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September 28, 2018

Via E-filing

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

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

Dear Ms. Chiavetta:

Enclosed for filing, please find Columbia Gas of Pennsylvania, Inc.'s comments in accordance with the Pennsylvania Public Utility Commission's request for input and guidance regarding the above-referenced dockets.

Please direct any questions with regard to this filing to the undersigned by calling (724) 416-6388.

Sincerely,

Nicole Paloney

Nicole Paloney

cc: Paul Diskin, Director, TUS
Bohdan R. Pankiw, Chief Counsel
Robert Young, Law Bureau
Erin Laudenslager, TUS
Andrew Herster, TUS
David Huff, TUS

**BEFORE THE**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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|---|---|---|
| Act 11 Implementation Final Order | : | Docket No. M-2012-2317272 |
| ROE Working Group | : | Docket No. M-2012-2293611 |

**COMMENTS OF COLUMBIA GAS OF PENNSYLVANIA, INC.**

## I. INTRODUCTION

On August 24, 2018, the Pennsylvania Public Utility Commission ("Commission") issued a Secretarial Letter in the referenced dockets. In the Secretarial Letter, the Commission proposed to modify the manner in which it determines Return on Equity ("ROE") for its Quarterly Earnings Report ("QER"). The ROE set forth in the Commission's QER is used in Distribution System Improvement Charge calculations for utilities that do not have an established ROE from a recent base rate case. In its Secretarial Letter, the Commission proposes to no longer set the ROE in its QERs by selecting the barometer group from the pool of eligible companies, but instead, to include all eligible industry-specific companies in the barometer group for the corresponding industry-specific ROE analysis.[1] No other change to the barometer group selection criteria is being proposed at this time.

[1] On March 29, 2018, the Commission issued a secretarial letter expanding the barometer group selection criteria for Electric Distribution Companies ("EDCs") to include *Value Line* East, Central, and West Group Electric Utility companies.

In its Secretarial Letter, the Commission seeks public input and guidance regarding its proposed modification. Columbia Gas of Pennsylvania, Inc. ("Columbia" or "the Company") appreciates the opportunity to provide input on this issue. At the outset, Columbia commends to the Commission's attention, and notes that it fully supports, the comments submitted by the Energy Association of Pennsylvania on this matter.

## II. BACKGROUND

As stated in the Commission's August 24th Secretarial Letter, Act 11 of 2012[2] ("Act 11"), *inter alia*, allows jurisdictional water and wastewater utilities, electric distribution companies ("EDCs"), natural gas distribution companies ("NGDCs"), and a city natural gas distribution operation ("CNGDO") to petition for a distribution system improvement charge ("DSIC"). A key component in the DSIC recovery calculation is the ROE. Act 11 provides that the ROE shall be the equity return rate approved in the utility's most recent fully litigated rate case. 66 Pa. C.S. § 1357(b)(2). However, for utilities that do not have an ROE from a recent rate case, Act 11 provides that the ROE shall be the equity return rate calculated by the Commission in the most recent QER. 66 Pa. C.S. § 1357(b)(3).

The current ROE parameters for the QER are as follows:

- 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;

[2] http://www.legis.state.pa.us/WU01/LI/LI/US/HTM/2012/0/0011..HTM.

- 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 the barometer group companies must be available to the Commission from more than one source, where more than one source exists, particularly earnings growth projections;
- The barometer group 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 CNGDO: *Value Line* Natural Gas Utility industry group companies; and

  Water/Wastewater: *Value Line* Water Utility industry group companies.

## III. COMMENTS

Columbia supports the proposed modification to use all eligible industry-specific companies for the corresponding industry-specific ROE analysis. The proposed modification would eliminate the second step in the Commission's barometer group selection process, thereby eliminating subjective judgment in the final selection process.

The Company submits that this modification will provide greater transparency into the barometer group selection process.

The Company also supports the proposed modification because it would increase the statistical reliability of the Commission's ROE analyses. For example, when the various cost of equity analytical models are applied to the market and/or financial data of the barometer group companies, various model inputs and/or assumptions are required, which contributes to the risk of observation error. For this reason, whenever possible, Columbia submits that the use of larger barometer groups is recommended to mitigate these effects and to ensure a higher level of confidence in the reliability of the analytical results. Accordingly, the proposed changes to the barometer group selection process would be expected to result in a more robust sample size that would help obviate potential distortions caused by observation errors in the various financial model inputs.

Notwithstanding the foregoing, the Company proposes one minor modification to the barometer group selection criteria as outlined in the Commission's Secretarial Letter. The second bullet point in the Secretarial Letter outlines one of the selection parameters as follows: "50% or more of the company's assets must be related to the jurisdictional utility industry". Although the Company agrees with the general premise that a significant component of a holding company's overall business activities should relate to the provision of jurisdictional utility services, the Company questions whether the relative share of assets between a holding company's jurisdictional utility operations and its non-utility operations is the best measure or reflection of these business activities. In view of the fact that the quantitative models employed by the Commission in estimating the cost of equity reference the market and/or financial data of the barometer group companies (including their respective stock prices, earnings-per-share ("EPS") growth rates, and dividend-per-share ("DPS") growth rates), the Company recommends that this particular selection criterion should instead be based on the jurisdictional utility's relative share of operating income rather than its relative share of assets. This is because operating income more closely correlates to a company's stock price and its EPS and DPS growth rates, as compared to its relative share of assets. Considering that a company's stock price and its expected EPS and DPS growth rates are key inputs into the cost of equity estimation process, Columbia recommends that evaluating a company's relative share of operating income rather than its relative share of assets would provide a more relevant and meaningful selection criterion.

## IV. CONCLUSION

As discussed above, with the exception of one modification, Columbia supports the Commission's proposed modification to selecting barometer group participants in determined return on equity for the Quarterly Earnings Report.

Respectfully submitted,

COLUMBIA GAS OF PENNSYLVANIA, INC.

By: Nicole Paloney

Nicole Paloney
Director, Rates and Regulatory Affairs