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September 28, 2018

E-FILED

Ms. Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
2nd Floor, Room-N201
400 North Street
Harrisburg, PA 17120

Re: ROE Working Group, M-2012-2293611
Act 11 Final Implementation Order, M-2012-2317272

Dear Secretary Chiavetta:

Enclosed please find Duquesne Light Company's Comments in the above-referenced proceeding.

Upon receipt, if you have any questions regarding the information contained in this filing, please contact the undersigned or Audrey Waldock at 412-393-6334 or awaldock@duqlight.com.

Sincerely,

Shelby A. Linton-Keddie
Manager, State Regulatory Strategy
And Senior Legal Counsel

Enclosure
c: Andrew Herster, Bureau of Technical Utility Services (aherster@pa.gov) (w/ enc.)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ROE Working Group	**:**	**M-2012-2293611**
Act 11 Final Implementation Order		**M-2012-2317272**

COMMENTS OF
DUQUESNE LIGHT COMPANY

Background

On November 27, 2017, the Pennsylvania Public Utility Commission ("PUC" or "Commission") issued a Secretarial Letter, seeking input and guidance regarding calculation of electric distribution companies' ("EDCs") return on equity ("ROE"), specifically looking at removing the current geographic limitation of using only *Value Line* East Group companies. On January 19, 2018, interested parties, including the Energy Association of Pennsylvania[1] and Duquesne Light Company ("Duquesne" or "Company"), filed comments that supported this proposed change.[2] On March 29, 2018, the PUC issued a Secretarial Letter and expanded the barometer group selection criteria to include Value Line East, Central and West Group Electric Utility Companies.

Subsequently, on August 24, 2018, the Commission issued another Secretarial Letter at the above-captioned dockets, seeking input and guidance regarding the potential use of all eligible industry-specific companies for the corresponding industry-specific ROE analysis ("August Secretarial Letter"). As noted in the August Secretarial Letter this proposed change would

[1] Duquesne Light is a member of the Energy Association of Pennsylvania, ("EAP"), who is also submitting Comments in this proceeding. In addition to the positions stated herein, Duquesne Light supports the positions articulated in EAP's Comments.
[2] *See generally*, *Comments on Behalf of Pennsylvania Electric Distribution Companies* (hereinafter "EAP January 2018 Comments") and *Comments of Duquesne Light Company*, Docket Nos. M-2012-2293611, M-2012-2317272 (Jan. 19, 2018).

eliminate the current process of having Commission Staff select the barometer group for each industry from the pool of eligible companies.[3]

Act 11 provides for a distribution system improvement charge ("DSIC") for utilities to timely recover costs for infrastructure. A key component of part of the DSIC recovery calculation is the ROE, which "should balance the interests of consumers and utilities, and be sufficient to attract, at reasonable rates, the capital needed to maintain and improve a utility's infrastructure."[4]

Pursuant to Act 11, the DSIC ROE for a utility shall be the equity return rate approved in that utility's last fully litigated rate case. 66 Pa.C.S.§ 1357(b)(2). However, in the event more than two years have elapsed between a rate case final order and the effective date of a DSIC, Act 11 provides for the Commission to use the equity return rate from the most recent Quarterly Earnings Report ("QER"). 66 Pa.C.S. § 1357(b)(3). In practice, when rate cases have been settled, utilities either choose to specify an ROE for DSIC purposes, or specifically indicate that the ROE used for DSIC purposes will be the one calculated in the most recent QER, typically updated by each quarter consistent with any changes to the equity return rate for that industry going forward. In addition, the QER serves a second purpose – to establish "the over-earnings cap to protect customers from unreasonably excessive distribution rates."[5]

During implementation of Act 11 in 2013, the Commission established a working group to review the QER process and the parameters used to determine the market-based ROE in each industry in light of the importance of the ROE. As determined in that proceeding and subsequently modified by the March 28, 2018 Secretarial Letter, the current parameters for the QER process are as follows:

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[3] *See* August Secretarial Letter at 2.
[4] November 27, 2017 and August 24, 2018 Secretarial Letters at 1.
[5] *See Statement of Chairman Gladys M. Brown, Quarterly Earnings Report of Pennsylvania Utilities,* Docket No. M-2018-3003513, (Aug. 2, 2018).

- Industry-specific barometer group companies will be reviewed by staff on a quarterly basis;

- 50% or more of a 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 each company must be available to the Commission from more than one source, where more than one source exists, particularly earnings growth projections;

- Companies 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, Central, and West Group Electric Utility companies; NGDCs and CDNGO: *Value Line* Natural Gas Utility industry group companies; and Water/Wastewater: *Value Line* Water industry group companies.[6]

As noted in the Company's comments filed January 19, 2018 in response to the November 27, 2017 Secretarial Letter, since establishment of the original parameters that restricted the electrics barometer group to *Value Line* East, Commission Staff had been unable to consistently select a sufficient number of barometer companies from the restricted *Value Line* East Group Electric Utilities geographic region. Thus in the QER, TUS had a group of five or six companies available to use in setting the ROE.

In the QER presented at the August 2, 2018 Public Meeting, the barometer group used in setting the ROE contained only six companies, despite the fact that the geographic restriction had been expanded to include Value Line companies from East, Central and West. Duquesne Light agrees that further refinements are needed in this process going forward for transparency.

[6] August 24, 2018 Secretarial Letter at 1.

Comments

A. Potential Use of All Eligible Industry-Specific Companies for Corresponding Industry-Specific ROE Analysis

While the Commission eliminated the geographic restriction of only selecting electric companies based on *Value Line* East Group Electric Utility companies and permitted Commission Staff to include EDCs from *Value Line* Central and West group of companies, the barometer group used in the August 2018 QER did not include a greater number of companies.

Here, rather than perpetuate the process where Commission Staff selects the barometer group from the pool of eligible companies, the PUC suggests instead that the barometer group going forward be determined solely by the QER parameters, thus taking out some of the current subjectivity in the current analysis.

As indicated in the Company's January 19, 2018 Comments, Duquesne Light, as well as the other utilities represented by EAP, agree that from a statistical perspective, a larger sample group is typically preferable. As explained in detail in EAP's January 19, 2018 comments, rather than being limited to five eligible companies (as will be the case with the SCANA merger), the electric barometer group, prior to use of the screening criteria, could be comprised of more than forty companies.[7] While the screening criteria does little to remove many companies from barometer group eligibility (according to Paul Moul only about six companies would be removed), the resulting range for Discounted Cash Flow ("DCF") would likely be larger and the result for Capital Asset Pricing Model ("CAPM") would likely be higher than in recent QERs.

These changes, combined with the Commission's use of subjective criteria such as giving consideration to the ROEs recently adjudicated by the Commission in the fully litigated rates cases

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[7] *See* EAP January 2018 Comments at 2; *see also* EAP Attachment A.

in each industry, as well as the need to attract, at reasonable rates, the capital needed to maintain and improve that industry's infrastructure and informed judgement, could give the Commission the tools it needs to evaluate EDCs' ROEs in a sound manner, thus ensuring accelerated DSIC spending will continue to take place to replace aging infrastructure that is desperately needed throughout the Commonwealth.

B. Revision of the ROE Calculation

In addition to removing the geographic restriction for EDCs, Duquesne Light renews its argument that other changes to the ROE calculation should be considered. While the Company understands that use of DCF with a CAPM check has been the accepted practice to date, Duquesne Light continues to believe that the Commission should consider use of other additional models such as the Risk Premium ("RP") approach and Comparable Earnings ("CE") approach when setting the QER ROE. Specifically, the RP approach's use of corporate bond yields would provide another perspective into market expectations on public utility growth, whereas the CE would give insight into the returns for companies not subject to cost-based regulation. In total, use of these methodologies, in addition to the DCF/CAPM already used, would serve to provide all parties with more information and, therefore, a more realistic check on the appropriateness of the ROE contained in the QER.

C. Even if Accepting This Change, Greater Transparency is Needed in the QER

Assuming that the Commission goes forward with the change to use all eligible industry-specific companies for the corresponding industry-specific ROE analyses, Duquesne Light again has some minor suggestions to improve the transparency of the QERs going forward. Consistent with the Sponsoring Utilities' 2013 Position Paper, the Company believes that an ROE, which is established in the QER, should meet the following goals:

1. It should be consistent with Act 11 of 2012;
2. It should be transparent;
3. It should employ an approach that is straight-forward and simple to apply; and
4. It should reflect and be consistent with ROE determinations by the Commission.

Sponsoring Utilities' Position Paper at 3. To that end, Duquesne Light echoes its request for two specific changes to the QER process. First, in order to replicate the calculations Staff uses to come up with the DCF and CAPM results, the Company believes that the betas must be provided for EDCs. This recommendation is consistent with a recommendation made by the Sponsoring Utilities in 2013.[8]

The second request to improve transparency is an explanation behind the exclusion of companies from the barometer group for each industry each quarter. Especially if the size of the EDC barometer group triples, it would be more transparent for this reasoning to be disclosed as part of the QER. For electric companies, this explanation could be incorporated by expanding Attachment F.

[8] Sponsoring Utilities Position Paper at 12.

Conclusion

Duquesne Light appreciates the Pennsylvania Public Utility Commission's request for input on improving the process of selecting eligible companies for each barometer group to include all eligible companies in its calculation of industry-specific ROEs. The continued refinement and transparency in this process is necessary. While the Company remains available to discuss these issues further, Duquesne Light requests that the Commission adopt the recommendations proposed herein as it reaches a final decision in this proceeding.

Respectfully submitted,

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