 acknowledgement of system threats. To mitigate this risk, the Company has five
20 regulator station improvement projects planned in 2022 and ten regulator station

² See I&E Exh. No. 4, Sch. 1.

³ See <https://www.govinfo.gov/content/pkg/FR-2020-09-29/pdf/2020-21508.pdf>.

⁴ See I&E Exh. No. 4, Sch. 2.

1 improvements in 2023, as listed in response I&E-PS-18-D.⁵ However, it remains
2 to be seen if these mitigation efforts will reduce the risk score associated with the
3 new regulator/relief asset category.

4
5 **Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO THE NEW**
6 **“REGULATORS/RELIEFS” ASSET CATEGORY?**

7 A. I recommend more clearly defined and broken-down DIMP asset categories in
8 place of the large singular regulator/relief asset category. Dividing regulator/relief
9 asset categories by pressure, location, and customer type as well as any other
10 granular category will give Valley a clearer picture of the system risks and where
11 to make system improvements to reduce the risk.

12
13 **Q. PLEASE EXPLAIN YOUR SECOND CONCERN WITH RESPECT TO**
14 **VALLEY’S PLAN TO REPLACE VINTAGE PLASTIC PIPELINES.**

15 A. I have reviewed Mr. Chapman’s response to I&E-PS-17-D⁶ as it relates to
16 Valley’s plan to replace vintage plastic pipelines. It appears system improvement
17 projects are chosen using a risk-based prioritization process. Mr. Chapman states
18 that Valley’s vintage plastic mains are more susceptible to failure than other pipe
19 materials. However, I am concerned that Valley’s focus on vintage plastic mains

⁵ See I&E Exh. No. 4, Sch. 3.

⁶ See I&E Exh. No. 4, Sch. 4.

1 means that it is not addressing newer plastic pipe in its system that has an elevated
2 failure risk.

3
4 **Q. PLEASE EXPLAIN YOUR CONCERN.**

5 A. Valley provided a response to I&E-PS-3-D⁷ illustrating a high rate of failures on
6 non-vintage pipe that was installed between July 2013 and December 2013. Of
7 the fifteen plastic failures in the last five years, four of these failures were on
8 plastic pipe installed during the second half of 2013. Therefore, over 25% of the
9 plastic pipeline failures in the last five years were on pipe installed during a six-
10 month timeframe in 2013. Additionally, one failure occurred on pipe installed in
11 December 2020. These failures are not on vintage plastic pipelines and were not
12 addressed as a top ten risk category in the most recent DIMP model. Accordingly,
13 I am concerned that the Company's focus on vintage plastic pipe is misplaced as
14 failures are occurring on non-vintage pipe, predominately on plastic pipe installed
15 in 2013.

16
17 **Q. IN SUMMARY, WHAT ACTIONS DO YOU RECOMMEND THE**
18 **COMPANY IMPLEMENT?**

19 A. I recommend Valley perform a root cause analysis of the four plastic failures of
20 pipe installed in the six-month period between July and December of 2013 and use

⁷ See I&E Exh. No. 4, Sch. 5.

1 that data to determine if any specific pipeline assets outside of vintage plastic
2 could be at an elevated risk of failure. Additionally, Valley must incorporate the
3 findings of the root cause analysis into DIMP and this new asset category's risk
4 score being reduced through appropriate mitigative measures. Mitigative measures
5 should include but not be limited to pipeline replacement, increased leak survey of
6 the asset and reporting plastic failures to I&E Pipeline Safety upon discovery.

7
8 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

9 A. Yes

I&E Exhibit No. 4
Witness: Jessalynn Heydenreich

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Exhibits to Accompany

the

Direct Testimony

of

Jessalynn Heydenreich

Bureau of Investigation & Enforcement

Concerning:

PIPELINE ASSET REPLACEMENT PRIORITIES
DIMP RISK REDUCTION

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

I&E-PS-10-D Provide the risk ranking scores generated by Valley Energy's Distribution Integrity Management Plan (DIMP) for all asset categories each year from 2017 through 2021.

Response:

Please see Attachment A to IE-PS-10-D.

**Response Provided by: Edward E. Rogers, President and Chief Executive Officer
Valley Energy, Inc.**

Date: June 30, 2022

ATTACHMENT A
 IE-PS-10-D
 Page 1 of 2

2015 - 2017

ASSET CATEGORIES	RISK RANKING SCORE
Excavation Damage - third party	13.38
Excavation Damage - first/second party	12.84
Aldyl-A pipe	1.28
Compression Coupling - steel tee	1.28
Plastic Cap - Plexco Celcon	1.28
Weld - service joint	1.28
Compression Coupling - bolted	1.28
Compression Coupling - riser	4.16
Electrofusion Coupling	1.28
Electrofusion Tee	4.16
Plastic Cap - Central	4.16
Weld - service tee	1.28
Curb Valve - compression	1.47
Compression Coupling - permaserts	1.28
Weld - fitting	1.28
Valve - Kerotest	1.28

2018 - 2020

ASSET CATEGORIES	RISK RANKING SCORE
Excavation Damage - third party	12.42
Aldyl-A pipe	9.91
Compression Coupling - steel riser	9.91
Water Crossings/Sloped Areas	9.68
Excavation Damage - first/second party	8.10
Riser - inlet seal	4.16
Plastic Cap - Central	4.16
Compression Coupling - permaserts	4.16
Plastic Cap - Plexco Celcon	4.16
Steel Pipelines - internal corrosion	1.51
Curb Valve - compression	1.47
Weld - service joint	1.28
Weld - fitting	1.28
Electrofusion Coupling	1.28
Electrofusion Tee	1.28
Weld - service tee	1.28
Valve - Kerotest	1.28
Valve - malfunction	1.17
Meters	1.17
Meter Barricades	0
Steel Pipelines - atmospheric corrosion	0
Excavated Damage - concentrated	0
Excavation Damage - blasting	0
Plastic With Isolated Metallic Fittings	0
Human Performance	0
Steel Pipelines - external corrosion	0

ATTACHMENT A
IE-PS-10-D
 Page 2 of 2

2021 - 2023	
ASSET CATEGORIES	RISK RANKING
	SCORE
Regulators/Reliefs	27.88
Compression Coupling - steel riser	8.36
Compression Coupling - permaserts	8.36
Aldyl-A pipe	8.36
Excavation Damage - third party	8.06
Excavation Damage - mislocating	6.36
Riser - inlet seal	6.01
Compression Coupling - nut follower	6.01
Compression Coupling - steel tee	6.01
Flooding - Athens, South of RR	5.60
Excavation Damage - entire system	5.45
System - high winds	5.06
Excavation Damage - first/second party (EE Root)	4.85
Stream Crossings	4.70
Flooding - Tannery Curve	4.70
Excavation Damage - third party (MR Dirt)	4.55
Excavation Damage - third party (VACRI)	4.55
Flooding - Towanda	4.34
Flooding - Monroeton	4.15
Plastic Cap - Central	3.66
Plastic Cap - Plexco Celcon	3.66
Snow/Ice Damage	3.63
System - lightning	3.63
Steel Pipelines - internal corrosion	3.63
Excavation Damage - first/second party	3.50
Flooding - Milltown	3.33
Flooding - Ulster	3.33
Flooding - Wysox	3.33
Steel Pipelines - atmospheric corrosion	3.28
Flooding - E. Sayre	3.03
Steel Pipelines - external corrosion	2.48
System - outside force	1.72
System - incorrect operations (OQ revocation)	1.65
System - failure to follow procedures	1.65
System - D&A	1.65
Steel Pipelines - corrosion - entire system	1.34
Couplings - bolted	1.31
Valve - Kerotest	1.31
Electrofusion Coupling	1.28
Valve - malfunction	1.23

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

I&E-PS-II-2 Referencing Valley Energy's response to I&E-PS-10 regarding the 2021-2023 Risk Ranking Score of asset category "Regulators/Reliefs". Did Valley Energy assign that category a risk ranking score of 27.88 based on specific events that occurred on Valley Energy's system or is it based on the Merrimack Valley incident and subsequent PHMSA advisory bulletin ADB-20-02.

Response:

"Regulators/Reliefs" were not a specified category prior to the 2021 revision of the Distribution Integrity Management Plan (DIMP). The Risk Ranking Score is not based on specific events that occurred on Valley Energy's system. The Merrimack Valley incident and subsequent PHMSA advisory bulletin ADB-20-02 were taken into consideration when developing "Regulators/Reliefs" as a specified category in DIMP.

The Risk Ranking is based on the relative risk not absolute risk. It should not be construed to suggest that a high ranked category is unsafe, but a tool to assist Valley Energy to prioritize its programs. One threat of regulator or relief failures would be to cause system pressure to exceed the maximum allowable operating pressure (MAOP). Regulator and relief failures have a high likelihood to become Grade 1 leak. It is recognized that regulator/reliefs may pose a higher potential consequence due to a failure may result in some effort to evacuate certain facilities, such as hospitals, schools, nursing homes, etc.

All of Valley Energy's district regulator stations are designed with an external relief device or configured as a worker/monitor design. There have been no instances exceedance of MAOP and no affects to system or customers.

**Response Provided by: Cody Chapman, Vice President of Operations
Valley Energy, Inc.**

Date: July 18, 2022

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

I&E-PS-18-D Provide a breakdown of the forecasted capital spending on systemic improvements in 2022 and 2023. Explain what is included.

Response:

See Attachment A to IE-PS-18-D for breakdown of the forecasted capital spending on systemic improvements in 2022 and 2023.

Response Provided by: Edward E. Rogers, President and Chief Executive Officer
Valley Energy, Inc.

Date: June 30, 2022

ATTACHMENT A
IE-PS-18-D
 Page 1 of 1

Attachment A to I&E-PS-18-D

2022 BUDGET - IMPROVEMENTS*

System	Description	Budget (\$)
City Gate	Upgrade grounding grid and additional conduits along with installation of pressure transmitters on regulator runs for pressure monitoring and remote terminal unit (RTU) replacement	\$ 196,875
Distribution main	Replacement of 2" Aldyl-A main and associated services	\$ 115,937
District Regulator Station	Replacement of district regulator station	\$ 60,923
District Regulator Station	Addition of overpressure protection devices to district regulator stations (qty 4)	\$ 126,282
Services	Replacement of vintage plastic services or steel tubing services (qty 12)	\$ 39,219
Services	Relocate services from inside to outside location (qty 12)	\$ 38,392
Meter set	Upgrade and replacement of commercial meter set	\$ 13,255

2023 BUDGET - IMPROVEMENTS*

System	Description	Budget (\$)
Distribution main	Replacement of high pressure steel main for regulator station replacement	\$ 48,938
Distribution main	Replacement of 2" Aldyl-A main and associated services	\$ 127,196
District Regulator Station	Replacement of two district regulator station	\$ 90,285
District Regulator Station	Installation of pressure transmitters on regulator runs for pressure monitoring	\$ 41,985
District Regulator Station	Addition of overpressure protection devices to district regulator stations (qty 8)	\$ 244,151
Services	Replacement of vintage plastic services or steel tubing services (qty 24)	\$ 60,513
Services	Relocate services from inside to outside location (qty 9)	\$ 26,313

* Budget improvements do not include costs for replacement of meters and regulators, replacement of IT or communication equipment, replacement of or addition of tools, equipment or vehicles.

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

I&E-PS-17-D Referencing Mr. Roger's (statement no. 4); pages 6, lines 19-23 and page 7, lines 1-8, provide the details of Valley Energy's systemic improvements and how it changes DIMP risk ranking and risk scores.

Response:

The Company utilizes DIMP risk ranking and risk scores to assist in planning systemic improvements. Over the last ten years, these systemic improvements have eliminated risks (such as eliminating bare steel from the system) and have lowered others (such as replacing vintage Aldyl-A plastic main with new plastic pipe).

Relative risk scores are based on four factors--probability, consequence, leak cause factor, and incident probability; therefore, even though an asset's quantity has been reduced in the system doesn't always correlate with a lower relative risk score. When asset quantities are reduced, the risk ranking can be adjusted accordingly by the Company's subject matter experts.

The risks in the Company's DIMP model have been adjusted over the last three iterations to list risks in a concise manner in place of the broad way in which they were accounted for previously. These changes have also affected the risk rankings and relative risk scores.

In 2018, the Company removed the last of the bare steel pipe (mains and services) from its system. In turn, this removed bare steel pipe as a risk on the DIMP risk ranking. The Company has been replacing vintage Aldyl-A plastic mains and services, which are prone to cracking due to the brittle nature of the pipe and stone/rock impingement. While the risk score for Aldyl-A pipe has not gone down, the quantity of the pipe within the system has been reduced.

The Company has added, replaced, or upgraded fourteen district regulator stations over the last ten years. These improvements have been made to address the high relative risk score that regulator and relief failures display in the Company's DIMP model. District regulator stations are designed with an external relief device or configured as a worker/monitor design. These designs, adhering to Code of Federal Regulations (CFR) 49, Parts 192.195, 192.199 and 192.201, only take into account one failure; therefore, the Company has started a plan to add an additional level of protection to each district regulator station that serves a low pressure system where site constraints allow. So far, four secondary relief stations have been added to district regulator stations, with four more planned in 2022. To further protect the Company's distribution system, the Company has added five remote pressure monitoring devices. These devices monitor and record the pressure of the systems and provide alerts if there is an overpressure or loss of pressure situation, possibly indicating a failure with a regulator or relief.

I&E Exhibit No. 4
Schedule No. 4
Page 2 of 2
Witness: Jessalynn Heydenreich

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

The compression couplings on plastic pipe have been ranked as the number two risk in the latest DIMP plan. This is due to being located near a building and the high likelihood that they will result in a Grade 1 leak. The Company no longer uses stab-type compression couplings on medium (elevated) pressure systems or services. Risers are purchased without the compression coupling on them and an electrofusion coupling is used in its place. By doing this, it reduces the number of couplings in the system that carry this higher risk.

**Response Provided by: Cody Chapman, Vice President of Operations
Valley Energy, Inc.**

Date: June 30, 2022

**VALLEY ENERGY, INC. RESPONSE TO
BUREAU OF INVESTIGATION AND ENFORCEMENT'S DATA REQUEST
DOCKET NO. R-2022-3032300**

I&E-PS-3-D Reference number 2 above and include the installation date of failed plastic material.

Response:

	2017	2018	2019	2020	2021
Installation date of failed plastic material	9/26/86 2/4/94 5/23/05 12/1/13	8/23/71 10/6/86 8/6/96 7/22/13 9/18/13	10/4/86 3/27/95	12/3/13	10/20/86 1/25/96 12/30/20

**Response Provided by: Edward E. Rogers, President and Chief Executive Officer
Valley Energy, Inc.**

Date: June 30, 2022

**I&E Statement No. 1-SR
Witness: Brian LaTorre**

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Surrebuttal Testimony

of

Brian LaTorre

Bureau of Investigation & Enforcement

Concerning:

OPERATING AND MAINTENANCE EXPENSES

CASH WORKING CAPITAL

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OFFICE SUPPLIES AND EXPENSE	4
COVID-19 RELATED EXTRAORDINARY COSTS.....	6
CASH WORKING CAPITAL.....	9

1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Brian LaTorre, and my business address is Pennsylvania Public Utility
4 Commission, Commonwealth Keystone Building, 400 North Street, Harrisburg,
5 PA 17120.

6

7 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

8 A. I am employed by the Pennsylvania Public Utility Commission (Commission) in
9 the Bureau of Investigation & Enforcement (I&E) as a Fixed Utility Financial
10 Analyst.

11

12 **Q. ARE YOU THE SAME BRIAN LATORRE WHO SUBMITTED I&E
13 STATEMENT NO. 1 AND I&E EXHIBIT NO. 1?**

14 A. Yes.

15

16 **Q. DOES YOUR SURREBUTTAL TESTIMONY INCLUDE AN
17 ACCOMPANYING EXHIBIT?**

18 A. No, however I refer to my direct testimony¹ and its accompanying exhibit² in this
19 surrebuttal testimony.

¹ I&E Statement No. 1.

² I&E Exhibit No. 1.

1 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

2 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of
3 Valley Energy, Inc. (Valley or Company) witness Howard S. Gorman (Valley
4 Statement No. 1-R) regarding operating and maintenance (O&M) expenses, state
5 income tax expense, and cash working capital.

6

7 **Q. DID THE COMPANY UPDATE ITS OVERALL REVENUE**
8 **REQUIREMENT CLAIM IN REBUTTAL TESTIMONY?**

9 A. No. The Company is continuing to request an annual total revenue increase of
10 \$999,631, however its supported increase was revised from \$1,234,913 to
11 \$1,218,962 in its rebuttal testimony by changing its rate base claim from
12 \$19,775,484 to \$19,756,771, and total operating expense claim from \$3,623,229 to
13 \$3,617,748.³

14

15 **Q. SUMMARIZE YOUR RECOMMENDED ADJUSTMENTS AS UPDATED**
16 **IN THIS SURREBUTTAL TESTIMONY.**

17 A. My updated recommended adjustments to O&M expenses and cash working
18 capital are as follows:

³ Valley Exhibit HSG-1R, Schedule C1 (R).

	Company Claim	I&E Recommended Allowance	I&E Adjustment
O&M Expenses:			
Office Supplies and Expense	\$80,374	\$66,964	<u>(\$13,410)</u>
Total O&M Adjustments			<u>(\$13,410)</u>
Rate Base Adjustments:			
Cash Working Capital	\$432,549	\$430,873	<u>(\$1,676)</u>
Total Rate Base Adjustments			<u>(\$1,676)</u>

1

2

3 **Q. DID THE COMPANY ACCEPT ANY OF YOUR RECOMMENDED**
4 **ADJUSTMENTS?**

5 A. Yes. Valley witness Howard Gorman accepts my recommended reduction to the
6 Pennsylvania corporate income tax rate (from 9.99% to 8.99%), and the change is
7 reflected in the Company's rebuttal filing.⁴

8

9 **SUMMARY OF I&E OVERALL UPDATED POSITION**

10 **Q. WHAT IS I&E'S TOTAL RECOMMENDED REVENUE REQUIREMENT?**

11 A. I&E's updated total recommended revenue requirement for the Company is
12 \$6,477,547. This recommended revenue requirement represents an increase of

⁴ Valley Statement No. 1R, p. 3.

1 \$956,372 to the claimed present rate revenues of \$5,521,175. This total
 2 recommended allowance incorporates my adjustments made in this testimony to
 3 O&M expenses and cash working capital and those recommended adjustments
 4 made in the testimony of I&E witness Christopher Keller.⁵

5 A calculation of the I&E recommended revenue requirement is shown
 6 below:

Valley Energy, Inc. R-2022-3032300		TABLE I INCOME SUMMARY			
	12/31/23 Proforma	INVESTIGATION & ENFORCEMENT			
	Present Rates	Adjustments	Present Rates	Allowances	Proposed
	\$	\$	\$	\$	\$
Operating Revenue	5,521,175	0	5,521,175	956,372	6,477,547
Deductions:					
O&M Expenses	3,617,748	-13,410	3,604,338	6,456	3,610,794
Depreciation	1,178,428	0	1,178,428		1,178,428
Taxes, Other	34,169	0	34,169	0	34,169
Income Taxes:					
Current State	-41,915	1,209	-40,706	85,397	44,691
Current Federal	37,809	2,570	40,379	181,549	221,928
Deferred Taxes	-9,148	0	-9,148		-9,148
ITC	0	0	0		0
Total Deductions	4,817,091	-9,631	4,807,460	273,402	5,080,862
Income Available	704,084	9,631	713,715	682,970	1,396,685
Rate Base	19,756,771	-1,676	19,755,095	0	19,755,095
Rate of Return	3.56%		3.61%		7.07%

7
8
9 **OFFICE SUPPLIES AND EXPENSE**

10 **Q. SUMMARIZE YOUR RECOMMENDATION IN DIRECT TESTIMONY**
 11 **FOR OFFICE SUPPLIES AND EXPENSE.**

12 **A.** I recommended an allowance of \$66,964, or a reduction of \$13,410 (\$80,374 -

⁵ I&E Statement No. 2-SR.

1 \$66,964) to the Company's claim.⁶ My recommendation was based on a lack of
2 support for the Company's projected increase from the future test year (FTY) to
3 the fully projected future test year (FPFTY) due to increases in travel, training,
4 and associated meals as there would be no new hires to train in the FPFTY.⁷
5

6 **Q. DID ANY WITNESS RESPOND TO YOUR RECOMMENDATION?**

7 A. Yes. Valley witness Howard Gorman disagrees with my recommended adjustment
8 to office supplies and expense.⁸
9

10 **Q. PLEASE SUMMARIZE MR. GORMAN'S RESPONSE.**

11 A. Mr. Gorman states that the new Training and Compliance Coordinator will be
12 hired in August 2022, and training for the new employee is not provided solely
13 within the year the new employee is hired but is an ongoing process that involves
14 multiple years, which leads to higher costs in the following year, the FPFTY.⁹
15

16 **Q. WHAT IS YOUR RESPONSE TO MR. GORMAN?**

17 A. In response to I&E-RE-14-D,¹⁰ the Company was asked to explain the increases to
18 office supplies and expenses of \$22,066 from the HTY to the FTY and \$13,410
19 from the FTY to the FPFTY. The Company cited initial training for the new
20 employee as one of the reasons for the increase in the FTY but did not cite training

⁶ I&E Statement No. 1, p. 5.

⁷ I&E Statement No. 1, pp. 5-6.

⁸ Valley Statement No. 1-R, p. 3.

⁹ Valley Statement No. 1-R, p. 3.

¹⁰ I&E Exhibit No. 1, Schedule 1, p. 1.

1 for the new employee as a factor in the FPFTY. The Company only cited an
2 “increase in travel, training, and associated meals” as the reason for the additional
3 expenses in the FPFTY. While I do not dispute that training of the new employee
4 may extend to the FPFTY, it is reasonable to assume that a majority of the training
5 will occur in the first three months of the new employee’s tenure, which is in the
6 FTY. The Company has not supported the additional \$13,410 in expenses above
7 the additional \$22,066 that the Company is claiming in the FTY.

8
9 **Q. DO YOU HAVE ANY CHANGES TO YOUR RECOMMENDATION FOR**
10 **OFFICE SUPPLIES AND EXPENSE?**

11 A. No. I continue to recommend an allowance of \$66,964, and accordingly, a
12 reduction of \$13,410 to the Company’s claim of \$80,374 as discussed above and
13 in my direct testimony.¹¹

14
15 **COVID-19 RELATED EXTRAORDINARY COSTS**

16 **Q. SUMMARIZE YOUR RECOMMENDATION IN DIRECT TESTIMONY**
17 **FOR COVID-19 RELATED EXTRAORDINARY COSTS.**

18 A. I accepted the Company’s total deferral claim of \$32,277 for the 2020 and 2021
19 COVID-19 extraordinary costs, as well as the proposed three-year amortization
20 period. I also recommended that the Company should not be allowed to continue
21 recording a regulatory asset for ongoing COVID-19 related incremental

¹¹ I&E Statement No. 1, pp. 5-6.

1 uncollectible accounts costs and for other COVID-19 related expenses after the
2 effective date of new rates for the instant proceeding. My recommendation was
3 based on the Company having a new uncollectible account percentage built into
4 rates that accounts for the increased delinquency rates and higher customer
5 balances. Additionally, any other COVID-19 related expenses such as masks,
6 hand sanitizers, etc. should be built into routine expenses and are likely not
7 material in nature. Finally, in the current inflationary environment, many
8 ratepayers will likely struggle to pay utility bills for reasons unrelated to the
9 COVID-19 pandemic, and, therefore, the Company should not be allowed to
10 continue deferring new expenses beyond the effective date of new rates in this
11 proceeding.¹²

12
13 **Q. DID ANY WITNESS RESPOND TO YOUR RECOMMENDATION?**

14 A. Yes. Valley witness Howard Gorman responded to my recommendation for
15 COVID-19 related extraordinary costs.¹³

16
17 **Q. SUMMARIZE MR. GORMAN'S RESPONSE TO YOUR**
18 **RECOMMENDATION REGARDING COVID-19 RELATED**
19 **EXTRAORDINARY COSTS.**

20 A. Mr. Gorman agreed that when the deferred COVID costs are fully recovered, that
21 amount should be removed from rates and should not extend beyond the three-year

¹² I&E Statement No. 1, pp. 9-10.

¹³ Valley Statement No. 1, p. 3.

1 amortization period. He further opines that because the Company's requested rate
2 increase is below the total revenue supported, it is debatable whether the Company
3 is recovering these costs at all. He then agrees that the Company will not include
4 any of these costs in a future rate case.¹⁴

5
6 **Q. DO YOU AGREE WITH MR. GORMAN?**

7 A. No. It is unclear what costs Mr. Gorman refers to when he states that the
8 Company will not include these costs in a future rate case. It appears that he is
9 only referring to COVID-19 costs that are claimed in the instant proceeding,
10 leaving the possibility that the Company will attempt to include "extraordinary"
11 COVID-19 costs beyond what are claimed in this proceeding in a future rate case.

12
13 **Q. DO YOU HAVE ANY CHANGES TO YOUR RECOMMENDATION FOR**
14 **COVID-19 RELATED EXTRAORDINARY COSTS?**

15 A. No. I continue to recommend that the Company should not be allowed to continue
16 recording a regulatory asset for ongoing COVID-19 related incremental
17 uncollectible accounts costs and for other COVID-19 related expenses after the
18 effective date of new rates for the instant proceeding as discussed above and in my
19 direct testimony.¹⁵

¹⁴ Valley Statement No. 1, p. 3.

¹⁵ I&E Statement No. 1 pp. 6-10.

1 **CASH WORKING CAPITAL**

2 **Q. SUMMARIZE YOUR RECOMMENDATION IN DIRECT TESTIMONY**
3 **FOR CASH WORKING CAPITAL (CWC).**

4 A. I recommended an allowance of \$431,558 or a reduction of \$1,676 (\$433,234 -
5 \$431,558).¹⁶ My recommendation included modification of the Company's claim
6 based on all recommended adjustments to O&M expenses discussed my direct
7 testimony.

8
9 **Q. DID ANY WITNESS RESPOND TO YOUR RECOMMENDATION?**

10 A. Yes. Valley witness Howard Gorman states that the Company agrees that CWC
11 should be adjusted to reflect the final revenue requirement.¹⁷

12
13 **Q. DID THE COMPANY UPDATE ITS CWC CLAIM IN REBUTTAL**
14 **TESTIMONY?**

15 A. Yes.

16
17 **Q. WHAT IS THE COMPANY'S UPDATED CWC CLAIM?**

18 A. Valley updated its FPPTY CWC claim from \$433,234 to \$432,549.¹⁸

¹⁶ I&E Statement No. 1, p. 13.

¹⁷ Valley Statement No. 1R, p. 3.

¹⁸ Valley Exhibit HSG-1R Schedule C1-6 (R), p. 1.

1 **Q. DO YOU AGREE WITH THE COMPANY’S UPDATED CLAIM?**

2 A. No. I disagree based on my recommended adjustment to O&M expenses as
3 explained below.

4

5 **Q. DO YOU HAVE AN UPDATED RECOMMENDATION FOR CWC?**

6 A. Yes. As stated in my direct testimony, all O&M expense adjustments that are
7 cash-based expense claims are included when determining the Company’s overall
8 CWC requirement. Therefore, my updated recommended allowance for CWC is
9 \$430,873 or a reduction of \$1,676 to the Company’s claim as shown in the table
10 below:

Company’s Updated CWC Claim		\$432,549
I&E Updated O&M Adjustments:		
Total O&M Adjustments (Office Supplies & Expenses)	<u>(\$13,410)</u>	
1/8 of Total O&M Adjustments		<u>(\$1,676)</u>
I&E Updated CWC Allowance		<u>\$430,873</u>

11

12

13 **Q. IS YOUR RECOMMENDED CWC ALLOWANCE A FINAL**
14 **RECOMMENDATION?**

15 A. No. All adjustments to the Company’s claims for revenues, expenses, and rate
16 base must be consistently brought together in the Administrative Law Judge’s
17 Recommended Decision and again in the Commission’s Final Order. This process,
18 which is known as iteration, effectively prevents the determination of a precise

1 calculation until such time as all adjustments have been made to the Company's
2 claim.

3

4 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

5 A. Yes.

**I&E Statement No. 2-SR
Witness: Christopher Keller**

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Surrebuttal Testimony

of

Christopher Keller

Bureau of Investigation & Enforcement

Concerning:

Rate of Return

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1 **INTRODUCTION OF WITNESS**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Christopher Keller. My business address is Pennsylvania Public Utility
4 Commission, Commonwealth Keystone Building, 400 North Street, Harrisburg, PA
5 17120.

6

7 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

8 A. I am employed by the Pennsylvania Public Utility Commission (Commission) in the
9 Bureau of Investigation & Enforcement (I&E) as a Fixed Utility Financial Analyst.

10

11 **Q. ARE YOU THE SAME CHRISTOPHER KELLER WHO SUBMITTED THE**
12 **DIRECT TESTIMONY CONTAINED IN I&E STATEMENT NO. 2 AND I&E**
13 **EXHIBIT NO. 2?**

14 A. Yes.

15

16 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

17 A. The purpose of my surrebuttal testimony is to address statements made by Valley Energy,
18 Inc. (Valley or Company) witness Dylan W. D'Ascendis (Valley Statement No. 2R) in
19 his rebuttal testimony regarding rate of return topics including the cost of common equity
20 and the overall fair rate of return, which will be applied to the Company's rate base. I
21 will also address the Company's size adjustment and management performance claims
22 discussed by Mr. D'Ascendis and Company witnesses Howard S. Gorman (Valley
23 Statement No. 1R) and Edward E. Rogers (Valley Statement No. 4R).

1 **SUMMARY OF MR. D’ASCENDIS’ REBUTTAL TESTIMONY**

2 **Q. SUMMARIZE MR. D’ASCENDIS’ RESPONSE TO YOUR RATE OF RETURN**
3 **RECOMMENDATIONS.**

4 A. Mr. D’Ascendis disputes my recommendations by first claiming that I failed to consider
5 the results of cost of equity models other than the Discounted Cash Flow (DCF) model.
6 Next, he criticizes my application of the Capital Asset Pricing Model (CAPM), claiming
7 that I have incorrectly relied on the 10-year Treasury Bond for my risk-free rate and have
8 not employed the Empirical CAPM (ECAPM). Mr. D’Ascendis also takes issue with my
9 dismissal of his Non-Price Regulated Proxy Group. He claims that I fail to account for
10 Valley’s size-specific risk. Finally, he disagrees with my recommended disallowance of
11 additional basis points for management performance.

12
13 **DISCOUNTED CASH FLOW**

14 **Q. SUMMARIZE MR. D’ASCENDIS’ REBUTTAL TESTIMONY REGARDING**
15 **YOUR DCF ANALYSIS.**

16 A. Mr. D’Ascendis opines that I have inappropriately relied solely on the DCF model for my
17 cost of equity recommendations (Valley Statement No. 2R, p. 4). He presents three cases
18 where he claims the Commission has considered multiple cost of equity models (Valley
19 Statement No. 2R, pp. 21-23). Then, Mr. D’Ascendis argues that market-to-book (M/B)
20 ratios have been in line with or above the ten-year average and likely cause the DCF
21 results to understate the investor-required return. He argues that the difference between
22 the market value, on which investors evaluate and receive their returns, and the book
23 value, on which regulators authorize returns, will cause the market-based results of the
24 DCF, which are applied to the book value capital structure, to understate the cost of

1 equity (Valley Statement No. 2R, pp. 12-18). Finally, although Mr. D’Ascendis is not
2 advocating for a leverage adjustment to the results of the DCF, he claims he provided the
3 discussion with the purpose of demonstrating the model’s limitations and supporting the
4 use of multiple models (Valley Statement No. 2R, p. 18).

5
6 **ALLEGED SOLE RELIANCE ON THE DCF**

7 **Q. PLEASE RESPOND TO MR. D’ASCENDIS’ ASSERTION THAT YOU RELIED**
8 **SOLELY ON THE DCF.**

9 A. As stated in my direct testimony, while my recommendation was based on the results of
10 my DCF analysis, I also employed the CAPM as a comparison only, as the DCF method
11 is the most reliable (I&E Statement No. 2, pp. 16-18). I have considered the fact that no
12 method can perfectly predict the return on equity, which is why I also use the CAPM as a
13 comparison to the DCF. Although no one method can capture every factor that
14 influences an investor, including the results of methods less reliable than the DCF, this
15 does not make the end result of the DCF less reliable or less accurate. As a result, I stand
16 by my method of using the DCF with a CAPM comparison, which is consistent with the
17 methodology historically used by the Commission in base rate proceedings, even as
18 recently as 2017, 2018, 2020, and 2021.¹

¹ *Pa. PUC v. City of DuBois – Bureau of Water*; Docket No. R-2016-2554150 (Order Entered March 28, 2017). *See generally* Disposition of Cost Rate Models, pp. 96-97; *Pa. PUC v. UGI Utilities, Inc. – Electric Division*; Docket No. R-2017-2640058 (Order Entered October 25, 2018). *See generally* Disposition of Cost of Common Equity, p. 119; *Pa. PUC v. Wellsboro Electric Company*; Docket No. R-2019-3008208 (Order Entered April 29, 2020). *See generally* Disposition of Primary Methodology to Determine ROE, pp. 80-81; *Pa. PUC v. Citizens Electric Company of Lewisburg, PA*; Docket No. R-2019-3008212 (Order Entered April 29, 2020). *See generally* Disposition of Cost of Common Equity, pp. 91-92. *Pa. PUC v. Columbia Gas of Pennsylvania, Inc.*; Docket No. R-2020-3018835 (Order Entered February 19, 2021). *See generally* Disposition of Cost of Common Equity, p. 131. *Pa. PUC v. PECO Energy Company – Gas Division*; Docket No. R-2020-3018929 (Order Entered June 22, 2021). *See generally* Disposition of Return of Rate on Common Equity, p. 171.

1 **Q. WHICH CASES DOES MR. D’ASCENDIS MENTION WHERE HE CLAIMS**
2 **THE COMMISSION HAS CONSIDERED MULTIPLE COST OF EQUITY**
3 **MODELS?**

4 A. Mr. D’Ascendis mentions the 2013 Columbia Water Company,² the 2014 Emporium
5 Water Company,³ and the 2021 Aqua Pennsylvania, Inc.⁴ cases to suggest the
6 Commission has considered multiple cost of common equity models (Valley Statement
7 No. 2R, pp. 21-23).

8

9 **Q. WHAT COMMENTS DO YOU HAVE REGARDING THE CASES MR.**
10 **D’ASCENDIS MENTIONS?**

11 A. First, within the citation Mr. D’Ascendis presents regarding the Columbia Water
12 Company case, the Commission specifically states that it used the DCF method as the
13 foundation in determining the cost of equity (Valley Statement No. 2R, p. 21). Any
14 adjustments to the cost of equity after the fact are at the Commission’s discretion and
15 independent of the result of any cost of equity model. Regarding the Emporium Water
16 Company case, the Commission simply summarized the recommendations presented by
17 OCA, I&E, and the Company; it did not specifically comment on which model(s) it relied
18 upon (Valley Statement No. 2R, pp. 21-22). Regarding the Aqua Pennsylvania, Inc.,
19 case, as I stated in my direct testimony, Aqua’s return on equity of 10.00% is above the
20 national average for water utility base rate cases and above the Distribution System

² *Pa. PUC v. The Columbia Water Company*, Docket No. R-2013-2360798, Order Entered January 23, 2014.

³ *Pa. PUC v. Emporium Water Company*, Docket No. R-2014-2402324, Order Entered January 28, 2015.

⁴ *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket Nos. R-2021-3027385 & R-2021-3027386, Order entered May 16, 2022.

1 Improvement Charge (DSIC) authorized by the Commission of 9.80%⁵ for water and
2 wastewater utilities based on the year ended March 31, 2022, issued at the recent Public
3 Meeting held August 4, 2022 which demonstrates the problem associated with using the
4 CAPM as a ceiling for determining a utility's return on equity. Additionally, the use of
5 the CAPM in this proceeding would result in a significant burden to ratepayers during a
6 time of increasing levels of inflation and economic decline (I&E Statement No. 2, p. 21,
7 line 13 through p. 22, line 16). Finally, as stated in my direct testimony, I did in fact
8 employ the CAPM as a comparison to my DCF result and my recommendation is
9 consistent with the methodology historically used by the Commission in base rate
10 proceedings, even as recently as 2017, 2018, 2020, and 2021⁶ (I&E Statement No. 2, p.
11 16, lines 3-10).

12 **MARKET-TO-BOOK RATIO**

14 **Q. WHAT DOES MR. D'ASCENDIS CLAIM REGARDING MARKET-TO-BOOK**
15 **RATIOS IN THIS PROCEEDING?**

16 **A.** He opines that a M/B ratio above 1.0 causes the market based DCF to understate the
17 return required by investors (Valley Statement No. 2R, p. 12-13).

⁵ PA Public Utility Commission, Bureau of Technical Utility Services Report on the Quarterly Earnings of Jurisdictional Utilities for the Year Ended March 31, 2022, p. 27, approved at Public Meeting on August 4, 2022 at Docket No. M-2022-3033561.

⁶ *Pa. PUC v. City of DuBois – Bureau of Water*; Docket No. R-2016-2554150 (Order Entered March 28, 2017). *See generally* Disposition of Cost Rate Models, pp. 96-97; *Pa. PUC v. UGI Utilities, Inc. – Electric Division*; Docket No. R-2017-2640058 (Order Entered October 25, 2018). *See generally* Disposition of Cost of Common Equity, p. 119; *Pa. PUC v. Wellsboro Electric Company*; Docket No. R-2019-3008208 (Order Entered April 29, 2020). *See generally* Disposition of Primary Methodology to Determine ROE, pp. 80-81; *Pa. PUC v. Citizens Electric Company of Lewisburg, PA*; Docket No. R-2019-3008212 (Order Entered April 29, 2020). *See generally* Disposition of Cost of Common Equity, pp. 91-92. *Pa. PUC v. Columbia Gas of Pennsylvania, Inc.*; Docket No. R-2020-3018835 (Order Entered February 19, 2021). *See generally* Disposition of Cost of Common Equity, p. 131.

1 **Q. DOES A MARKET-TO-BOOK RATIO ABOVE ONE (1.0) CAUSE THE DCF TO**
2 **INCORRECTLY ESTIMATE THE INVESTOR-REQUIRED RETURN ON**
3 **EQUITY?**

4 A. No. Although, there are differences between the book value and market value of gas
5 utilities, Mr. D'Ascendis' assertion that the difference causes the DCF to undervalue the
6 rate of return assumes that investors are unaware of the difference. The forecasted
7 growth rates used in the DCF are set by analysts based on current conditions and what
8 they expect the future could be for the stock. If a market-to-book ratio is above 1.0, no
9 rational investor would invest in a utility stock that has been trading above book value for
10 several years and be surprised that rates continue to be set based on the book value capital
11 structure. A market-to-book ratio of above 1.0 for utility stocks reflects their value in the
12 market and implies that investors expect future cash flows to be more valuable than the
13 historical accounting value of the company. Since the stock market is impacted by
14 regulatory policies and economic and financial conditions, a market-to-book ratio could
15 be less than 1.0 when the stock market is in a depression or a company is experiencing
16 under-performance, so it is inappropriate to evaluate DCF results with the market-to-book
17 ratio.

18

19 **CAPITAL ASSET PRICING MODEL**

20 **Q. SUMMARIZE MR. D'ASCENDIS' RESPONSE TO YOUR CAPM ANALYSIS.**

21 A. Mr. D'Ascendis disputes my use of the 10-year U.S. Treasury Note as a proxy to measure
22 the risk-free rate that I use in my CAPM analysis as well as the inputs I chose from Blue
23 Chip forecasts. He also disagrees with my exclusion of the ECAPM method of
24 computing the Company's return on equity (Valley Statement No. 2R, p. 23).

1 **RISK-FREE RATE**

2 **Q. WHAT IS MR. D’ASCENDIS’ RESPONSE TO YOUR USE OF THE YIELD ON**
3 **THE 10-YEAR U.S. TREASURY BOND?**

4 A. Mr. D’Ascendis claims his use of the yield on a 30-year U.S. Treasury Bond is more
5 appropriate than my use of the yield on a 10-year Treasury Bond because it better reflects
6 the life of the underlying investment. He also claims 30-year U.S. Treasury Bonds do not
7 have maturity risk as an investor will receive the stated coupon rate and principal when
8 the bond has matured. Additionally, he asserts that since the cost of equity is a long-term
9 concept, the investment horizon of an individual investor is irrelevant. Finally, he claims
10 that not incorporating the longest projection available is inconsistent with the DCF
11 assumption of a constant rate of dividend growth and the Efficient Market Hypothesis
12 (EMH), which assumes that all available information is considered by investors (Valley
13 Statement No. 2R, pp. 23-26).

14
15 **Q. IS THE LIFE OF THE INVESTMENT THE ONLY FACTOR THAT SHOULD BE**
16 **CONSIDERED IN THE CHOICE OF A RISK-FREE RATE?**

17 A. No. The risk-free rate is the return that can be earned without accepting any risk, and
18 while the life of the investment can be considered in the choice of risk-free rates, the
19 most important consideration is that the rate be as risk-free as possible. As explained in
20 my direct testimony, I chose the 10-year Treasury Note as it mitigates the short-comings
21 of the short-term Treasury-Bill and the 30-year Treasury Bond (I&E Statement No. 2, p.
22 28, line 9 through p. 29, line 6). Although long-term Treasury Bonds have less risk of
23 being influenced by federal policies, they have substantial maturity risk associated with

1 market risk. In addition, long-term Treasury Bonds bear the risk of unexpected inflation.
2 As such, my choice of a 10-year Treasury Note is appropriate. Further, as also pointed
3 out in my direct testimony, the Commission recently agreed with I&E that the 10-year
4 Treasury Note is the superior measure of the risk-free rate of return.⁷
5

6 **Q. DO YOU AGREE WITH MR. D’ASCENDIS THAT 30-YEAR TREASURY**
7 **BONDS DO NOT HAVE MATURITY RISK?**

8 A. No. Longer term bonds have maturity risk associated with them because long term
9 forecasts are less accurate in predicting inflation, interest rates, the market as a whole,
10 changes in the tax code, and other unpredictable events that affect the value of a bond;
11 therefore, their uncertainty, or risk, is increased. Accordingly, the 10-year U.S. Treasury
12 Note is superior to the 30-year Treasury Bond in providing a measurement of the risk-
13 free rate of return.
14

15 **Q. DOES THE PROJECTED RISK-FREE RATE NEED TO REPRESENT THE**
16 **LONGEST TIME PERIOD AVAILABLE AS MR. D’ASCENDIS CLAIMS?**

17 A. No. The time period reflected in a projected risk-free rate should include the period in
18 which rates will be in effect. Since Valley is not setting rates to be applicable far into the
19 future, using projections for six or more years from now, as Mr. D’Ascendis suggests, is
20 inappropriate (Valley Statement No. 2R, p. 25). The yield on the 10-year Treasury Note
21 is expected to range between 3.00% and 3.30% from the third quarter of 2022 through the
22 third quarter of 2023 and is forecasted to be 2.90% from 2023-2027. For my forecasted

⁷ *Pa. PUC v. UGI Utilities, Inc. – Electric Division*; Docket No. R-2017-2640058 (Order Entered October 25, 2018).
See generally Disposition of Capital Asset Pricing Model (CAPM), p. 99.

1 CAPM analysis, I calculated 3.15%, which is the average of all the yields I observed
2 (I&E Exhibit No. 2, Schedule 9). In addition, the further out into the future one forecasts,
3 the less reliable and more speculative the estimates become; therefore, to give more
4 weight to less reliable estimates would not be prudent. My calculation provides a balance
5 of shorter-term future estimates.

6
7 **EXCLUSION OF THE ECAPM**

8 **Q. PLEASE SUMMARIZE MR. D’ASCENDIS’ RESPONSE TO YOUR EXCLUSION**
9 **OF THE ECAPM IN YOUR ANALYSIS.**

10 A. Mr. D’Ascendis asserts that the empirical Security Market Line (SML) described by the
11 traditional CAPM is not as steeply sloped as the CAPM model predicts and that tests of
12 the CAPM have measured the level of which security returns and betas are related as
13 predicted by the CAPM (Valley Statement No. 2R, pp. 26-29).

14
15 **Q. WHY IS THE ECAPM EXCLUDED FROM YOUR ANALYSIS?**

16 A. The ECAPM is a modified version of the CAPM which attempts to address the belief that
17 the actual risk vs. return correlation is flatter than what is predicted by the CAPM. The
18 implication is that the CAPM underestimates returns with lower levels of risk and
19 overestimates the returns associated with higher levels of risk. The model entails
20 assigning 25% weight to the market beta and 75% weight to the individual company or
21 proxy group.⁸

22 Additionally, the use of the ECAPM in estimating the cost of capital does not

⁸ David C. Parcell, “The Cost of Capital – A Practitioner’s Guide,” 2010 Edition, p. 104.

1 increase the validity of the result but merely adds another measure of subjectivity to the
2 CAPM in an attempt to make the SML more accurate. The ECAPM reduces the purpose
3 of the beta, which is the only company-specific variable in the CAPM model. This
4 additional layer of subjectivity provides an even stronger basis to rely on the DCF as the
5 primary method to calculate a utility's cost of equity.

6
7 **Q. HAVE YOU CHANGED YOUR CAPM RETURN ON EQUITY**
8 **RECOMMENDATION AS A RESULT OF MR. D'ASCENDIS' REBUTTAL**
9 **TESTIMONY?**

10 A. No. I continue to recommend using my CAPM result of 13.53% (I&E Exhibit No. 2,
11 Schedule 11) only as a comparison to my DCF result of 9.70% (I&E Exhibit No. 2,
12 Schedule 7).

13
14 **NON-PRICE REGULATED PROXY GROUP**

15 **Q. WHAT WAS YOUR RECOMMENDATION IN DIRECT TESTIMONY**
16 **CONCERNING MR. D'ASCENDIS' UTILIZATION OF A NON-REGULATED**
17 **PROXY GROUP?**

18 A. I recommended the Commission reject all analyses performed using the non-price
19 regulated company proxy group as it is highly speculative and subjective. Mr.
20 D'Ascendis' non-regulated proxy group in effect blends the CE approach into the DCF,
21 RP, and CAPM models, and I cited that the Commission has ruled on the use of non-
22 utility companies in comparable groups for the CE approach as being highly speculative
23 (I&E Statement No. 2, pp. 36-37).

1 **Q. SUMMARIZE MR. D’ASCENDIS’ RESPONSE REGARDING YOUR**
2 **DISAGREEMENT WITH HIS USE OF A NON-REGULATED PROXY GROUP.**

3 A. In rebuttal testimony, Mr. D’Ascendis attempts to justify the use of the companies
4 contained in his non-regulated proxy group based on the betas and standard errors of the
5 regression being similar to that of the companies in his gas company proxy group,
6 therefore, opining they are similar to Valley (Valley Statement No. 2R, pp. 38-41).

7
8 **Q. HAS MR. D’ASCENDIS PROVEN THAT THE RISKS FACED BY HIS NON-**
9 **REGULATED PROXY GROUP ARE SIMILAR TO THAT OF HIS GAS**
10 **UTILITY GROUP?**

11 A. No. The risks faced in each industry for the companies used in Mr. D’Ascendis’
12 unregulated group differ from the risks faced by his gas utility group. Specifically, the
13 level of competition between non-price regulated companies and monopolies, which
14 utilities largely are, is too difficult a factor to control. Although beta is an indicator of a
15 company’s investment risk in relation to the entire stock market, beta is not a
16 quantification of the total investment risk of a given company. Mr. D’Ascendis’
17 unregulated proxy group may have a beta comparable to that of his gas proxy group, but
18 that does not mean the companies face sufficiently similar risks to be used as a substitute
19 for an industry’s market. Both beta and the standard error of regression are measures of
20 the past performance of a stock and as such do not necessarily reflect where an industry is
21 going or what risks it is expected to face.

1 Additionally, the Commission made the following comments in a recent UGI
2 Electric case regarding the CE method, specifically, the use of non-utility companies in
3 comparable groups, and stated,⁹

4 With respect to the CE method, as noted above, this cost of equity
5 method utilizes data for non-regulated firms. Thus, by its very
6 nature, determining which companies are comparable is entirely
7 subjective. In addition, the record indicates that the companies UGI
8 utilized in its CE group results in the selection of companies such as
9 Coca-Cola Company, Kellogg Company, and Walmart Stores,
10 Inc....Each of these companies operate in industries that are very
11 different from a utility company and have significantly more
12 competition, which would require a higher return for the associated
13 additional risk.

14 Finally, I am advised by counsel that this premise defies the principle set forth in
15 the *Hope* and *Bluefield cases*¹⁰ that a utility is entitled to a return similar to that being
16 earned by companies with similar risks and uncertainties, but not as high as those earned
17 by highly profitable or speculative ventures.

18
19 **SIZE ADJUSTMENT**

20 **Q. SUMMARIZE YOUR DIRECT TESTIMONY REGARDING MR. D’ASCENDIS’**
21 **CLAIM FOR AN ADJUSTMENT FOR THE COMPANY’S SMALL SIZE.**

22 A. In direct testimony, I stated that Mr. D’Ascendis’ 90-basis point adjustment is
23 unnecessary because none of the technical literature cited in his direct testimony
24 supporting an adjustment related to the size of a company is specific to the utility
25 industry. Additionally, I presented an article by Dr. Annie Wong that demonstrated there

⁹ *Pa. PUC v. UGI Utilities, Inc. – Electric Division*; Docket No. R-2017-2640058 (Order Entered October 25, 2018), p. 105. The Commission has also ruled “[t]he use of nonregulated companies as a comparable group for regulated firms requires numerous unsupportable assumptions which results in a highly speculative finding.” *Pennsylvania Public Utility Commission v. Philadelphia Electric Co.* 33 PUR 4th 319, 341 (Pa PUC 1980).

¹⁰ *See Bluefield Water Works & Improvements Co. v. Public Service Comm. of West Virginia*, 262 U.S. 679,692-93 (1923), and the *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

1 is no need to make an adjustment for the size of a company in utility rate regulation.

2 Finally, I indicated that the Commission has recently rejected the application of a size
3 adjustment to the cost of equity calculation (I&E Statement No. 2, pp. 37-40).

4
5 **Q. SUMMARIZE MR. D'ASCENDIS', MR. GORMAN'S, AND MR. ROGERS'**
6 **RESPONSE IN REBUTTAL TESTIMONY REGARDING A SIZE RISK FACTOR**
7 **ADJUSTMENT.**

8 A. Mr. D'Ascendis opines that firms of smaller size are less able to cope with significant
9 events affecting sales, are less diverse in their operations, and have less financial
10 flexibility. He supports these statements by pointing to a study from Fama and French
11 relating the size of a company to its return on equity. Mr. D'Ascendis also attempts to
12 discredit a study performed by Dr. Wong, that I relied upon in rejection of his size
13 adjustment, by citing a review of her study authored by Thomas M. Zepp. Additionally,
14 Mr. D'Ascendis inaccurately asserts that I claim his size risk premium is not specific to
15 utilities because the study he cites utilizes data from the New York Stock Exchange
16 (NYSE), American Stock Exchange (AMEX), and National Association of Security
17 Dealers Automated Quotation System (NASDAQ). Finally, Mr. D'Ascendis points to a
18 2019 Commission order where the Commission considered a size adjustment (Valley
19 Statement No. 2R, pp. 29-34).

20 Mr. Gorman and Mr. Rogers state that Valley was awarded a size adjustment in
21 its last base rate proceeding and opines that Valley should be awarded a size adjustment
22 to be consistent with prior proceedings (Valley Statement No., 1R, pp. 12-13 and Valley
23 Statement No. 4R, pp. 4-5).

1 **Q. ARE THE WITNESSES' ASSERTIONS REGARDING FIRMS OF SMALLER**
2 **SIZE RELEVANT TO THE REGULATED UTILITY INDUSTRY?**

3 A. No. The study performed by Dr. Wong provides empirical evidence that refutes Mr.
4 D'Ascendis' claim which I will further elaborate upon below. Furthermore, regulated
5 utility companies have the option to file base rate cases to address declining revenues and
6 to recover the increasing costs of doing business in addition to emergency rate relief
7 provisions for large unforeseen impacts. In contrast, non-utility businesses that may be
8 significantly impacted by events of this nature due to small operating size do not have
9 these opportunities. Further, while a smaller utility may pay higher prices for services
10 and materials just due to volume buying power, the actual costs are part of the revenue
11 requirement presented by that company, so to increase the return to account for the
12 potential size disadvantage would only further unfairly burden ratepayers who are already
13 likely paying higher utility bills to recover the higher operating costs.

14
15 **Q. WHAT ARE YOUR OBSERVATIONS REGARDING THE STUDIES MR.**
16 **D'ASCENDIS RELIES ON TO SUPPORT HIS CLAIM OF A SIZE**
17 **ADJUSTMENT?**

18 A. The Fama and French study is not specific to the utility industry. While I relied upon the
19 Fama and French study in this proceeding, as Mr. D'Ascendis correctly points out, the
20 purpose for which I cited the study was to demonstrate empirically the shortcomings of
21 the CAPM. The Fama and French study is irrelevant toward the determination of the size
22 risk factor because it is not specific to the utility industry.

1 **Q. PLEASE COMMENT ON THE REVIEW OF DR. WONG’S STUDY**
2 **PERFORMED BY DR. ZEPP.**

3 A. The article Mr. D’Ascendis references from Dr. Zepp does not recreate Dr. Wong’s
4 study; it simply speculates on other possible reasons for her results and references the
5 results of two other studies. The first study, completed by the California Public Utilities
6 Commission Staff in 1991, is not included in the article, and, therefore, Dr. Zepp’s
7 opinions cannot be properly evaluated. Dr. Zepp also draws his conclusions about an
8 entire industry based on the second study, which examines the effects of size on only four
9 water utility companies. This article does not contain enough credible evidence to refute
10 Dr. Wong’s findings.

11
12 **Q. PLEASE DISCUSS THE INCORRECT INTERPRETATION MADE BY MR.**
13 **D’ASCENDIS ABOUT YOUR DIRECT TESTIMONY.**

14 A. Mr. D’Ascendis appears to have mistaken an observation I made in direct testimony as a
15 criticism of his analysis. He incorrectly asserts in rebuttal testimony that I stated his size
16 adjustment is not specific to utilities because the study he cites uses data from the NYSE,
17 AMEX, and NASDAQ. However, I merely observed that Mr. D’Ascendis used market
18 information from NYSE, AMEX, and NASDAQ exchanges as a means to calculate his
19 perceived size risk premium for Valley. This is an important observation because it is not
20 appropriate to compare highly competitive private companies with regulated,
21 monopolistic, public utilities.

1 **Q. HAVE YOU FOUND FURTHER EVIDENCE TO SUPPORT YOUR**
2 **RECOMMENDATION REGARDING SIZE ADJUSTMENTS?**

3 A. Yes. The difficulty in predicting the risk effect of a company's size is demonstrated in
4 the variance from year to year of the measurement of difference between the annual
5 returns on the large and small-capitalization stocks of the NYSE/AMEX/NASDAQ in the
6 Ibbotson *Stocks, Bonds, Bills & Inflation: 2015 Yearbook*. As stated on page 100,

7 While the largest stocks actually declined in 2001, the smallest
8 stocks rose more than 30%. A more extreme case occurred in the
9 depression-recovery year of 1933, when the difference between the
10 first and 10th decile returns was far more substantial. The divergence
11 in the performance of small- and large- cap stocks is evident. In 30
12 of the 89 years since 1926, the difference between the total returns
13 of the largest stocks (decile 1) and the smallest stocks (decile 10)
14 has been greater than 25 percentage points.

15 Page 109 states,

16 In four of the last 10 years, large-capitalization stocks (deciles 1-2
17 of NYSE/AMEX/NASDAQ) have outperformed small-
18 capitalization stocks (deciles 9-10). This has led some market
19 observers to speculate that there is no size premium. But statistical
20 evidence suggests that periods of underperformance should be
21 expected.

22 Page 112 states,

23 Because investors cannot predict when small-cap returns will be
24 higher than large-cap returns, it has been argued that they do not
25 expect higher rates of return for small stocks.

26

27 **Q. WHAT IS YOUR RESPONSE TO MR. D'ASCENDIS' REBUTTAL TESTIMONY**
28 **REGARDING THE REFERENCED COMMISSION ORDER FOR CITIZENS'**
29 **ELECTRIC COMPANY?**

30 A. Although the Commission in the Citizens' Electric Company (Citizens) proceeding
31 agreed that there is an inverse relationship between size and risk, the Commission

1 concluded there is not substantial evidence that size is specifically a risk for utilities as
2 follows,

3 At the same time, however, we echo the ALJs that the Parties have
4 presented offsetting arguments such that there is not substantial
5 evidence to determine whether size is specifically a risk for utilities.
6 As I&E and the OCA both noted, the technical literature presented
7 by Citizens' is not specific to the utility industry and also may not
8 definitively support a size adjustment. Additionally, as I&E
9 observed, the empirical study undertaken by the Company's witness
10 Mr. D'Ascendis illustrates the difficulty in predicting the risk effect
11 of a company's size. More specifically, while Mr. D'Ascendis used
12 market information from the NYSE, the AMEX, and the NASDAQ,
13 we find that I&E offered evidence indicating that for certain periods,
14 large-capitalization stocks have outperformed small-capitalization
15 stocks such that there is not sufficient correlation to prove that size
16 is a specific risk for utilities. I&E St. 2-SR at 23-24. Therefore, we
17 are not persuaded by the Company's argument that the ALJs erred
18 by not awarding Citizens' a greater size adjustment. For this reason,
19 we decline to award an explicit 100-basis point size adjustment, as
20 advocated by Citizens'.¹¹
21

22 **Q. WHAT IS YOUR RESPONSE TO MR. GORMAN'S AND MR. ROGERS'**
23 **REBUTTAL TESTIMONY REGARDING THE COMMISSION AWARDED A**
24 **SIZE ADJUSTMENT FOR VALLEY IN ITS LAST BASE RATE PROCEEDING?**

25 A. As discussed above regarding Citizens' last base rate case, although the Commission in
26 the Valley proceeding agreed that there is an inverse relationship between size and risk,
27 the Commission concluded that there is not substantial evidence that size is specifically a
28 risk for utilities as follows,

29 At the same time, however, we echo the ALJs that the Parties have
30 presented offsetting arguments such that there is not substantial
31 evidence to determine whether size is specifically a risk for utilities.
32 As I&E and the OCA both noted, the technical literature presented
33 by Valley is not specific to the utility industry and also may not
34 definitively support a size adjustment. Additionally, as I&E

¹¹ *Pa. PUC v. Citizens Electric Company of Lewisburg, PA*; Docket No. R-2019-3008212 (Order Entered April 29, 2020). See generally *Disposition of Cost of Common Equity*, pp. 103-104.

1 observed, the empirical study undertaken by the Company’s witness
2 Mr. D’Ascendis illustrates the difficulty in predicting the risk effect
3 of a company’s size. More specifically, while Mr. D’Ascendis used
4 market information from the NYSE, the AMEX, and the NASDAQ,
5 we find that I&E offered evidence indicating that for certain periods,
6 large-capitalization stocks have outperformed small-capitalization
7 stocks such that there is not sufficient correlation to prove that size
8 is a specific risk for utilities. I&E St. 2-SR at 23-24. Therefore, we
9 are not persuaded by the Valley’s argument that the ALJs erred by
10 not awarding the Company a greater size adjustment. For this
11 reason, we decline to award an explicit 100-basis point size
12 adjustment, as advocated by Valley’.¹²
13

14 Finally, as stated in my direct testimony, the Commission has
15 recently rejected the application of a size adjustment to the cost of equity
16 calculation (I&E Statement No. 2, p. 40, lines 6-7).
17

18 **Q. HAS YOUR RECOMMENDATION REGARDING MR. D’ASCENDIS’ SIZE**
19 **ADJUSTMENT CHANGED SINCE YOUR DIRECT TESTIMONY?**

20 A. No. I continue to recommend that any adjustments in consideration of the Company’s
21 size be disallowed.
22

23 **MANAGEMENT PERFORMANCE POINTS**

24 **Q. SUMMARIZE MR. D’ASCENDIS’, MR. GORMAN’S, AND MR. ROGERS’**
25 **REBUTTAL TESTIMONY REGARDING MANAGEMENT PERFORMANCE**
26 **POINTS.**

27 A. Mr. D’Ascendis simply states, “the Companies should each be awarded five-basis point
28 upward adjustment to their indicated ROE based on Code 66 Pa. C.S. § 523 regarding

¹² *Pa. PUC v. Valley Energy, Inc.*; Docket No. R-2019-3008209 (Order Entered April 27, 2020). *See generally* Disposition of Cost of Common Equity, pp. 113-114.

1 performance factor” (Valley Statement No. 2R, p. 34). He further states, “Simply put,
2 Code 66 Pa. C.S. § 523 is in existence to incentivize companies to ‘do their job’ at a high
3 level. The Companies in this case fulfill the requirement of the statute and should receive
4 the benefit of doing so” (Valley Statement No. 2R, pp. 34-35). He does not offer an
5 explanation beyond what he argued in his direct testimony.

6 Mr. Gorman simply states that the Commission consistently apply its criteria for
7 authorizing size and performance adjustments and that an insufficient return on equity
8 would affect investment decisions and planning for future financial activities, including
9 the timing of rate cases (Valley Statement No. 1R, p. 13).

10 Mr. Rogers reiterates most of Mr. D’Ascendis’ reasons from his direct testimony
11 to support the Company’s claim for a performance adjustment. These reasons include
12 replacing all cast-iron, bare-steel, and the majority of its vintage plastic mains without
13 assessing a DSIC, low customer complaints, its emergency response, favorable customer
14 feedback, its adoption of Smarthub, low lost and unaccounted for gas, and its customer
15 service representative efforts to assist payment troubled accounts during the COVID-19
16 pandemic (Valley Statement No. 4R, pp. 2-3).

17
18 **Q. WHAT IS YOUR RESPONSE TO MR. D’ASCENDIS’, MR. GORMAN’S, AND**
19 **MR. ROGERS’ REBUTTAL TESTIMONY REGARDING MANAGEMENT**
20 **PERFORMANCE?**

21 A. My position remains unchanged from the arguments made in my direct testimony.
22 Awarding the Company management effectiveness points would add an increased cost to
23 ratepayers for service. Furthermore, any savings from effective operating and
24 maintenance cost measures should flow through to ratepayers and investors. These

1 claimed savings would likely be offset by the addition of basis points for management
2 effectiveness as ratepayers would have to fund the additional costs. This defeats the
3 purpose of implementing cost saving measures to benefit ratepayers.

4 Additionally, the Company should not be awarded management performance
5 points in order to provide a sufficient return on equity or to affect investment decisions
6 and planning for future financial activities, including the timing of rate cases. The
7 purpose of base rate cases is to allow a utility to recover its costs and provide it the
8 *opportunity* to earn a reasonable return on capital investments where additional basis
9 points for management performance would not be necessary if management was as
10 effective as they claim.

11 The Company should also not be rewarded for management performance for not
12 utilizing the DSIC when it replaced its mains. The Commission offers risk reducing
13 mechanisms such as the DSIC and the FPPTY to help reduce any regulatory lag in
14 recovery of infrastructure investment or other unforeseen expenditures, however, the
15 DSIC and the use of a FPPTY were not designed to eliminate the need for periodic base
16 rate filings. The DSIC was specifically designed to encourage its use and to incentivize
17 accelerated pipeline replacement and infrastructure upgrades to bring the existing aging
18 infrastructure closer to meeting safety and reliability requirements in between base rate
19 filings. The Company should not be rewarded additional basis points for not utilizing the
20 DSIC mechanism which would have assisted the Company at the time that they were
21 replacing cast-iron, bare-steel and vintage plastic mains rather than wait until after the
22 fact to receive additional basis points on its return on equity for management
23 performance.

1 Finally, as discussed in my direct testimony, true management effectiveness is
2 earning a higher return through its efficient use of resources and cost cutting measures.
3 The greater net income resulting from cost savings and true efficiency in management
4 and operations is available to be passed on to shareholders. Valley, or any utility, should
5 not be awarded additional basis points for doing what they are required to do in order to
6 provide adequate, efficient, safe, and reasonable service under 66 Pa C.S.A. §1501.

7
8 **OVERALL RATE OF RETURN**

9 **Q. HAS YOUR OVERALL RATE OF RETURN RECOMMENDATION CHANGED**
10 **FROM YOUR DIRECT TESTIMONY?**

11 A. No. I continue to support each recommendation made in I&E Statement No. 2.

12
13 **Q. WHAT IS YOUR RATE OF RETURN RECOMMENDATION?**

14 A. I recommend the following rate of return for the Company:

Type of Capital	Ratio	Cost Rate	Weighted Cost Rate
Long-Term Debt	50.47%	4.49%	2.27%
Common Equity	<u>49.53%</u>	9.70%	<u>4.80%</u>
Total	<u>100.00%</u>		<u>7.07%</u>

15
16
17 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

18 A. Yes.

**I&E Statement No. 3-SR
Witness: Esyan A. Sakaya**

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Surrebuttal Testimony

of

Esyan A. Sakaya

Bureau of Investigation and Enforcement

Concerning:

**Fully Projected Future Test Year Reporting Requirements
Forfeited Discount Revenue
Scale Back of Rates**

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1 **INTRODUCTION**

2 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS**
3 **ADDRESS?**

4 A. My name is Eryan A. Sakaya. My business address is Pennsylvania Public Utility
5 Commission, Commonwealth Keystone Building, 400 North Street, Harrisburg,
6 Pennsylvania 17120.

7
8 **Q. ARE YOU THE SAME ERYAN A. SAKAYA THAT SUBMITTED DIRECT**
9 **TESTIMONY IN THIS CASE ON JULY 25, 2022?**

10 A. Yes. I submitted Bureau of Investigation and Enforcement (“I&E”) Statement No.
11 3 and I&E Exhibit No. 3 on July 25, 2022.

12
13 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

14 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony
15 submitted on behalf of Valley Energy, Inc. (“Valley” or “Company”) by Howard
16 Gorman (Valley St. No. 1-R) and Edward Rogers (Valley St. No. 4-R). My
17 surrebuttal testimony specifically addresses the issues of fully projected future test
18 year reporting requirements, forfeited discounts, and a scale back of rates.

19
20 **Q. DOES YOUR TESTIMONY INCLUDE AN EXHIBIT?**

21 A. No. However, I will refer to my direct testimony and its accompanying exhibit in
22 this surrebuttal testimony (I&E St. No. 3 and I&E Ex. No. 3).

1 **REPORTING REQUIREMENTS**

2 **Q. WHAT DID YOU RECOMMEND REGARDING PLANT ADDITIONS**
3 **THAT THE COMPANY PROJECTS TO BE IN SERVICE DURING THE**
4 **FTY ENDING DECEMBER 31, 2022 AND THE FPFTY ENDING**
5 **DECEMBER 31, 2023?**

6 A. Yes. In my direct testimony I recommended that the Company provide the
7 Commission’s Bureau Investigation and Enforcement and the Office of Consumer
8 Advocate with an update to Valley Exhibit_(HSG-1), Schedule C3(R) no later
9 than April 1, 2023, under this docket number, which should include actual capital
10 expenditures, plant additions, and retirements by month for the twelve months
11 ending December 31, 2022. I also recommended that an additional update be
12 provided for actuals through December 31, 2023, no later than April 1, 2024.

13
14 **Q. DID THE COMPANY RESPOND TO YOUR RECOMMENDATION?**

15 A. Yes. The Company stated on page 14 of Valley Statement No. 4-R that, “[t]he
16 Commission has not yet adopted comprehensive regulations concerning the
17 obligations for public utilities utilizing the FPFTY. The company should not be
18 burdened with additional filing requirements unless those requirements are part of
19 regulations applicable to all NGDCs. I&E will have opportunities to review this
20 information when the Company files a subsequent base rate case.”

1 **Q. IS IT TRUE THAT THE COMMISSION HAS NOT YET IMPLEMENTED**
2 **COMPREHENSIVE REGULATIONS CONCERNING THE**
3 **OBLIGATIONS FOR PUBLIC UTILITIES UTILIZING THE FPFTY?**

4 A. Yes. However, I&E has routinely recommended these same reporting
5 requirements in multiple other base rate proceedings that utilized an FPFTY.
6 While I&E recognizes that these reporting requirements have largely occurred
7 through the settlement process, the fact remains that other Commission regulated
8 utilities have routinely agreed to provide these requested updates. To add context,
9 the FPFTY was signed into law in February 2012 and I&E recommended this
10 reporting requirement in the first-rate case that utilized the FPFTY, which was the
11 2012 Columbia Gas of Pennsylvania, Inc.'s base rate filing at Docket No. R-2012-
12 2321748. Since that time, I&E has consistently recommended this reporting
13 requirement in rate cases that employed an FPFTY; and it has been agreed to in
14 settlements numerous times in the ten years since Act 11 was passed. The fact that
15 there are no current regulations regarding the FPFTY does not preclude the
16 Company from agreeing to file the requested updates.

17
18 **Q. PLEASE RESPOND TO THE COMPANY'S CLAIM THAT THE**
19 **REQUIREMENT IS BURDENSOME, AND THE INFORMATION CAN BE**
20 **REVIEWED BY THE PARTIES IN THE NEXT BASE RATE CASE?**

21 A. The Company made these plant additions claims; therefore, it should agree to
22 track these claims. Reporting these claims to the parties should not be

1 burdensome. I do agree that the information could generally be provided in the
2 next base rate case, but this specific information is not a filing requirement, which
3 means a party must compile a data request, send it to the Company, and wait for
4 the response, leading to an increased burden on all parties and unnecessary delays.

5
6 **Q. DO YOU WISH TO CHANGE YOUR RECOMMENDATION?**

7 A. No. I continue to advocate for the recommended reporting requirements for all of
8 the reasons stated in my direct testimony (I&E St. No. 3, pp. 6-7).

9
10 **FORFEITED DISCOUNTS**

11 **Q. WHAT DID YOU RECOMMEND REGARDING THE AMOUNT OF**
12 **REVENUE FROM FORFEITED DISCOUNTS THE COMPANY WILL**
13 **RECEIVE UNDER PROPOSED RATES FOR THE FPFTY ENDING**
14 **DECEMBER 31, 2023?**

15 A. I recommended that the forfeited discount revenue be increased by \$1,617, from
16 \$14,197 to \$15,814 (I&E Ex. No. 3, Sch. 2, col G, lines 17-20).

17
18 **Q. HOW DID YOU DETERMINE THE INCREASE OF \$1,617?**

19 A. I began by summarizing base and gas revenue under present and proposed rates
20 excluding contract revenue (I&E Ex. No. 3, Sch. 1, line 15). Then I determined
21 the percent of total revenue and gas cost revenue to calculate the amount of
22 present late payment revenue attributable to base rate revenue and the amount of

1 late payment revenue attributable to gas costs. Using this calculation, I
2 determined that \$7,522 of late payment revenue is attributable to base rates (I&E
3 Ex. No. 3, Sch. 1, lines 16-17). The \$1,617 was determined by multiplying this
4 \$7,522 of base rate late payment revenue times the 21.5% increase in base rates
5 (less contract revenue) to arrive at the \$1,617. The total late payment revenue
6 under proposed rates of \$15,814 (\$1,617 + \$14,197) is shown on (I&E Ex. No. 3,
7 Sch. 1, line 20).

8
9 **Q. DID YOU ALSO RECOMMEND THAT THE \$1,617 BE REDUCED IF**
10 **THE COMMISSION GRANTS LESS THAN THE FULL INCREASE?**

11 A. Yes. I recommended that the Company include revenue under proposed rates
12 from forfeited discounts equal to the percent increase in base rates (less contract
13 revenue) upon determination of the total revenue granted by the Commission.

14
15 **Q. DID THE COMPANY RESPOND TO YOUR RECOMMENDATION**
16 **REGARDING FORFEITED DISCOUNTS?**

17 A. No. Therefore, it should be approved as recommended in my direct testimony and
18 as summarized above.

1 **SCALE BACK OF RATES**

2 **Q. WHAT DID YOU RECOMMEND IF THE COMMISSION GRANTS LESS**
3 **THAN THE FULL INCREASE?**

4 A. If the Commission grants an increase less than the amount Valley requested, I
5 recommended that the percentage increase for each class be adjusted so each class,
6 other than the Contract classes, receive the same percentage increase. I
7 recommended that the customer charges be included in the scale back to limit the
8 increase in the customer charge that is applicable to zero and low usage customers.
9 The proposed customer charges and usage rates are shown on Valley Ex. HSG-1,
10 Sch. B-5.

11
12 **Q. WHY DID YOU RECOMMEND THAT EACH CLASS OTHER THAN THE**
13 **CONTRACT CLASSES RECEIVE THE SAME PERCENTAGE INCREASE?**

14 A. Valley did not provide a COSS to compare the revenue received to the expenses
15 incurred to provide service to each class. Thus, there is no justification for
16 proposing a different percentage increase for the classes receiving an increase.
17 Therefore, scaling back the rates so each class receives the same percentage
18 increase is the most reasonable approach to establish rates if the Commission
19 grants less than the full increase.

1 **Q. DID THE COMPANY RESPOND TO YOUR SCALE BACK**
2 **RECOMMENDATION?**

3 A. Yes. The Company agreed with my scale back recommendation (Valley St. No-
4 1R, p. 10).

5

6 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

7 A. Yes.

**I&E Statement No. 4-SR
Witness: Jessalynn Heydenreich**

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

VALLEY ENERGY, INC.

Docket No. R-2022-3032300

Surrebuttal Testimony

of

Jessalynn Heydenreich

Bureau of Investigation & Enforcement

Concerning:

**PIPELINE REPLACEMENT PRIORITIES
PLASTIC PIPE RISK REDUCTION**

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
2 **ADDRESS.**

3 A. My name is Jessalynn Heydenreich. I am a Fixed Utility Valuation Engineer in
4 the Pipeline Safety Division of the Pennsylvania Public Utility Commission's
5 ("Commission") Bureau of Investigation and Enforcement ("I&E"). My business
6 address is Pennsylvania Public Utility Commission, 400 North Street, Harrisburg,
7 PA 17120.

8
9 **Q. ARE YOU THE SAME JESSALYNN K. HEYDENREICH WHO**
10 **SUBMITTED DIRECT TESTIMONY ON BEHALF OF THE BUREAU OF**
11 **INVESTIGATION AND ENFORCEMENT?**

12 A. Yes. I submitted I&E Statement No. 4 and I&E Exhibit No. 4.

13
14 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

15 A. The purpose of my surrebuttal testimony is to address Valley witness Cody
16 Chapman's testimony identified as statement No. 7-R concerning Valley's
17 pipeline replacement costs and system leaks.

18
19 **Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.**

20 A. In my direct testimony I recommended that the "Regulators/Relief" asset category
21 be more clearly addressed in DIMP and that the Company conduct a thorough
22 investigation of non-vintage pipe failures.

1 **Q. DID MR. CHAPMAN ADDRESS YOUR DIRECT TESTIMONY IN HIS**
2 **REBUTTAL TESTIMONY?**

3 A. Yes. Mr. Chapman replied to my direct testimony by stating Valley is willing to
4 explore the creation of some sub-categories within the DIMP “Regulators/Relief”
5 asset category. He also proposed that Valley adopt I&E’s recommendation for its
6 next DIMP update, which will be completed in 2024 (Valley Statement No. 6R, p.
7 2).

8
9 **Q. DOES THE COMPANY’S PROPOSAL SATISFY YOUR CONCERN?**

10 A. Yes. Valley’s willingness to explore these sub-categories and implement the
11 “Regulators/Relief” category in its next DIMP update appropriately addresses my
12 recommendation.

13
14 **Q. MR. CHAPMAN REBUTS YOUR DIRECT TESTIMONY ASSOCIATED**
15 **WITH NON-VINTAGE PLASTIC PIPE FAILURES. DO YOU AGREE**
16 **WITH THIS ARGUMENT REGARDING NON-VINTAGE PLASTIC PIPE**
17 **FAILURES?**

18 A. Yes. After due consideration, I agree with Mr. Chapman’s argument for not
19 performing a root cause analysis of the non-vintage plastic pipe failures. Mr.
20 Chapman stated an analysis for the four failures of non-vintage pipe has
21 previously been performed and the cause of each of the failures is currently being
22 addressed in the current DIMP Plan (Valley Statement No. 6R, p. 3).

1 Accordingly, I withdraw my recommendation to perform a root cause analysis of
2 the non-vintage plastic pipe failures.

3
4 **Q. MR. CHAPMAN SUGGESTS UTILIZING A MONTHLY FORM TO**
5 **ADDRESS NOTIFICATION OF PLASTIC PIPE FAILURES, DOES THIS**
6 **SATISFY I&E’S NOTIFICATION REQUEST?**

7 A. No, I do not agree with using a monthly report. Mr. Chapman’s proposal of
8 sending a copy of the information currently provided to the Plastic Pipe Database
9 committee monthly does not meet the intent of the notification to I&E when a
10 failure occurs on plastic pipe. To address potential issues with plastic pipe, it is
11 more useful to receive notice as soon as the failure occurs and only when a failure
12 occurs; therefore, a monthly notification when there is no failure is unnecessary.
13 The form documenting failures found in Valley Exhibit CC-1R page 2 would
14 provide helpful information about the failure, and I recommend inclusion of this
15 form in the failure notice to I&E going forward.

16
17 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

18 A. Yes

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY	:	
COMMISSION	:	Docket No. R-2022-3032300
	:	
v.	:	
	:	
Valley Energy, Inc.	:	
Base Rates	:	

**WITNESS VERIFICATION
THE BUREAU OF INVESTIGATION AND ENFORCEMENT**

I, Brian LaTorre on behalf of the Bureau of Investigation and Enforcement, hereby verify that the documents preliminarily identified as:

- I&E Statement No. 1; and, I&E Exhibit No. 1.
- I&E Statement No. 1-SR.

were prepared by me or under my direct supervision and control. Furthermore, the facts contained therein are true and correct to the best of my knowledge, information and belief and I expect to be able to prove the same at an Evidentiary Hearing in this matter. This Verification is made subject to the penalties of 18 Pa. C.S. § 4904 relating to unsworn falsification to authorities.

/s/ Brian LaTorre
Brian LaTorre

Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement

Dated: September 8, 2022

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY	:	
COMMISSION	:	Docket No. R-2022-3032300
	:	
v.	:	
	:	
Valley Energy, Inc.	:	
Base Rates	:	

**WITNESS VERIFICATION
THE BUREAU OF INVESTIGATION AND ENFORCEMENT**

I, Christopher Keller, on behalf of the Bureau of Investigation and Enforcement, hereby verify that the documents preliminarily identified as:

- I&E Statement No. 2; and, I&E Exhibit No. 2.
- I&E Statement No. 2-SR.

were prepared by me or under my direct supervision and control. Furthermore, the facts contained therein are true and correct to the best of my knowledge, information and belief and I expect to be able to prove the same at an Evidentiary Hearing in this matter. This Verification is made subject to the penalties of 18 Pa. C.S. § 4904 relating to unsworn falsification to authorities.

/s/ Christopher Keller
Christopher Keller
Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement

Dated: September 8, 2022

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY	:	
COMMISSION	:	Docket No. R-2022-3032300
	:	
v.	:	
	:	
Valley Energy, Inc.	:	
Base Rates	:	

**WITNESS VERIFICATION
THE BUREAU OF INVESTIGATION AND ENFORCEMENT**

I, Esyan A. Sakaya, on behalf of the Bureau of Investigation and Enforcement, hereby verify that the documents preliminarily identified as:

- I&E Statement No. 3; and, I&E Exhibit No. 3.
- I&E Statement No. 3-SR.

were prepared by me or under my direct supervision and control. Furthermore, the facts contained therein are true and correct to the best of my knowledge, information and belief and I expect to be able to prove the same at an Evidentiary Hearing in this matter. This Verification is made subject to the penalties of 18 Pa. C.S. § 4904 relating to unsworn falsification to authorities.

/s/ Esyan A. Sakaya
Esyan A. Sakaya

Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement

Dated: September 8, 2022

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

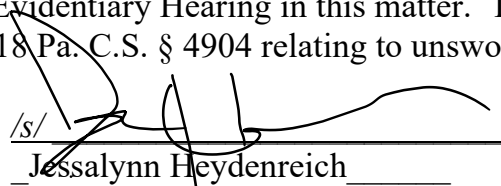
PENNSYLVANIA PUBLIC UTILITY	:	
COMMISSION	:	Docket No. R-2022-3032300
	:	
v.	:	
	:	
Valley Energy, Inc.	:	
Base Rates	:	

**WITNESS VERIFICATION
THE BUREAU OF INVESTIGATION AND ENFORCEMENT**

I, Jessalynn Heydenreich, on behalf of the Bureau of Investigation and Enforcement, hereby verify that the documents preliminarily identified as:

- I&E Statement No. 4; and, I&E Exhibit No. 4.
- I&E Statement No. 4-SR.

were prepared by me or under my direct supervision and control. Furthermore, the facts contained therein are true and correct to the best of my knowledge, information and belief and I expect to be able to prove the same at an Evidentiary Hearing in this matter. This Verification is made subject to the penalties of 18 Pa. C.S. § 4904 relating to unsworn falsification to authorities.

/s/ 

Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement

Dated: September 9, 2022