COMMONWEALTH OF PENNSYLVANIA

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January 19, 2018

Via Electronic Mail
Andrew Herster
Technical Utility Services
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: Implementation of Act 11 of 2012 ROE Working Group
Docket Nos. M-2012-2317272
M-2012-2293611

Dear Secretary Chiavetta:

Attached for electronic filing are the Comments of the Office of Consumer Advocate in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

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Participants in the Commission's Return on Equity (ROE) Working Group

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of Act 11 of 2012 ROE Working Group	: :	Docket Nos. M-2012-2317272, M-2012-2293611

COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

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Dated: January 19, 2018
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I. Introduction

On February 14, 2012, Governor Corbett signed into law Act 11 of 2012 (Act 11), which amended the Public Utility Code, in part, to provide for a distribution system improvement charge (DSIC) for Pennsylvania's regulated gas, electric and wastewater utilities. Act 11 provides that the cost of equity used to calculate the DSIC shall be the equity return rate approved in the utility's most recent fully litigated base rate proceeding for which a final order was entered within two years of the effective date of the DSIC. 66 Pa. C.S. § 1357(b)(2). If more than two years has elapsed since the last base rate case, the statute provides that "the equity return rate used in the calculation shall be the equity return rate calculated by the commission in the most recent Quarterly Report on the Earnings of Jurisdictional Utilities released by the commission." 66 Pa. C.S. § 1353(b)(3).

On August 2, 2012, the Public Utility Commission (Commission or PUC) issued a Final Implementation Order, which, *inter alia*, called for the formation of a working group to propose guidelines to be used by the Commission in preparing the Quarterly Earnings Reports and calculating a return on equity (ROE) for a DSIC for each jurisdictional utility industry. At the first working group, held September 13, 2012, industry-specific working sub-groups were formed to propose guidelines on the following:

1. Guidelines for selection and use of barometer groups,
   E.g., PA/non-PA; holding/non-holding; debt rating comparability; capital structure; etc.
2. Cost of equity models and their weightings
   E.g., Elements: DCF; DCF with check; CAPM; Weighting, etc.
3. Range of reasonableness and establishment of a specific ROE for computation of the DSIC
   E.g., +/- basis points; standard deviation, etc.
4. Other Issues
   E.g., timing of periodic resets; smoothing or results; other states' procedures; coordination with use of fully projected future test year in a rate case, etc.

Commission Staff Email of Sept. 21, 2012. On November 2, 2012, the Energy Association of Pennsylvania, Aqua Pennsylvania, Inc., and the Pennsylvania Chapter of the National Association of Water Companies submitted a position paper that presented their proposed guidelines. The Office of Consumer Advocate (OCA), as a stakeholder in the Commission's implementation of Act 11, submitted statements regarding its positions and provided its Comments on the proposals discussed in the utility' s position paper on May 31, 2012.

On April 17, 2013, the Commission issued a Secretarial Letter adopting parameters for the Quarterly Earnings Report process. With regard to barometer groups, it determined:

- Industry-specific barometer group companies will be reviewed by staff on a quarterly basis;
- 50% or more of the company's assets must be related to the jurisdictional utility industry;
- Company stock must be publicly traded and must have at least three years of earnings history;
- Companies targeted by merger and acquisition (M&A) activity will be excluded; companies involved in M&A activity may be excluded;
- Investment information for company must be available to the Commission from more than one source, where more than one source exists, particularly earnings growth projections;
- Company must have an investment grade credit rating (S&P BBB- or better, Moody's Baa3 or better; and
- Companies will be selected based on geographic regions:
  EDCs: Value Line East Group Electric Utility companies;
  NGDCs and CNGDO: Value Line Natural Gas Utility industry group companies; and Water/Waste water: Value Line Water Utility industry group companies.

April 2013 Secretarial Letter at 2.

On November 27, 2017, the Commission issued a Secretarial Letter stating that, with regard to the EDC barometer group, the selection criteria is too restrictive. It stated:

> Commission Staff is unable to consistently select EDC barometer group companies restricted to the Value Line East Group Electric Utilities geographic region. The Commission asks for input and guidance to eliminate the geographic restriction of only selecting companies based on Value Line East Group Electric Utility companies and permit Commission Staff to include EDCs from Value Line Central

> and West Group of Electric Utility group of companies. No other change to our barometer group selection criteria is being proposed at this time.

Nov. 2017 Secretarial Letter at 2. The OCA submits the following Comments in response to the narrow issue on which the Commission has requested input.

II. OCA's Comments

In its original comments regarding appropriate barometer groups, the OCA did not take a specific position regarding the geographic selection of companies. The OCA stated that, as a general matter, companies selected for a barometer group should have mostly regulated utility operations and to the extent practicable have risk profiles comparable to those of Pennsylvania utilities. Conversely, utilities with excessive risk (particularly from unregulated operations) should not be included. The OCA acknowledged that there is an element of judgment in the establishment of the barometer groups, and for that reason the OCA suggests that group membership be periodically reviewed (*e.g.*, every two or three years) for reasonableness.

The OCA's position remains the same as set forth in its original comments. The OCA does not object to eliminating the geographic restriction so that utilities may be included from Value Line Central and West data base, with the understanding that the other guidelines established by the Commission remain in place. Those guidelines will be important to determining whether EDCs from those data base groups are appropriate for inclusion in the barometer group. In addition, to the extent possible, the companies selected for the barometer group should not include companies with relatively large amounts of risky merchant generation or other unregulated activity. While even regulated vertically-integrated generation is riskier than providing electric utility delivery service, as a practical matter, we recognize that nearly all Central and West utilities in the Value Line data base own and operate generation. Consequently, the Commission should recognize that the cost of equity estimates using this barometer group will tend to at least slightly overstate the cost of equity for Pennsylvania EDCs. Unfortunately, due to merger activity in recent years there are simply too few "pure play" electric delivery service utilities to provide a robust barometer group.

III. Conclusion

The OCA appreciates this opportunity to provide further input into the process for developing a DSIC ROE. The OCA looks forward to continuing to work with the Commission, Staff, and stakeholders on this important issue.

Respectfully Submitted,

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