COMMONWEALTH OF PENNSYLVANIA

March 3, 2021

E-FILED

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

Re: Pennsylvania Public Utility Commission v. PECO Energy Company – Gas Division / Docket No. R-2020-3018929

Dear Secretary Chiavetta:

Enclosed please find the Main Brief, on behalf of the Office of Small Business Advocate ("OSBA"), in the above-captioned proceeding.

Copies will be served on all known parties in this proceeding, as indicated on the attached Certificate of Service.

If you have any questions, please do not hesitate to contact me.

Sincerely,

/s/ Steven C. Gray

Steven C. Gray
Senior Supervising
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Enclosures
cc: Robert D. Knecht
Parties of Record

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	**Docket No. R-2020-3018929**
	:	
PECO Energy Company – Gas Division	:	

MAIN BRIEF ON BEHALF OF THE OFFICE OF SMALL BUSINESS ADVOCATE

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Date: March 3, 2021

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I. Introduction

A. Description of the Company

The OSBA is not addressing this issue in this Main Brief.

B. Procedural History

On September 30, 2020, PECO Energy Company – Gas Division ("PECO" or the "Company") filed Tariff Gas Pa. P.U.C. No. 4 ("Tariff No. 4") with the Pennsylvania Public Utility Commission ("Commission"). PECO's Tariff No. 4 proposed an annual increase to the Company's distribution revenue of approximately $68.7 million.

On October 15, 2020, the Office of Small Business Advocate ("OSBA") filed a Complaint against Tariff No. 4.

On November 9, 2020, a prehearing conference was held before Deputy Chief Administrative Law Judge ("DCALJ") Christopher P. Pell.

On November 10, 2020, DCALJ Pell issued his Prehearing Order #1.

On December 22, 2020, the OSBA served the Direct Testimony of Robert D. Knecht, in both Public and Confidential versions.

On January 19, 2021, the OSBA served the Rebuttal Testimony of Mr. Knecht.

On February 9, 2021, the OSBA served the Highly Confidential Surrebuttal Testimony of Mr. Knecht.

On February 17, 2021, DCALJ Pell conducted an evidentiary hearing.

The OSBA submits this Main Brief in accordance with DCALJ Pell's November 10th Prehearing Order #1.

C. Overview of PECO's Filing

The OSBA is not addressing this issue in this Main Brief.

D. Burden of Proof

The Commission recently addressed the legal standards, including the burden of proof, that are to be applied in this proceeding. The Commission's legal analysis (entered a mere 12 days ago) was comprehensive and will not be repeated here in the interest of judicial economy. *See Pennsylvania Public Utility Commission, et al. v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-2020-3018835 (Order entered February 19, 2021), at 8-12 ("*Columbia Order*").

II. Summary of Argument

The DCALJ and the Commission should award PECO an ROE of no more than the 8.75 percent.

The DCALJ and the Commission should grant no upward adjustment to PECO's awarded ROE for the Company's management performance.

The DCALJ and the Commission should adopt either the GCOSS presented by the OSBA or the GCOSS presented by the OCA in this proceeding.

The DCALJ and the Commission should adopt any of the Rate GC revenue allocation proposals of PECO, the OCA, or I&E.

The DCALJ and the Commission should adopt the revenue allocation proposals for the TS-F and TS-I classes presented by either the OSBA or the OCA.

The DCALJ and the Commission should apply the OSBA's hybrid scaleback mechanism to any reduction in the overall proposed revenue increase.

The DCALJ and the Commission should adopt PECO's proposal to continue to recover costs for the Company's Universal Service programs for low-income customers from the Rate GR residential class.

The DCALJ and the Commission should adopt PECO's revised proposed customer charge for Rate GC of $28.55 per month.

The DCALJ and the Commission should adopt PECO's revised proposed declining block rates for Rate GC as set forth in PECO's rebuttal testimony.

The DCALJ and the Commission should adopt PECO's revised proposal for rate differentials between the small and large customers in Rates TS-F and TS-I.

The DCALJ and the Commission should adopt PECO's revised proposal to eliminate the Rate IS margin sharing mechanism.

Rate L service should be limited to the regular high load factor customers as it was intended and designed. The DCALJ and the Commission should require that transportation of PECO's standby supply gas be made using the transportation rates within the TS-F and TS-I tariffs.

The OSBA recommends that the Commission adopt strict policies and procedures regarding the use of negotiated rates for larger customers.

PECO has not met its burden with respect to negotiated rates for five of its six Rate NGS customers. PECO's claimed revenue increase should be reduced by the amount of the unjustified rate discounts to these five customers.

III. Overall Position on Rate Increase Request

The OSBA did not independently develop a full-blown revenue requirement proposal in this proceeding. The OSBA's position on the rate increase request is limited to (a) the Company's excessive proposed return on equity ("RoE") award, and (b) the Company's failure to justify rate discounts for five negotiated-rate customers.

IV. Rate Base

The OSBA is not addressing these issues in this Main Brief.

V. Revenues

The OSBA is not addressing this issue in this Main Brief.

VI. Expenses

The OSBA is not addressing these issues in this Main Brief.

VII. Taxes

The OSBA is not addressing this issue in this Main Brief.

VIII. Rate of Return

A. Introduction

At the time of this writing, the yield on the U.S. 10-Year Treasury Bond is 1.44%.[1] In this proceeding, the Company is requesting a Return on Equity ("ROE") of 10.95%. That is 951 basis points above the 10 Year T-Bond. That is an unreasonable risk premium for a public utility such as PECO.

In addition, PECO requested an upward adjustment to its ROE of 25 basis points based upon exemplary management performance. PECO Statement No. 5, at 2. The OSBA respectfully submits that a management adder is inappropriate during the COVID-19 Pandemic. As the Commission explained in approving the ALJ's recommended decision and rejecting the proposed management adder in the recently concluded Columbia Gas base rates proceeding:

> The ALJ stated that she agreed with I&E, the OCA, and the OSBA that Columbia failed to provide sufficient evidence to support its proposal for an additional twenty-basis points for 'strong management performance.' The ALJ reasoned that while effective operating and maintenance cost measures should flow through to ratepayers and/or investors, Columbia's proposal defeats the purpose of cutting expenses to benefit ratepayers, particularly during a pandemic when so many ratepayers have experienced reduced household income from job loss or reduction in hours. Therefore, the ALJ recommended that no upward management effectiveness adjustment be made to the Company's cost of equity.

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[1] *See* https://www.bloomberg.com/markets/rates-bonds/government-bonds/us.

* * *

> As noted above, no Party filed Exceptions objecting to the ALJ's recommendation on this issue. We find that the ALJ's recommendation is supported by ample record evidence and is just and reasonable. Accordingly, we shall adopt it without further comment.

Columbia Order, at 134-135.

The OSBA recommends that PECO be awarded an ROE of no more than the 8.75 percent recommendation of Office of Consumer Advocate ("OCA") witness Kevin W. O'Donnell, CFA.

B. Capital Structure Ratios

The OSBA is not addressing this issue in this Main Brief.

C. Cost of Long-Term Debt

The OSBA is not addressing this issue in this Main Brief.

D. Common Equity Cost Rate

PECO is requesting a Return on Equity ("ROE") of 10.95% in this proceeding. OSBA witness Robert D. Knecht, testified, as follows:

> The Company requests a 10.95 percent return on equity capital, an equity share of invested capital of 53.4 percent, and an overall average return of 7.70 percent. This is, of course, outrageous. With current 10-year Treasury Bond yields of 0.90 percent, the Company is asking for an equity risk premium of over 1000 basis points.
>
> * * *
>
> Duff & Phelps (the successor to the respected Ibbotson Associates and Morningstar entities for tracking cost of capital data) recently lowered its average risk cost of equity capital to 8.0 percent, consisting of a risk-free rate of 2.5 percent and an equity risk premium of 5.5 percent. Since regulated natural gas utilities mostly serve customers who have no credible competitive alternatives and are allowed to pass on costs where they face the highest risk, their relative risk should imply a cost of equity capital well below 8.0 percent.

OSBA Statement No. 1, at 7-8 (footnote omitted).

Furthermore, Mr. Knecht recommended that the Commission reduce its reliance on the Discounted Cash Flow ("DCF") analysis when calculating an appropriate ROE. Mr. Knecht recommended:

> The Commission should increase its reliance on risk premium methods (including the capital asset pricing model) that reflect long-term historical norms adjusted for the reduced utility risk and reduce its reliance on the DCF method.

OSBA Statement No. 1, at 13.[2]

The OSBA respectfully recommends that the DCALJ and Commission award PECO an ROE significantly below the Company's requested 10.95%. Bureau of Investigation and Enforcement ("I&E") witness Christopher Keller recommended an award of 10.24%, with no change to the Company's proposed capital structure. I&E Statement No. 2, at 6. OCA witness Mr. O'Donnell recommended an award of 8.75%, and Mr. O'Donnell also recommended that the Company's share of equity capital in its capital structure be reduced to 50 percent. OCA Statement No. 3, at 4.

As Mr. Knecht demonstrated, all of these proposals imply a risk premium for utility equity that far exceeds the historical risk premium awarded to utilities in the United States. The inability of utility regulators across the country to reasonably regulate the steady increases in equity risk premiums cannot, of course, be resolved by the Pennsylvania Public Utility Commission. Nevertheless, the Commission can avoid making the problem worse.

Moreover, only the OCA proposed award is even in the ballpark with current regulatory awards, as shown in Figure IEc-R1 of Mr. Knecht's rebuttal testimony, copied below:

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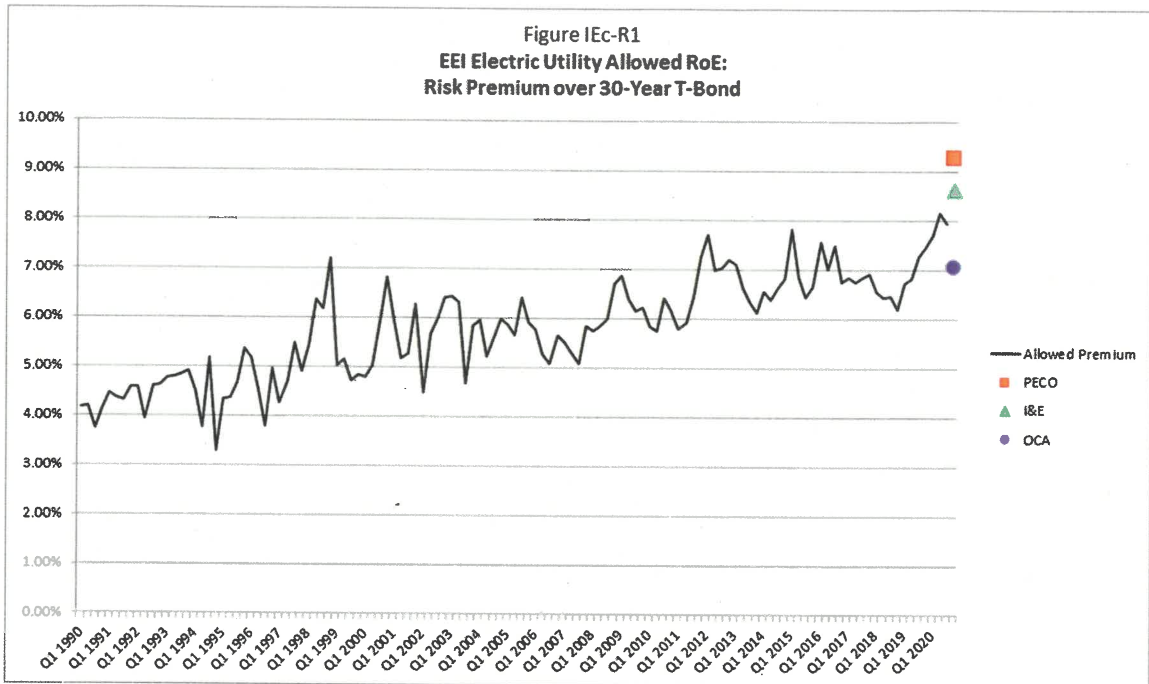
[2] Mr. Knecht provided an extensive review and analysis of the problems associated with over-reliance on the DCF methodology. *See* OSBA Statement No. 1, at 9-11.



The OSBA respectfully submits that, while excessive by historical standards, the OCA recommended return on equity award is the only credible proposal in today's economic environment.

E. Business Risks and Management Performance

The OSBA recommends that PECO receive no upward adjustment in its awarded ROE for its management's performance.

F. Other Parties' Equity Cost Rate Recommendations & Principal Areas of Dispute

The OSBA is not addressing this issue in this Main Brief.

IX. Customer Programs and Miscellaneous Issues

The OSBA is not addressing these issues in this Main Brief.

X. Rate Structure

A. Cost of Service

A class cost of service study ("GCOSS") for a regulated natural gas distribution company ("NGDC") is a tool that assigns the utility's entire revenue requirement among the various rate

classes. In this proceeding, PECO's original filing presented a GCOSS that contained a significant error in its summary calculations which severely distorted both the cost allocation results and the Company's revenue allocation and rate design proposals. When advised of this error by the OSBA early in the process, PECO opted to correct the cost allocation results in an interrogatory response (OSBA-I-2), but it chose *not* to correct its revenue allocation and rate design proposals until the rebuttal phase. OSBA Statement No. 1-S, at 2.

The GCOSS necessarily includes a wide array of methodological choices and quantitative analyses that underpin the allocation of different utility costs. For NGDCs, the most important issue involves the classification and allocation methodology that is used to assign gas mains costs. OSBA Statement No. 1, at 14 and 19.

This methodological choice, however, is far from the only issue that must be addressed in a GCOSS. In this proceeding, OSBA witness Mr. Knecht undertook a thorough evaluation of the Company's GCOSS. OSBA Statement No. 1, at 14-33; OSBA Statement No. 1-S, at 3-10. In addition to the methodological choice for mains cost allocation, Mr. Knecht identified significant errors in PECO's development of the design day demand allocation factor, as well as various other technical issues. Mr. Knecht explained, in detail, the issues involved in how costs should be allocated to interruptible customers. He also identified problems with PECO's cost allocation methodology for meters and services, but the Company was unable to provide sufficient data to develop any better methodology. This brief addresses only the two major methodological changes specifically recommended by Mr. Knecht, namely the mains cost allocation method and the design day demand allocation factors.

1. PECO Revised Gas Cost of Service Study

a. Mains Plant Classification and Allocation

In this proceeding, PECO's proposed GCOSS relies on a load-factor-weighted average-and-excess ("A&E") methodology for classification and allocation of mains cost. OSBA Statement No. 1, at 24. On December 22, 2020, Mr. Knecht served direct testimony that examined the Commission precedent regarding the use of the A&E methodology. His testimony went as far back as a National Fuel Gas case at Docket No. R-00942991. OSBA Statement No. 1, at 23-24. Until a modern cost allocation methodology is developed by the utilities, Mr. Knecht recommended that the Commission rely on its most recent precedent from the 2007 PGW base rates proceeding, in which the Commission approved the use of a 50/50 A&E method. OSBA Statement No. 1, at 24.

As OCA witness Mr. Watkins explains in some detail, the A&E allocation factor has some characteristics that are not, as they say, intuitively obvious. As expected, the A&E allocator is a weighted average of an average demand factor (which is arithmetically equivalent to annual gas usage) and excess demand (which is peak *minus* average demand). With a little algebra, it can be demonstrated that the A&E allocation factor can be expressed as a weighted average of peak demand and average demand for any particular utility load shape. Mr. Knecht and Mr. Watkins agree that the 50/50 A&E factor approved by the Commission in PGW is arithmetically equivalent to an allocation method based 67 percent on peak demand and 33 percent on average demand if it is applied to PECO Gas. OCA Statement No. 4R, at 8; OSBA Statement No. 1-S, at 3-4.

The important issue to recognize is that the load-factor-weighted A&E method used by PECO is almost identical arithmetically to a pure peak demand allocator, with virtually none of

the costs being allocated based on average demand. OSBA Statement No. 1, at 23; OCA Statement No. 4R, at 8. The OSBA respectfully submits that this approach is not consistent with the Commission's order in the 2007 PGW matter, which, at the time evidence was filed in this proceeding, represented the prevailing precedent. As Mr. Knecht indicated, when approving a 50/50 A&E allocation factor, the Commission explicitly indicated that allocation of mains costs should rely on both average and peak demand. OSBA Statement No. 1, at 23-24.

However, on February 19, 2021, the Commission entered its *Columbia Order*. In that case the Commission was presented with extensive testimony that detailed at least eight different GCOSS's, none of which involved either a load-factor-weighted A&E method or a 50/50 weighted A&E method. Ultimately, the Commission (in a 4-0 decision) chose a 50/50 weighted peak and average ("P&A") GCOSS favored by the OCA. Because the Commission did not consider an A&E method, and because PECO Gas is a different utility from Columbia Gas, the OSBA recognizes that the *Columbia Order* is not dispositive for the current matter. Nevertheless, the OSBA now views the 50/50 P&A methodology as the most relevant Commission precedent regarding gas mains cost allocation policy in the Commonwealth. The OSBA observes that the 50/50 P&A methodology is only modestly different from the method used by Mr. Knecht, which is arithmetically equal to a 67/33 P&A methodology.

In his direct testimony, Mr. Knecht identified a series of errors and inconsistencies in PECO's originally filed GCOSS. OSBA Statement No. 1, at 25-27. In response to Mr. Knecht, PECO submitted a "revised" Gas Cost of Service Study ("GCOSS"). Mr. Knecht summarized that revised GCOSS, as follows:

> The Company's gas class cost of service study ('GCOSS') is changed only modestly from the version filed in response to OSBA-I-2, which was submitted to correct a major error related to summary calculations that existed in the original filing.

> However, when the Company corrected the summary GCOSS calculations in response to OSBA-I-2, it did not update its revenue allocation and rate design proposals. It did so in rebuttal.
>
> Moreover, in rebuttal, the Company opted to comply with the settlement provision in its 2008 base rates case, which required the Company to propose rates for Rates GC (commercial) and Rate L (high load factor) equal to allocated costs over two base rates proceedings.
>
> As this is the second base rate proceeding since that settlement, the Company's revised proposal sets class revenues for Rate GC and Rate L at the allocated cost in its rebuttal GCOSS.

OSBA Statement No. 3, at 2 (footnote omitted) (formatting added).

Because it is not consistent with the Commission precedent set forth either in the 2007 PGW decision or in the *Columbia Order*, the OSBA concludes that PECO's use of a load-factor-weighted A&E method in its revised GCOSS should be rejected. If an A&E method is to be retained, it should be the 50/50 A&E method approved by the Commission in the PGW matter.

b. Design Day Demand Allocation Factors

A significant portion of the costs in an NGDC's GCOSS is allocated directly (or indirectly through an A&E method) using a design day demand allocation factor. Because most gas customers are not daily metered, the Company must develop estimates of customers daily usage under extreme weather conditions – both for system planning and gas procurement purposes. For cost allocation purposes, the Company must develop these "design day" demands on a class-by-class basis.

In this proceeding, Mr. Knecht expressed concern regarding PECO's class-specific design day demand estimates. Aside from the issues involving the beleaguered Rate L (discussed below), Mr. Knecht's concerns in his direct testimony involved (a) the derivation of class-specific design day demands for smaller, non-daily-metered customers, and (b) the design

day demands for Rate TS-F customers. OSBA Statement No. 1, at 26. To address both of those issues, Mr. Knecht applied a statistical analysis of the historical weather sensitivity of customer loads to develop alternative design day demand estimates. OSBA Statement No. 1, at 28.

Regarding the TS-F design day demand, the Company's rebuttal testimony adjusted its proposed design day demand to properly exclude a demand from a customer served by direct-assigned mains.[3] Mr. Knecht agreed with this correction in his surrebuttal testimony, and he accepted that revision to the design day demand estimate for Rate TS-F. OSBA Statement No. 1-S, at 9-10. No other party put on evidence contesting that value. The OSBA deems it significant that the PAIEUG expert did not contest the Company's demand allocator for the TS-F rate class. As Mr. Knecht indicated, this change served to increase costs and revenue assigned to the TS-F class compared to what is set forth in his direct testimony. OSBA Statement No. 1-S, at 13.

Regarding Mr. Knecht's alternative design day calculations for smaller customers, PECO offered rebuttal that demonstrated its statistical ignorance. The Company first claimed that Mr. Knecht assumed that all load was weather sensitive in developing his design day demands. This assertion is simply wrong and displays a shocking ignorance of basic statistical methods. OSBA Statement No. 1-S, at 6-7. The Company then claimed that Mr. Knecht did not follow the Company's method for estimating design day demands using daily-metered data. Since daily metered data is not separately available for the small volume rate classes, the OSBA wonders just where the Company thinks Mr. Knecht should have found this daily-metered data for Rate

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[3] Some larger customers are served by dedicated and identifiable mains. PECO directly assigns the costs for those mains to the appropriate customer class. The balance of mains costs is allocated using the general allocation method. Including the demands from customers served from the directly assigned mains in the general allocation factor improperly double-counts costs, and thus the Company corrected its error. *See* PECO Statement No. 6-R, at 22-23. Note that Ms. Ding appears to have inadvertently used "directly-assigned meters" when referring to directly-assigned mains.

GR and Rate GC customers. As Mr. Knecht explained, he used a standard approach for estimating design day demands where daily-metered data are not available. In short, the Company's complaint is ridiculous. OSBA Statement No. 1-S, at 7.

The OSBA submits that Mr. Knecht's estimates of design day demands for smaller customers are superior to those offered by the Company, and that this provides another reason why the Company's GCOSS is not appropriate for this proceeding.

2. Opposing Party Recommendations

OCA witness Mr. Glenn Watkins presented testimony in support of the use of a 50/50 P&A allocation method for mains costs. OCA Statement No. 4, at 21-22. In rebuttal testimony, Mr. Watkins agreed that Mr. Knecht's "rather thorough examination of the Company's forecasted class design day demands" resulted in a demand allocation factors that "are more reasonable than those utilized by Ms. Ding in her CCOSS." Mr. Watkins then incorporated those allocators into his proposed GCOSS. OCA Statement No. 4R, at 8-9.

Because the OCA GCOSS as revised in rebuttal testimony is consistent with the more recent Commission precedent set forth in the *Columbia Order*, and because it correctly reflects Mr. Knecht's proposed changes to design day demand allocation factor, the OSBA does not object to the use of the OCA's GCOSS P&A methodology in this proceeding, notably with the correction to the design day demand allocation factors.

Although PAIEUG witness Ms. Billie LaConte expressed theoretical disagreement with the Company's proposed cost allocation methodology for mains costs, PAIEUG generally supported the Company's proposed ACOSS methodology. PAIEUG Statement No. 1, at 3-4. I&E witness Mr. Ethan H. Cline also accepted the Company's GCOSS. I&E Statement No. 3, at

26. Neither party addressed the problems associated with the design day demand allocation factors.

a. Summary

Despite the significant disagreement among the parties regarding cost allocation methodology, the results show a consistent story for the Rate GC class. The table below compiles the class rates of return at present rates from the three GCOSS options presented in this proceeding for the major rate classes:

GCOSS Class Rates of Return at Present Rates			
	PECO Rebuttal	OCA Rebuttal	OSBA Surrebuttal
GR	4.8%	4.8%	4.8%
GC	8.1%	9.1%	9.0%
TS-F	6.7%	4.6%	5.3%
TS-I	8.3%	3.1%	3.0%
Total	**5.7%**	**5.7%**	**5.7%**
Sources: PECO Exhibit JD-1R, OCA Statement No. 4R, Table 2-R, OSBA Statement No. 1-S, RDK WP2S			

As shown above, the Rate GC class exhibits a class rate of return well above system average under all methods proposed in this proceeding. In fact, the Rate GC class return at present rates exceeds the system average proposed rate, which means a rate decrease is necessary to move rates into line with allocated cost. The primary issue of debate involves the disparate results for the transportation service classes. PECO's GCOSS, supported by I&E and PAIEUG, assign a lower share of costs to the transportation service classes, while the OCA and OSBA methods assign a higher share. This choice is substantially dependent on whether the Commission retains its historical expressed preference for including average demand in its mains cost allocation policy. The OCA and OSBA methods are consistent with Commission precedent; the PECO method is not.

B. Revenue Allocation

1. PECO Revised Revenue Allocation

This proceeding involves two unusual features for revenue allocation. First, as explained earlier, PECO's filed GCOSS contained a serious error that distorted the Company's revenue allocation and rate design. Since this error was not corrected until the rebuttal stage of this proceeding, it must be acknowledged that the Company's original revenue allocation proposal must be rejected in its entirety.

Second, as Mr. Knecht explained, in the settlement of the Company's 2008 base rates proceeding, the Company agreed that it would propose to align class rates of return for the Rate GC and Rate L classes with the system average over its next two base rates proceedings. OSBA Statement No. 1, at 5. *This* is the second proceeding. While PECO failed to meet its commitment in its filing, it did so in its rebuttal testimony. While the settlement of the 2008 proceeding allowed other parties to oppose that proposal based on alternative cost allocation and rate design criteria, the OSBA respectfully submits that the parties to the 2008 settlement recognized that there was a significant inequity in rates for those two classes that needed serious remediation. As shown in every GCOSS filed in this proceeding, that need is still very real for the Rate GC class, which consistently exhibits class rates of return well above system average at current rates.

2. Opposing Party Alternative Revenue Allocations

In his surrebuttal testimony, Mr. Knecht summarized the revenue allocations that result from the various GCOSS methodologies favored by the various parties to this proceeding, as

well as the parties' consideration of other rate design criteria. After Mr. Knecht's preparation of that table, I&E modified its revenue allocation proposal in surrebuttal. Mr. Knecht's table, as modified for the I&E surrebuttal, is shown below:

Comparison of Revenue Allocation Proposals ($000)						
	PECO Gas (original)	PECO Gas (rebuttal)	Knecht/OSBA (surrebuttal)	Watkins/OCA (rebuttal)	Cline/I&E (surrebuttal)	LaConte/ PAIEUG
GR	41,720	63,920	$58,096	59,973	62,074	53,750
GC	17,310	(3,877)	0	(436)	0	9,119
L	35	292	195	0	32	35
MV-F	97	(86)	126	128	(34)	(7)
MV-I	1	(1)	0	0	0	0
IS	0	(4)	35	10	(2)	13
TCS	56	(497)	0	0	7	0
TS-F	5,370	4,583	3,960	4,400	1,515	3,021
TS-I	2,378	(75)	2,020	2,711	664	903
Total	**$66,787**	**$64,257**	**$64,432**	**$66,787**	**$66,786**	**$66,834**
Sources: RDK WP-R1, WP-1S, I&E Statement No. 3-SR at 21						

OSBA Statement No. 3, at 14.

In its role as an advocate for small businesses, OSBA does not contest the Rate GC revenue allocation proposals of PECO, OCA or I&E. The OSBA observes that, while PECO, I&E and PAIEUG all support the Company's rebuttal GCOSS, they offer substantially different recommendations for rate increases to the TS-F and TS-I rate classes. The OSBA will not attempt to explain this substantial inconsistency, and observes only that all of these proposals are based on a GCOSS that is now clearly inconsistent with Commission precedent. As such, the credible proposals for revenue allocation to the TS-F and TS-I classes are those offered by OSBA and OCA.

PAIEUG is the only party recommending a substantial rate increase for the GC class in this proceeding. As Mr. Knecht explained, the PAIEUG recommendation results from two factors. First, PAIEUG relies on the Company's GCOSS methodology, which relies on the load-factor A&E allocation method for mains costs that allocates costs almost entirely based on peak demand. OSBA Statement No. 1, at 23. As discussed above, this approach is inconsistent with Commission precedent in the 1994 NFG case, the 2007 PGW case, and the *Columbia Order*, because virtually no costs are allocated based on average demand. This method significantly reduces the costs allocated to higher load factor customers, especially for the interruptible TS-I class.

Second, PAIEUG imposes a strict rule of thumb for rate gradualism, limiting the magnitude of any class increase to no more than 1.25 times system average. OSBA Statement No. 1-R, at 12-13. As the Commission knows, some intervenors tend to favor more strict rules for rate gradualism when they are under-recovering costs, and more lax rules when they are over-recovering costs. The OSBA respectfully submits that the rule-of-thumb most often advanced in Pennsylvania base rate proceedings is 1.5 times (or even 2.0 times) the system average increase. As such, the OSBA respectfully submits that the PAIEUG proposal should be rejected because it relies on a flawed GCOSS and it unreasonably perpetuates long-standing inequities.

3. Scale Back of Rates

In his rebuttal testimony, Mr. Knecht addresses the issues and problems raised when scaling back the rate increases in this proceeding. OSBA Statement No. 1-R, at 15-19. Specifically, Mr. Knecht testified, as follows:

> The most common approach for doing so in Pennsylvania cases is the 'proportional scaleback,' in which increases to each rate class are reduced in proportion to the overall reduction in the increase.

> Thus, for example, if the utility proposed increase is $100 million and the approved increase is $40 million, the revenue increase allocated to each class is adjusted by a factor of 0.4. That is, if the approved revenue allocation for the Residential class was $60 million of the $100 million, the scaled back increase would be 0.4 * $60 million = $24 million.
>
> This approach has a couple of practical advantages. First, it is easy to understand and easy to calculate. Second, it maintains the same relative increases among rate classes. That is, if the percentage rate increase for the Commercial class is twice that of the Residential class at the full increase, it will also be twice the system average at the scaled back increase. Similarly, if the Residential class increase is 1.5 times the system average at the full increase, it would remain at 1.5 times the system average at the scaled back increase.
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> The disadvantages of the proportional scaleback are two-fold.
>
> First, the proportional scaleback only works if all the rate increases are positive. If the full requirements revenue allocation includes a rate reduction, the proportional scaleback produces a nonsensical result.
>
> *.*.*
>
> The second disadvantage of the proportional scaleback is that it serves to reduce the progress toward cost-based rates that is built into the full requirements revenue allocation. This is not a major concern when the scaleback is relatively small, such as reducing the magnitude of the increase by 20 percent (say, from $100 million to $80 million). However, when the amount being scaled back is relatively large, much of the economic efficiency and equity gained in the full requirements revenue allocation proposal is lost.

OSBA Statement No. 1-R, at 16-17 (formatting added).

Mr. Knecht recommended a "hybrid" approach[4] to a scale back of rate increases in this proceeding:

> In this case, there is (somewhat unusual) agreement among the parties that the Rate GC class is substantially over-recovering allocated costs and should be assigned a minimal increase at the

[4] Supporting formulae for this hybrid approach are provided in Mr. Knecht's workpapers, RDK WP-R1.

> full revenue requirement. Much of the progress toward cost-based rates for that class would be lost, however, with a proportional scaleback and a material reduction in the rate increase. I therefore propose a hybrid approach to a scaleback, in which the rate reduction is scaled back partly based on the proportional scaleback method and half based on current rate revenues.

OSBA Statement No. 1-R, at 19. Mr. Knecht continued, as follows:

> [T]his approach allows the GC class to partially share in the overall reduction of the revenue requirement, much of which would be lost in a traditional proportional scaleback. It may, of course, be argued that assigning the Rate GC class a rate decrease is inequitable when all other classes are assigned rate increases.
>
> However, I note (a) [I&E witness] Mr. Cline actually proposes a rate decrease for rate GC even at the full revenue requirement, (b) not allowing the Rate GC class to benefit at all from a significant reduction in the revenue requirement would be inequitable, and (c) there is significant agreement among the parties that the Rate GC class revenues should be reduced materially relative to all other rate classes to reflect allocated costs.
>
> Thus, in the context of this proceeding, I do not believe this scaleback proposal is inequitable or unreasonable.

Id., at 20.

The OSBA respectfully proposes that Mr. Knecht' scaleback mechanism be applied to any reduction in the overall proposed increase.

C. Allocation of Universal Service Costs

1. Commission Precedent

In this proceeding, the Company proposed to continue to recover costs for its Universal Service programs for low-income customers from the Rate GR residential class. This policy was supported by OSBA and PAIEUG, and opposed by OCA and CAUSE-PA. The substance of this debate is discussed below. This debate was triggered by the Commission in its recently updated Policy Statement on Customer Assistance Programs, which opened the door for reconsideration

of the Commission's long-standing precedent to assign these costs entirely to the residential rate classes. This issue has arisen in two recent base rates proceeding, namely the UGI Gas proceeding at Docket No. R-2019-3015162 and the Columbia Gas proceeding at Docket No. R-2020-3018835. The methodological issues and the debate in those proceedings and the current one are essentially identical. The UGI Gas case was resolved by settlement. After the presentation of evidence in this proceeding, the Commission reached a decision on this issue in the Columbia Gas matter. In that case, the Commission determined:

> In consideration of the large percentage increases to the large C&I classes, based on the Company's full requested increase, as well as the economic impacts commercial and industrial customers are experiencing due to the COVID-19 pandemic, absent more compelling evidence to the contrary, we do not find it appropriate to change the manner in which we have traditionally permitted USP costs to be allocated under the circumstances in this case.

Columbia Order, at 261.

The OSBA respectfully submits that the factual considerations which led to the Commission's decision in the *Columbia Order* are similar to those in the current proceeding. First, the COVID-19 Pandemic rages on, and the timing, duration and effectiveness of the recovery remain in doubt. Second, ratepayer impacts for larger customers are likely to be similar, particularly if the Commission adopts the 50/50 P&A mains cost allocation methodology it did in the *Columbia Order*. The rate increases for the TS-F and TS-I classes proposed by both the OSBA and OCA witnesses in this proceeding are well above system average and are constrained by rate gradualism concerns, resulting in rate increases that are insufficient to move revenue into line with allocated costs.[5] Further burdening these classes with universal service charges would be inconsistent with the principle established the *Columbia Order*.

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[5] The primary difference between the OCA and OSBA revenue allocation proposals is that Mr. Knecht applies his rate gradualism constraint (1.5 times system average) to only the *non-negotiated* rate customers within the class,

In addition, the OSBA observes that no party other than OSBA has attempted to evaluate the impact of including an alternative allocation of universal service costs in the context of overall revenue allocation. As Mr. Knecht's analysis demonstrates, the cost allocation analysis using any of the GCOSSs filed in this proceeding would imply that the Rate GC should be assigned a significant rate decrease. Under the OSBA's proposal, that increase would be set to zero, to reflect rate gradualism considerations as well as the impacts of the COVID-19 Pandemic. However, even if the OCA alternative allocation for universal service costs were approved, a reasonable overall revenue allocation approach would still produce a zero increase for the Rate GC class.

Thus, because changing the universal service cost allocation methodology would (a) unduly burden large customers, and (b) have little impact on OSBA's proposed revenue allocation for the Rate GC class, the OSBA respectfully submits that any change in the allocation methodology for these costs be deferred until such time as the issue of mains cost allocation is fully clarified and the impacts of that change are fully reflected in rates for larger industrial customers.

2. Universal Service Cost Recovery Policy

52 Pa. Code Sections 69.261 – 69.267 address the recently updated Policy Statement on Customer Assistance Programs ("CAPs"). Commission policy statements do not have the binding force of a statute or a regulation but do provide guidance on issues under the Commission's jurisdiction.

The following policy language is typically cited in support of the argument that CAP costs should be allocated to all PECO customers:

---

while Mr. Watkins applies it to the *entire* class. In effect, Mr. Watkins necessarily assigns an even larger increase to those customers without negotiated rates. OSBA Statement No. 1-R at 12; OCA Statement No. 4S, at 9.

In rate cases, parties may raise the issue of recovery of CAP costs, whether specifically or as part of universal service program costs in general, from all ratepayer classes. No rate class should be considered routinely exempt from CAP and other universal service obligations.

52 Pa. Code Section 69.266(b).

However, in its Policy Statement, the Commission instructs the following regarding cost recovery:

In evaluating utility CAPs for ratemaking purposes, ***the Commission will consider both revenue and expense impacts***.

52 Pa. Code § 69.266(a) (emphasis added).

Mr. Knecht identified two alternative fundamental philosophies that can underpin cost recovery policies for CAP costs:

A universal service program is a form of insurance, in which residential gas customers are paying premiums to the utility, so that they will be eligible for cash benefits in the event they have an unfortunate turn in their economic circumstances. In this model, it can be argued that it is not unfair that only gas customers should get the benefits from the program, because it is only gas customers who pay for the program. It can also be argued that these programs are an integral part of utility service, and there is less need to separately report the charge on the utility bill.

OSBA Statement No. 1-R, at 23 (formatting added). Mr. Knecht continued, as follows:

The alternative model is the government policy tax model.

This model, as described in some detail by both Mr. Colton and Mr. Miller, is based on the argument that there are societal benefits associated with assisting low-income residents. Under this paradigm, all customers should pay because all customers obtain the social benefits. In effect, this form of a low-income programs looks like many other such government programs which provide both individual and societal benefits, and the costs of which are borne by the taxpayers. The government, of course, has a great deal more flexibility as to how and from whom it can recover those costs than does a regulated utility.

OSBA Statement No. 1-R, at 23 (formatting added).

Mr. Knecht concluded:

> My recommendation is that the Commission retain the insurance model, for reasons of cost causation and equity. ***In this model, customers pay for the benefits for which they are eligible.*** Residential customers benefit from the insurance, and residential customers pay for that insurance. Non-residential customers are not eligible for that insurance, and they therefore should not pay for the insurance.

OSBA Statement No. 1-R, at 24 (emphasis added).

3. OCA Cost Allocation Proposal

In addition, the OCA did not provide any specifics how the universal service costs would be recovered from the non-residential classes. Mr. Knecht explained the OCA proposal, as follows:

> Mr. Colton recommends that the costs be allocated on a 'competitively neutral' basis, based on 'the percentage of revenue provided by each customer class at base rates.' In so doing:
>
> Mr. Colton does not specify the test year magnitude of universal service costs, or even define what specific cost items would be included in his proposed allocation;
>
> Mr. Colton does not provide any allocation calculations, or assessment of the impact of the proposed change on allocated costs;
>
> Mr. Colton also does not offer any recommendations regarding whether the 'flex' rate classes with market-based rates or the negotiated rate customers should be assigned surcharges related to universal service costs;
>
> Mr. Colton does not offer any proposal for rate recovery of the allocated costs.

OSBA Statement No. 1-R, at 25-26.

Although the OCA does not provide any guidance as to the impact of having non-residential customers pay for universal service costs, Mr. Knecht did attempt to calculate that

impact. Mr. Knecht calculated that the OCA proposal would save the average residential customer 76 cents per month. OSBA Statement No. 1-R, at 26-27. In contrast, "large businesses would face a cost increase of 3 to 6 cents per mcf, while small businesses face cost increases over 15 cents per mcf." *Id.*, at 27.

Consequently, the OCA proposal to allocate universal service costs does not pass the necessary expense and revenue impact test of 52 Pa. Code § 69.266(a). Savings that are *de minimis* for the residential class, but significantly impact the rates paid by PECO's small businesses, is not a just and reasonable result. Furthermore, as only the residential class is eligible for CAP benefits, the residential class should be solely responsible for its costs.

D. Tariff Structure

1. Residential Customer Charge

The OSBA is not addressing this issue in this Main Brief.

2. Non-Residential Customer Rate Design

a. Rate GC Customer Charge

In its initial filing, PECO proposed to increase the Rate GC customer charge from $28.55 to $40.00 per month. In his direct testimony, Mr. Knecht explained that the Rate GC customer charge should reflect the costs for the smaller customers within the GC class, and not the average for the entire class. He therefore recommended that no increase be assigned to the Rate GC customer charge. OSBA Statement No. 1, at 48-50.

In PECO's rebuttal testimony, the Company decided to keep the customer charge for rate GC at $28.55 per month – *i.e.*, a zero dollar increase over current rates. OSBA Statement No. 1-S, at 18-19. No other party addressed the Rate GC customer charge.

The OSBA supports PECO's proposed customer charge for rate GC.

b. Rate GC Declining Block Volumetric Charge Differential

PECO's Rate GC tariff currently includes a two-tier declining block volumetric tariff charge. As Mr. Knecht explained, this tariff structure provides for lower average rates for larger customers relative to smaller customers. Too often in base rates proceedings do these specific tariff design matters go unanalyzed, because they principally serve to allocate the class' revenue requirement within the class. In this proceeding, Mr. Knecht prepared an analysis of the primary factors that may justify a rate differential between smaller and larger customers within the Rate GC class. He concluded that the existing rate differential was not supported by the analysis, and he recommended that the Company narrow the tariff charge differential. OSBA Statement No. 1, at 50-52.

In rebuttal testimony, the Company accepted Mr. Knecht's proposal. PECO Statement No. 7-R, at 15.

Mr. Knecht created a table setting forth both the Company's updated rebuttal GC monthly customer charge and the Company's updated rebuttal GC declining block rates. That table is set forth below:

Table IEc-S5
PECO Gas Rate Design Proposal: Rate GC

	Current Rate	Filed Rate	Rebuttal Rate	Rebuttal Percent
Customer Charge ($/mo.)	$28.55	$40.00	$28.55	0.0%
First 200 mcf ($/mcf)	$3.7319	$4.5625	3.7837	1.4%
Over 200 mcf ($/mcf)	$2.5924	$3.1694	2.8509	10.0%
DSIC Average* ($/mcf)	$0.2103	$0.0000	$0.0000	-100%
TCJA Average* ($/mcf)	$0.0549	$0.0000	$0.0000	-100%
Average Excl PGC/MFC/GPC	**$4.490**	**$5.255**	**$4.292**	**-3.9%**

* Applied as a percent, so the per-mcf rate varies with customer load.
Sources: RDK WP1, "RevPrf" tab.

OSBA Statement No. 1-S, at 19.

The OSBA supports PECO's proposed declining block rates for rate GC as modified in PECO's rebuttal testimony.

c. Rate TS-F and TS-I Volumetric Charge Differential

The PECO Gas transportation tariffs include a firm service option (TS-F) and an interruptible service option (TS-I). However, within each tariff class, the Company has completely different customer and volumetric charges for customers *under* and customers *over* 18 million cubic feet per year. The Company does not separate these customer groups for cost allocation, and it refused to provide the information necessary for Mr. Knecht to do so. OSBA Statement No. 1, at 19.

In the absence of detailed cost allocation data, Mr. Knecht reviewed the available information regarding relative cost causation for the smaller and larger customers within each tariff class. He recommended that the volumetric rate differentials for service above and below 18 mmcf per year in the TS-F and TS-I tariffs be narrowed, to better align rates with the relative load factors of smaller and larger customers. OSBA Statement No. 1, at 52-56.

In its rebuttal testimony, PECO indicated that it generally accepted Mr. Knecht's proposal. However, as presented in the rebuttal, the Company apparently had only adjusted the differentials for the TS-F class, but not the TS-I class. In his surrebuttal testimony, Mr. Knecht explained this problem and offered an alternative solution for Rate TS-I. However, just prior to the due date for surrebuttal, the Company identified its own error and proposed a revised solution. As Mr. Knecht explained:

> Subsequent to my preparation of this analysis, the Company submitted its response to PAIEUG-V-1. As this response was not filed until late afternoon on February 8, 2021 (yesterday), I have not reviewed it carefully. However, this response appears to

> recognize that the Company had not narrowed the rate differential within the TS-I rate class as it intended, and it presented a correction to do so. Based on a quick review, it appears that the Company's correction is very similar to that shown in RDK WP-1S.

OSBA Statement No. 1-S, at 22 (footnote 14.)

Because PECO's revised proposal in PAIEUG-V-1 is consistent with Mr. Knecht's proposal for Rate TS-I, and because the Company's rebuttal proposal for Rate TS-F is similarly consistent with Mr. Knecht's proposal, the OSBA recommends that the Company's revised proposals for rate differentials between small and large customers in Rates TS-F and TS-I be approved.

d. Elimination of Rate IS Margin Sharing

Dating to a policy adopted in the Carter administration, the Company proposed to retain a sharing mechanism for Rate IS (interruptible sales service), in which market-based rate revenues in excess of the cost of gas are shared between purchased gas cost customers (75%) and PECO shareholders (25%). No revenues were credited to base rates.

Consistent with the direct testimony of Mr. Knecht and Mr. Watkins, the Company modified its originally filed proposal in rebuttal to eliminate this sharing mechanism. To OSBA's knowledge, no party supports a continuation of this archaism. The OSBA respectfully submits that the sharing mechanism should be eliminated.

e. Elimination of Rate IS, MV-I and TCS

In Mr. Knecht's direct testimony, he recommended that the Company consider eliminating its legacy market-based interruptible bundled service rate classes, namely MV-I, TCS and IS. OSBA Statement No. 1, at 45-46. Mr. Knecht explained his recommendation, as follows:

> My recommendation was based on the fact that these are bundled services in an unbundled regulatory environment, and that the tariffs could be used to provide PECO Gas with an inequitable competitive advantage for gas supply. In addition, I observed that there was little customer interest in Rates MV-I and IS, and only modest interest in Rate TCS.

OSBA Statement No. 1-S, at 25. However, based upon the revised evidence presented in PECO's rebuttal testimony, Mr. Knecht concluded, as follows:

> Based on the Company's rebuttal GCOSS, the Company's forecast revenues for all three of these rate classes is sufficient to recover allocated costs (particularly for Rate TCS, which exhibits a very high rate of return).
>
> * * *
>
> Thus, I continue to believe that these tariffs are anachronistic and have the potential to be anti-competitive. Nevertheless, I also recognize that, (a) overall, the proposed rates are forecast to produce revenues in excess of allocated cost, (b) the number of customers and load is relatively small, and (c) no competing natural gas suppliers have come forward to complain about anti-competitive rates. As such, the negative aspects of retaining the tariffs are likely to be minimal, and the Company could address the issue over a longer term.

OSBA Statement No. 1-S, at 26.

Therefore, in accordance with the testimony of Mr. Knecht, the OSBA recommends that, at a minimum, PECO address, in a future case, whether these customer classes should be eliminated from the Company's tariff. In the alternative, the Commission could reasonably determine that these tariff categories are anachronistic and anti-competitive, and that they should be phased out as soon as possible.

f. Rate L

If Rate L were a car, it would be an Edsel. PECO's tariff says that Rate L is "Large volume high load factor service for use in commercial and/or industrial applications, with the

right reserved to restrict its use as a boiler fuel and for other non-critical use. This service shall be under a contract specifying in Mcf, the maximum daily quantity (MDQ) of natural gas to be supplied on a seasonal basis." PECO Exhibit JAB-2, page 60 of 83. By contrast, PECO's cost allocation analyst unabashedly asserts that the average load factor for this class is about 3.2 percent, and PECO's rate design experts fall over themselves trying to explain why this is somehow acceptable. OSBA Statement No. 1, at 26; PECO Statements No. 6-R, at 16 and No. 8-R, at 4-6.

As Mr. Knecht explained at some length, Rate L currently has four "regular" Rate L customers, who presumably opted to take the service because it was designed for high load factor customers. It is likely that Rate L used to have many such customers, but they have migrated elsewhere.

For its transportation service customers in Rate TS-F and TS-I, PECO offers a gas supply standby option. Remember: this is a *gas supply* rate option, not a base rates service. Nevertheless, for reasons that are far from clear, PECO requires that any transportation customer who takes the *gas supply* standby option to have that gas delivered under a regular service distribution tariff. Most of this gas is delivered in Rate L. PECO readily admits that it will charge such a customer a different rate if the Company provides the standby gas supply option rather than if a competitive NGS were to supply the gas. OSBA Statement No. 1, at 27.

The problem, of course, is that the standby supplies are a much larger contributor to Rate L class demand than are the demands of the regular customers. PECO Statement No. 6-R, at 17. This situation produces the anomalous low load factor in a high load factor class, and it results in extremely costly service as measured by the GCOSS. OSBA Statement No. 1, at 34. Since the Company agreed to propose that tariff revenues for Rate L be moved into line with allocated cost

for this class in this proceeding, it was obligated to propose a 387% increase for this class (511% for the commodity charge) in its rebuttal testimony. OSBA Statement No. 1-S, at 24.

The OSBA respectfully submits that there are two potential solutions to this problem: the "Sensible Way" and the "Company Way."

The Sensible Way was explained by Mr. Knecht in his direct testimony. In that approach, Rate L service would be limited to regular high load factor customers as it was intended and designed. Transportation of PECO standby supply gas would be made using the transportation rates within the TS-F and TS-I tariffs, in the same way that NGS gas is delivered. OSBA Statement No. 1, at 52; OSBA Statement No. 1-S, at 23. Moreover, the OSBA observes that if the Company feels that the standby *gas supply rates* not producing sufficient revenues to justify the standby *gas supply costs*, it should address that issue by proposing an alternative standby *gas supply* option in a Section 1307(f) proceeding.

Under the Sensible Way, and based on Mr. Knecht's cost allocation analysis, this approach would involve a zero increase to the regular Rate L customers in this proceeding.

The Company, of course, opposed Mr. Knecht's recommendation, generally because "we've always done it that way," "the customers are used to it," and of course, "our computer systems cannot handle any kind of change we don't feel like making." PECO Statement No. 8-R, at 4-6. This then gives rise to the Company Way, which is to impose a massive rate increase on Rate L. PECO Statement No. 7-R, at 12. This increase will, of course, cause the few remaining regular Rate L customers to switch to Rate GC or to transportation service. Moreover, the increase will likely cause transportation customers who use PECO's standby gas supply service to obtain standby supplies from NGSs, which can be delivered under the Rate TS-F and

TS-I distribution charges. OSBA Statement No. 1-S, at 24-25. Ultimately, the Company Way will likely mean that Rate L will go unused.

The OSBA respectfully recommends that the Commission choose the Sensible Way. Consistent with the intent of gas supply competition, PECO should not be charging a different distribution rate if the customer chooses standby supplies from the utility rather than if the customer chooses standby supplies from competitive NGSs. Moreover, the intent of Rate L was to recognize that there are some high load factor customers that are less costly to serve, and the tariff provided a reasonable mechanism for doing so. Rate L would be preserved as a viable rate option under the Sensible Way, and it would effectively be killed under the Company Way.

3. DSIC Cost Allocation

In Mr. Knecht's direct testimony, he expressed a concern that PECO allocated costs related to its distribution system improvement charge ("DSIC") in such a way that the charges to Rate GC customers appeared to exceed the statutory cap of 5 percent, both historically and prospectively. OSBA Statement No. 1, at 46-48. PECO attempted to clear up the issue in their rebuttal testimony, as Mr. Knecht explained:

> As I understand his [PECO witness Mr. Bisti] rebuttal, he asserts that the Company's DSIC charges are, in fact, capped at 5 percent of the amount billed for distribution service for each rate class, but that the Company's budgeting process incorrectly allocated DSIC costs.
>
> Mr. Bisti claims that the budgeting process has been corrected and the effects reflected in Exhibit JAB-4 regarding current rates costs.
>
> For some classes, that statement appears to be correct. For others, specifically Rate OL, Rate L, Rate MV-I, Rate TS-F and Rate TS-I, it does not appear that the current-rates DSIC charge is five percent of the current base rates charges. As Mr. Bisti has not provided his calculations, I cannot determine whether the budgeting problem has been corrected.

OSBA Statement No. 1-S, at 18 (formatting added). Mr. Knecht continued, as follows:

> Nevertheless, based on Mr. Bisti's rebuttal testimony, my more serious concern, namely that the actual DSIC exceeded the five percent limit for individual rate classes, does not appear to be correct. The problem appears to have been limited to a budgeting error which did not affect actual DSIC charges.

OSBA Statement No. 1-S, at 18.

Therefore, with the Company's corrections set forth in its rebuttal testimony, the OSBA believes that DSIC allocation issue to be resolved. The OSBA trusts that the Commission's audit staff will ensure that DSIC charges are, in fact, being imposed on the same percentage basis across all rate classes.

4. Negotiated Gas Service

Pennsylvania NGDCs generally offer below-tariff negotiated rate options to their larger industrial customers who have competitive options, involving alternative fuels, bypass to interstate pipeline, or alternative business locations. Mr. Knecht explained that under very specific economic conditions these negotiated rates serve to benefit all ratepayers, and thus represent a useful device in the toolbox.[6]

Unfortunately, this tool can easily be misused. Utilities may choose to offer discounted rates to large customers in order to maintain good working relationships or for political reasons, since the utilities' shareholders do not bear the costs. This problem becomes larger when the Commission adopts cost allocation policies that assign significant costs to larger industrial customers, such as the Commission's policy to exclude a customer component from the allocation of gas mains cost. Moreover, as the facts in this case demonstrate, a shift from an A&E allocation method to a P&A method for mains costs will likely serve to further increase the

[6] These negotiated rates are often referred to as "flex" rates in Pennsylvania. However, PECO uses "flex" rates to refer to market-based bundled service under Rates IS, MV-I and TCS service. *See* OSBA Statement No. 1, at 16-17.

regular tariff rates for larger industrial customers. This change will then further increase the (politically powerful) demands from larger industrial customers for discounted negotiated rates. And we all know which class will bear any cost recovery shortfall from the large industrial customers.

The OSBA respectfully submits that the Commission, in conjunction with its cost allocation policy, must establish strict rules for the conditions under which negotiated rates apply, as well as for the evidence that must be submitted by utilities to justify those rates. Mr. Knecht described those economic conditions as follows:

> Below-tariff negotiated rates are justified in certain circumstances. Specifically, discounted rates can benefit all parties when (a) the rate is sufficient to recover all of the incremental cost of providing the service, and (b) the customer would refuse to take service at the regular tariff rate. Customers' reasons for refusing to take service can include a lower cost alternative fuel, a physical opportunity to bypass the distribution utility and take service directly from a pipeline or a producer, the opportunity to relocate the business to an alternative jurisdiction, or business shutdown. Meeting these criteria would justify a discounted rate, because retaining the customer revenues in excess of incremental costs reduces rates for all other customers. However, it is also important that the discounted rate charged to the customer be set at the maximum possible while remaining low enough to retain the customer. That is, simply because the customer has an alternative does not mean that the utility can reasonably offer an excessive rate discount.

OSBA Statement No. 1, at 39-40.

Mr. Knecht went on to explain his understanding of what the utility should be required to demonstrate in order to justify discounted rates:

> I am advised by counsel that the Company has an obligation to demonstrate that its negotiated rates are justified by these circumstances. That is, the utility must show that a credible customer alternative exists, and the utility must show that it has evaluated the customer's cost for pursuing that alternative and has set the discount accordingly.

> Where the Company cannot demonstrate that it has met these conditions, the rates revenue for these customers should be based on the full tariff rates for the class.

OSBA Statement No. 1-S, at 40.

As the Commission appears to be pursuing a policy of substantially increasing costs assigned to larger customers, the OSBA strongly encourages the Commission to adopt strict policies and procedures regarding the use of negotiated rates for larger customers. This will preclude those larger customers and the utilities from doing an end-run around Commission cost allocation policy by the unfettered use of negotiated rates.

In this case, the Company offers negotiated rate service to six customers through Rate NGS, in some cases at a very large discount from regular rates. The OSBA respectfully submits that the Company has not met its burden for five of these customers. These issues are addressed in detail based on data in Mr. Knecht's direct testimony and again in surrebuttal testimony. OSBA Statement No. 1, at 39-42; OSBA Statement No. 1-S, at 16-17. These confidential arguments are not repeated here. As demonstrated in that testimony, PECO has not met its burden with respect to negotiated rates for five of the six customers. The Company's claimed revenue increase should therefore be reduced by the amount of the unjustified rate discounts to these customers.

5. Theft/Fraud Investigation Charge

The OSBA is not addressing this issue in this Main Brief.

E. Summary and Alternatives

The OSBA is not addressing this issue in this Main Brief.

XI. Conclusion

Therefore, the OSBA respectfully requests that the DCALJ and Commission:

1. Award PECO an ROE of no more than the 8.75 percent;
2. Grant no upward adjustment to PECO's awarded ROE for the Company's management performance;
3. Adopt the GCOSS presented by the OSBA or, in the alternative, the GCOSS presented by the OCA;
4. Adopt any of the Rate GC revenue allocation proposals of PECO, the OCA, or I&E;
5. Adopt the revenue allocation proposals for the TS-F and TS-I classes presented by either the OSBA or the OCA;
6. Apply the OSBA's hybrid scaleback mechanism to any reduction in the overall proposed revenue increase;
7. Adopt PECO's proposal to continue to recover costs for the Company's Universal Service programs for low-income customers from the Rate GR residential class;
8. Adopt PECO's revised proposed customer charge for Rate GC of $28.55 per month;
9. Adopt PECO's revised proposed declining block rates for Rate GC;
10. Adopt PECO's revised proposal for rate differentials between the small and large customers in Rates TS-F and TS-I;
11. Adopt PECO's revised proposal to eliminate the Rate IS margin sharing mechanism;

12. Require that transportation of PECO's standby supply gas be made using the transportation rates within the TS-F and TS-I tariffs; and
13. Reduce PECO's claimed revenue increase by the amount of the unjustified rate discounts provided to five NGS customers.

Respectfully Submitted,

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Dated: March 3, 2021

APPENDIX

Proposed Findings of Fact

1. PECO's originally filed Gas Cost of Service Study contained significant errors and methodological inconsistencies. OSBA Statement No. 1, at 25-27.

2. OSBA witness Robert D. Knecht testified to (a) the derivation of class-specific design day demands for smaller, non-daily-metered customers, and (b) the design day demands for Rate TS-F customers. OSBA Statement No. 1, at 26.

3. OSBA witness Robert D. Knecht applied a statistical analysis of the historical weather sensitivity of customer loads to develop alternative design day demand estimates. OSBA Statement No. 1, at 28.

4. PECO adjusted its proposed Rate TS-F design day demand to properly exclude a demand from a customer served by direct-assigned mains. PECO Statement No. 6-R, at 22-23.

5. OSBA witness Robert D. Knecht used a standard approach for estimating design day demands where daily-metered data are not available. OSBA Statement No. 1-S, at 7.

6. PECO Rate GC class exhibits a class rate of return well above system average under all Gas Cost of Service Study methods proposed in this proceeding. OSBA Statement No. 1-S, RDK WP2S.

7. In the settlement of PECO's 2008 base rates proceeding, PECO agreed that it would propose to align class rates of return for the Rate GC and Rate L classes with the system average over its next two base rates proceedings. This is the second proceeding. OSBA Statement No. 1, at 5.

8. OSBA witness Robert D. Knecht testified to a hybrid approach to the scale back of rates due to the unique challenges presented by Rate GC is this proceeding. OSBA Statement No. 1-R, at 15-20.

9. No party to this proceeding analyzed the impact of the OCA proposal to assign Universal Service Costs to all customer classes. OSBA Statement No. 1-R, at 25-27.

10. OSBA witness Robert D. Knecht calculated that the OCA proposal would save the average residential customer 76 cents per month, while large businesses would receive a cost increase of 3 to 6 cents per mcf and small businesses would receive a cost increase over 15 cents per mcf. OSBA Statement No. 1-R, at 26-27.

11. PECO, in its rebuttal testimony, proposed to keep the customer charge for Rate GC at $28.55 per month, a zero dollar increase over current rates. OSBA Statement No. 1-S, at 18-19.

12. PECO, in its rebuttal testimony, proposed to revise its declining block rates for Rate GC. OSBA Statement No. 1-S, at 19.

13. PECO agreed to OSBA witness Robert D. Knecht's proposal to revise the rate differentials between small and large customers in Rates TS-F and TS-I. OSBA Statement No. 1-S, at 20-22.

14. PECO offers negotiated rate service to six customers through Rate NGS. PECO has not justified the rates granted to five of these six customers. OSBA Statement No. 1, at 39-42; OSBA Statement No. 1-S, at 16-17.

Proposed Conclusions of Law

1. The Public Utility Commission has jurisdiction over the parties and the subject matter of this proceeding as set forth in the Public Utility Code, 66 Pa. C.S. § 101, *et seq*.

2. PECO has the burden of establishing the justness and reasonableness of every element of its requested rate increase. 66 Pa. C.S. § 315(a).

3. PECO has the burden of proving that the rate involved is just and reasonable. 66 Pa. C.S. §§ 315(a), 1301, and 1308(e).

4. PECO has not met its burden of proof to establish that its cost of equity is reasonable and supported by record evidence.

5. PECO has not met its burden of proof that its proposed rates contained in Tariff Gas Pa. P.U.C. No. 4 are just, reasonable and otherwise lawful.

Proposed Ordering Paragraphs

1. PECO shall not place into effect the rates contained in Tariff Gas Pa. P.U.C. No. 4, which have been found to be unjust and unreasonable.

2. PECO is to be granted an ROE of 8.75 percent.

3. The Gas Cost of Service Study methodology submitted by the OSBA is adopted.

4. The revenue allocation proposal of the OSBA is adopted.

5. The revenue allocation proposal of the OSBA for Rates TS-F and TS-I is adopted.

6. The OSBA's hybrid scaleback mechanism shall be applied to the final reduction in the overall proposed revenue increase.

7. PECO shall continue to recover costs for the Company's Universal Service programs for low-income customers exclusively from the Rate GR residential class.

8. The customer charge for Rate GC shall be set at $28.55 per month.

9. Rate GC declining block rates shall be set as proposed by PECO's revised proposal.

10. The rate differentials between the small and large customers in Rates TS-F and TS-I shall be set as proposed by PECO's revised proposal.

11. The Rate IS margin sharing mechanism shall be eliminated.

12. The transportation of PECO's standby supply gas shall be made using the transportation rates within the Rate TS-F and TS-I tariffs.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	**Docket No. R-2020-3018929**
	:	
PECO Energy Company – Gas Division	:	

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been served via email (*unless otherwise noted below*) upon the following persons, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

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DATE: March 3, 2021