PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17120

Establishment of Ratemaking Working Group	**Public Meeting of September 10, 2026**
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<u>MOTION OF CHAIRMAN STEPHEN M. DeFRANK</u>

The Commission, as economic regulator of the Commonwealth's investor-owned electric, water, wastewater, and natural gas distribution utilities, has a duty to ensure that all rates are just and reasonable. This duty comes with the responsibility to continuously review our existing regulatory processes and procedures to keep them modern, efficient, and effective in the face of ever dynamic macroeconomic and utility sector specific evolution. The utility industry has experienced significant and continued turbulence in recent years, driven by high inflation, trade tariffs, increased customer account arrears, forever chemicals, lead lines, plastic pipe, supply chain constraints, data center development, global conflicts, and electric reserve margin shortages. Many of these circumstances led to an extraordinary increase in the number of proposed rate increases filed with the Commission.

Governor Josh Shapiro recognized these circumstances, including the rate increase and affordability concerns experienced in the Commonwealth's utility sectors, when he gave this year's budget address. The Governor asked the Commission to scrutinize utility spending to ensure each customer-dollar is well spent.

At this time, I believe the circumstances described above, along with the Governor's call-to-action, warrant due consideration from this Commission to review certain areas of utility ratemaking. Most notable are those associated with establishing appropriate return-on-equity (ROE) parameters.

The intent here is not to overturn or upend over a century of case law designed to provide utilities and their investors with the opportunity to earn a fair return. Nor is it to eliminate the foundational metrics used to analyze utility economics, such as the discounted cash flow (DCF) model. Rather, the overall goal here would be to ensure our ratemaking procedures are modernized for these dynamic times in a manner that balances affordability with the need for continued prudent investment and enhancement in our Commonwealth's vital fixed utility infrastructure.

To that end, I propose the creation of a Ratemaking Working Group (RWG). The purpose of the RWG would be to create an initial report, and potential future reports, detailing proposals to modernize and revise ratemaking parameters and processes. I propose the following topics as initial points of the review for the RWG.

The Litigation of ROE Positions

The RWG would research the value of moving ROE litigation into separate cost-of-capital proceedings, handled outside of individual utility rate cases. Cost-of-capital proceedings could commence once every three years for each fixed utility sector, with the sector-specific determined ROEs becoming the baseline to be utilized in any individual utility rate case. As an example, year one could be the electric sector, year two water and wastewater, and year three natural gas, with the proceedings starting anew for the electric sector in year four.

I also submit that the RWG should review appropriate industry-specific performance metrics that the Commission could apply to company-specific ROEs. Example metrics include but are not limited to electric reliability, natural gas safety, and water quality. Such adjustments could be applied either in a discretionary or a formulaic manner. Further, I believe the RWG should consider the appropriate proceeding to apply such performance adjustments, whether in the cost-of-capital proceeding, in the company-specific rate case, or some other proceeding. The RWG should also consider whether interim updates could occur due to market changes and how utility cost recovery for the proceedings should be handled.

I believe this process may help reduce the resources applied to these complex issues during specific utility rate cases. This in turn could free up bandwidth for the Commission, advocates, and other interested parties to better scrutinize utilities' capital expenditures, operating expenses, service quality, customer assistance programs and any other relevant issues. As well, it would permit utilities the opportunity to compartmentalize their subject matter focus, time, and resources between the two separate proceedings.

Stipulation of Metrics in Rate Case Settlements

Parties in rate proceedings often utilize settlement procedures to achieve amicable results. Settlements can be a useful vehicle for achieving results the Commission may not be able to assess on its own. For instance, rate case stay-outs as well as donations to low-income assistance programs are often components included in settlements.

With that said, the use of "black box" settlements at the Commission have led to concerns about transparency and the inability of the public to truly evaluate important metrics or figures key to establishing rates. Most notably, the ROE and the equity capitalization ratio have recently been discussed as areas that lack transparency. I propose that the RWG issue recommendations on various methods by which settling parties may stipulate ROE, equity capitalization, and any other metric or figure deemed important by the RWG to facilitate better transparency around rate case settlements.

I recognize that this issue may work in conflict with the cost-of-capital proceedings proposed above but nonetheless seek RWG recommendations on both issues.

Establishment of the ROE Utilized in the Distribution System Improvement Charge (DSIC)

Presently the Commission utilizes informed judgment to determine the DSIC ROE for each of the three rate base/rate-of-return utility sectors. Pursuant to the Public Utility Code, the Commission publishes this determination in its Report on Quarterly Earnings of Jurisdictional Utilities (QER). The Commission's determination is based on the results of DCF and capital asset pricing model (CAPM) analyses included in the QER, along with any consideration for other factors such as ROEs authorized in other jurisdictions.

I believe it is prudent to evaluate migrating from the informed judgment process to a strictly formulaic process. For example, I propose the RWG consider whether the Commission should establish the DSIC ROE within each QER using the rolling average of the below formula from the four most recent QERs:

*Industry DSIC ROE = .50 * Overall DCF + .50 * CAPM*

Using a formulaic approach, like that proposed above, or some other variant utilizing objective economic indices could further provide the benefit of increased transparency while allowing market and company financial fundamentals to drive outputs. I would also add that the RWG may want to consider the nexus between the DSIC ROE and any company-specific rate case or cost-of-capital proceeding established ROEs. As well, the RWG should consider how to preserve the predictability and moderation of the DSIC ROE as well as be cognizant that the ROE set in the QER is both the return utilities earn in the DSIC as well as the overearnings rate that would disqualify a utility from a DSIC surcharge.

Further Reports on Other Areas or Issues Deemed Necessary

The areas of interest articulated above are intended to constructively guide the RWG toward its goal of authoring a final initial report on the topics and proposals detailed above. However, these guiding topics are not meant to be an exhaustive list. The RWG would be further utilized in the future, at the direction of the Commission, to issue further reports with recommendations on any other ratemaking issues deemed worthy of revision or modernization to assist the Commission in balancing affordability with necessary utility investment.

Composition of the Ratemaking Work Group (RWG)

The proposed RWG would be managed by the Commission's Office of Executive Director (OED) and chaired by Commission staff or the Commission's designee, with administrative and technical support provided from the various Commission offices and bureaus as needed. I propose to populate the RWG with individual voting member representatives from the following entities or areas of interest:

- The Commission's Bureau of Investigation and Enforcement
- The Office of Consumer Advocate
- The Office of Small Business Advocate
- The Industrial Energy Consumers of Pennsylvania
- The Governor's Special Counsel for Energy Affordability
- The majority and minority Chairs of the House Consumer Protection, Technology & Utilities Committee
- The majority and minority Chairs of the Senate Consumer Protection & Professional Licensure Committee
- The low-income advocate community
- Class A electric distribution companies (EDCs)
- Class A water/wastewater utilities
- Class A natural gas distribution companies (NGDCs)
- Small electric/natural gas/water utilities

The RWG would also include a Finance Subcommittee comprised of three non-voting individuals from the following entities or areas of interest:

- Credit ratings community
- Investment bank community
- Equity analyst community

The Finance Subcommittee would be given the opportunity to append comments to any reports issued by the RWG.

The low-income advocate community, EDCs, Class A water/wastewater utilities, NGDCs, small utilities, credit ratings community, investment bank community, and equity analyst community would all be availed the opportunity to self-nominate their membership representative to the OED. All other entities, as individual enterprises, would directly submit their representative to the OED. RWG membership nomination submissions would be due to the Commission's OED 30 days after the publication of the order officially commencing the RWG in the Pennsylvania Bulletin. The full membership of the RWG would then be announced by the Commission within 15 days after the deadline for nominations, with work processes to follow shortly thereafter at the direction of the RWG Chairman. The RWG Chairman would establish the timeline for issuance of the initial RWG report based on input received from the working group as well as consideration of the scope and complexity of issues being addressed. With that said, I ask that the initial report be concluded in a timely manner in order for the Commission to avail itself of the RWG recommendations as soon as practicable.

I recognize the Commission and the RWG members all have limited resources. However, I believe this endeavor is necessary to establish a forum to address continued concerns being raised regarding utility ratemaking.

THEREFORE, I MOVE THAT:

1. The Office of Executive Director, in coordination with the Commission's various Bureaus and Offices, draft an Order consistent with this Motion.

<u>September 10, 2026</u>
Date

Stephen M. DeFrank
Chairman