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March 3, 2021

VIA eFILING

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 for filing is the public version of the **Main Brief of PECO Energy Company** ("Brief"), in the above-captioned proceeding. As evidenced by the Certificate of Service, copies of the Brief are being served upon Deputy Chief Administrative Law Judge Christopher P. Pell, and all parties of record.

A confidential version of the Brief will also be emailed directly to you, with copies to Shirley Spunaugle and Ariel Wolf.

If you have any questions, please do not hesitate to contact me at 215.963.5384.

Very truly yours,

Kenneth M. Kulak

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Enclosures

c: Per Certificate of Service (w/encls.)

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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	:	

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served a copy of the **Main Brief of PECO Energy Company** on the following persons in the manner specified in accordance with the requirements of 52 Pa. Code § 1.54:

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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v.	:	**Docket No. R-2020-3018929**
PECO ENERGY COMPANY – GAS DIVISION	:	

MAIN BRIEF OF PECO ENERGY COMPANY

PUBLIC VERSION

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I. INTRODUCTION

A. Description of Company

PECO Energy Company ("PECO" or "the Company") is a public utility as defined in 66 Pa.C.S. § 102.[1] The Company serves approximately 1.6 million electric customers and 534,000 natural gas customers through its certificated service area, which includes all or portions of five counties and encompasses approximately 2,100 square miles in southeastern Pennsylvania with a population of approximately four million people. PECO is a subsidiary of Exelon Corporation ("Exelon"). Another subsidiary of Exelon, Exelon Business Services Company (the "Service Company" or "EBSC"), provides certain corporate and administrative services to Exelon's electric and natural gas utility subsidiaries. *See* PECO St. 1, pp. 2-5; PECO St. 2, pp. 16-18.

B. Procedural History

PECO last filed for an increase in gas base rates in March 2010. On September 30, 2020, PECO initiated this rate case by filing Tariff Gas – Pa. P.U.C. No. 4 ("Tariff No. 4") requesting Pennsylvania Public Utility Commission ("Commission" or "PUC") approval of an increase in its total annual operating revenues to become effective November 29, 2020. PECO originally planned to seek rate relief in March 2020, but delayed filing this rate case until September 30, 2020, in light of the onset of the COVID-19 pandemic.

The requested increase in PECO's initial filing equaled $68.7 million, or 8.9% of PECO's total Pennsylvania jurisdictional gas operating revenues anticipated for the fully projected future test year ("FPFTY") ending June 30, 2022. Various revisions and updates were made by PECO during the proceeding, which are reflected in its final accounting exhibit (PECO Exhibit MJT-1 Revised). Schedules setting forth the Company's final revenue, expense and rate base claims are

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[1] Hereafter all references to a "Section" are to the Pennsylvania Public Utility Code ("Code"), 66 Pa.C.S. §§ 101 *et seq*., unless indicated otherwise.

attached as Appendix A. PECO's final revenue increase request, as shown on Appendix A, is $66.2 million, which represents an approximate $2.5 million reduction to PECO's original request.

By Order entered on October 29, 2020, the Commission instituted an investigation of PECO's existing and proposed rates and the Company's proposed tariff was suspended by operation of law until June 29, 2021. The matter was subsequently assigned to Deputy Chief Administrative Law Judge Christopher P. Pell for purposes of conducting hearings and issuing a Recommended Decision.

In addition to the Commission's Bureau of Investigation and Enforcement ("I&E"), several parties participated actively in this proceeding: the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania ("CAUSE-PA") and the Philadelphia Area Industrial Energy Users Group ("PAIEUG").[2] A telephonic Prehearing Conference was held on November 9, 2020, and two telephonic public input hearings were held on December 10, 2020.

Along with Tariff No. 4, PECO filed extensive and detailed supporting information for the historic test year ("HTY") ended June 30, 2020, the future test year ("FTY") ending June 30, 2021, and the FPFTY. The Company's supporting information included the prepared direct testimony of nine initial witnesses and the various exhibits sponsored by those witnesses. Considerable additional information was provided in response to approximately 650 interrogatories and data requests.

[2] On October 14, 2020, the OCA filed a Formal Complaint, Public Statement and Notices of Appearance. On October 15, 2020, the OSBA filed a Formal Complaint, Verification, Public Statement and Notice of Appearance. On February 8, 2021, OCA filed an additional Notice of Appearance. Formal Complaints were also filed by PAIEUG and a number of individual customers who did not elect to be active parties in this case.

In accordance with the schedule established in the Prehearing Order # 1 (November 10, 2020), CAUSE-PA, I&E, OCA, OSBA, and PAIEUG submitted a total of thirteen written statements of direct testimony and accompanying exhibits on December 22, 2020. On January 19, 2021, PECO, OCA, OSBA and PAIEUG submitted a total of fifteen written statements of rebuttal testimony with accompanying exhibits. On February 9, 2021, CAUSE-PA, I&E, OCA, OSBA, and PAIEUG submitted a total of thirteen written statements of surrebuttal testimony with accompanying exhibits. On February 12, 2021, PECO submitted an Oral Rejoinder Outline for five witnesses.

A telephonic evidentiary hearing was held on February 17, 2021. At the hearing, PECO witnesses Ronald A. Bradley, Robert J. Stefani, Paul R. Moul, Richard A. Schlesinger and Doreen L. Masalta presented oral rejoinder testimony and were cross-examined by counsel for other parties. In addition, the written testimony and exhibits of all parties were admitted into evidence as listed on PECO Hearing Exhibit No. 1.

C. Overview of PECO's Filing

The principal reason for this rate request is PECO's substantial investment in new and replacement gas utility plant to maintain and enhance the safety and reliability of PECO's gas distribution system. Indeed, the Company projects that it will need to invest approximately $1.2 billion in gas utility plant between July 1, 2020 and June 30, 2024. *See* PECO St. 1, pp. 5-7; PECO St. 2, pp. 2-5.

Due in large part to the substantial investment in utility plant and declining residential per-customer usage since 2011, PECO's gas operations are projected to produce an overall return on invested capital of only 5.74% for the FPFTY. More importantly, the indicated return on common equity under presented rates is anticipated to be only 7.40%, which is far less than

required to provide the Company with a reasonable opportunity to attract capital. *See* PECO Ex. MJT-1 Revised, Sch. A-1.

D. Burden of Proof

While Section 315(a) provides that a utility has the burden to prove that proposed rates are just and reasonable, it "cannot reasonably be read to place the burden of proof on the utility with respect to an issue the utility did not include in its general rate case filing and which, frequently, the utility would oppose."[3] A party proposing an adjustment to a ratemaking claim bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment,[4] and Section 332(a) establishes a burden of proof separate from that in Section 315 for those entities that propose a rule or order. Rejecting evidence contrary to a public utility's position is not an impermissible shifting of the evidentiary burden.[5]

II. SUMMARY OF ARGUMENT

This is the first proposed rate increase for PECO's gas distribution service in more than a decade. As PECO Vice President of Gas, Mr. Bradley, testified, PECO is seeking a rate increase because it will need to invest approximately $1.2 billion in new or replacement gas utility plant between July 1, 2020 and June 30, 2024, and its base rates are no longer sufficient to provide a reasonable return on the Company's ongoing investment in the facilities required to provide PECO's customers with the safe and reliable service that they have come to expect.

As previously noted, PECO delayed its request for rate relief by six months in light of the onset of the COVID-19 emergency. This delay benefitted customers by postponing any rate increase until after the winter heating season (when customers necessarily incur higher gas utility

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[3] *Pa. P.U.C. v. Columbia Gas of Pa., Inc.*, R-2020-3018835A (Opinion and Order entered Feb. 19, 2021) ("*Columbia Gas*").
[4] *NRG Energy, Inc. v. Pa. P.U.C.*, 233 A.2d 936 (Pa. Cmwlth. Ct. 2020).
[5] *U.S. Steel Corp. v. Pa. P.U.C.*, 456 A.2d 686 (Pa. Cmwlth. Ct. 1983).

bills), but had the effect of depriving PECO of tens of millions of dollars of additional revenue. While the OCA and CAUSE-PA recommend that the Commission now deny PECO any rate increase due to the COVID-19 pandemic, the Commission has made clear in recent decisions (including in *Columbia Gas* and in rate case proceedings initiated by Pennsylvania-American Water Company)[6] that "the continued use of traditional ratemaking methodologies during this pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards."[7]

After first addressing the no-increase arguments of the OCA and CAUSE-PA, the Company addresses all of the revenue requirement adjustments, program changes, and rate design issues raised by the parties. Where possible, the Company has adopted recommendations of several parties, particularly in the area of rate design. In other areas, the Company has fully explained the bases and justifications for its claims and programs. The major issues addressed in Sections IV through X are summarized below.

Rate Base. The OCA proposes a $271 million rate base reduction on the grounds that the OCA does not believe that PECO will add any plant in service during the FPFTY based on OCA witness Morgan's review of PECO data and concerns with respect to construction delays associated with the COVID-19 pandemic. The evidence demonstrates that Mr. Morgan's concerns are misplaced, and that there is no basis to conclude that the Company's projected plant additions for the FPFTY will not be achieved despite the effects of the pandemic. I&E's proposed reduction based on the timing for completion of the Company's "Natural Gas

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[6] *Pennsylvania-American Water Co. v. Pa. P.U.C.*, Docket Nos. R-2020-3019369 and R-2020-3019371 (Opinion and Order entered Feb. 25, 2021) ("*PAWC*").
[7] *Columbia Gas*, p. 51 (citing *Bluefield Waterworks and Imp. Co. v. P.S.C. of West Virginia*, 262 U.S. 679 (1923) ("*Bluefield*") and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope*")).

Reliability" project should also be rejected, as the Company is only seeking to include those portions of the project that will be operational and in service during the FPFTY. Furthermore, the Company is properly including its pension asset in rate base due to the difference in the calculation of pension costs for ratemaking purposes in Pennsylvania and the calculation of pension costs under Generally Accepted Accounting Principles ("GAAP").

Revenues. The Company submitted extensive financial and accounting data depicting the results of its gas operations during the HTY, FTY, and FPFTY. The only revenue issue identified by the parties involved forfeited discounts (late payment charges), in which PECO properly based its claim on a three-year period ending December 31, 2019, instead of December 31, 2020, given the effects of the COVID-19 pandemic.

Expenses. PECO provided extensive documentation and explanation of the reasonableness of all of its expense claims. Both OCA and I&E proposed a variety of adjustments, which the Company's witnesses addressed as discussed in Section VI. In particular, the Company explained why proposed adjustments to payroll expense based on double counted vacancy rates were inappropriate, and that the Company's projected contracting and materials expense and outside services expenses were fully justified. The Company's proposal to increase its spending on energy efficiency programs is also entirely appropriate in light of the Company's plan to expand program offerings to customers with associated marketing and outreach to increase customer participation.

Rate of Return. PECO presented expert evidence to justify an overall return of 7.64% based on the Company's actual capital structure, long-term cost of debt, and a cost of equity of 10.95%, which incorporates a recognition of the Company's exemplary performance. I&E recommended an overall return of 7.32% based on a cost of equity of 10.24%, without any

recognition of management performance and with a key error in its discounted cash flow ("DCF") analysis. The OCA recommended a clearly deficient overall rate of return of 6.30% based on a cost of equity of 8.75% and an analysis that was replete with errors, including use of a hypothetical capital structure, a flawed barometer group, and a failure to include any leverage adjustment. For its part, the OSBA offered a proposed a cost of equity below 8.0% that lacked any substantial evidentiary support, based primarily on its expert's general opinion that natural gas utilities have lower than average risk.

Customer Programs. Since the start of the pandemic, PECO has offered a variety of programs to support customers during the COVID-19 emergency, including the opportunity for all customers (not only low-income customers) to enter into long-term payment agreements. Separately, PECO has proposed an extensive redesign of its customer assistance program ("CAP") which incorporates many components of the Commission's recent CAP Program Policy Statement and is now pending before the Commission. While the Company has not sought to introduce extensive new low-income programs in this proceeding in response to the proposals of the OCA and CAUSE-PA given the programs already under consideration by the Commission, the Company has proposed to expand several gas-specific customer programs, including its gas energy efficiency and conservation programs and Neighborhood Gas Pilot Rider ("NGPR"). Contrary to the contentions of the OCA, the evidence showed that PECO's projected growth assumptions for the NGPR were appropriate and that the proposed energy efficiency programs were cost-effective.

Revenue Allocation and Rate Design. PECO's proposed revenue allocation moves all rate classes closer to the cost of service indicated by its revised Cost of Service Study and fulfills prior settlement commitments regarding the elimination of the remaining differences between

class rates of return for General Service – Commercial and Industrial ("Rate GC") and Large High Load Factor Service ("Rate L") and the system average rate of return, while also remaining substantially within the range of alternative proposals by other parties. PECO's proposal to increase its residential customer charge to $16.00 is entirely reasonable in light of the cost of service for these customers and the residential customer charges of other major gas distribution companies in Pennsylvania. With respect to non-residential customer rate design, the Company adopted recommendations of various parties where reasonable, but continues to maintain several interruptible rates that the Company believes are essential for protecting firm customers. The Company also agreed to provide additional information relating to certain negotiated gas service ("NGS") contracts, but proposals to regularly engage in contract re-evaluation will hinder the Company's ability to enter into such contracts and potentially increase costs to other customers and should be rejected.

For the reasons explained below in detail, the Company's request for rate relief and its various proposals for customer programs and rate design set forth in its original filing and the testimony of Company witnesses should be approved.

III. OVERALL POSITION ON RATE INCREASE REQUEST

The OCA and I&E both presented expert analysis on an overall rate of return and the OSBA offered general observations on an appropriate rate of return, which are addressed in Section VIII *infra*. In this Section, the Company addresses the recommendations of OCA witness Scott J. Rubin and CAUSE-PA witness Mitchell Miller that the Commission deny PECO any rate increase due to the COVID-19 emergency.

In support of his recommendation, Mr. Rubin offered a theory that the Commission can set utility rates based on general economic conditions in a "null" zone outside of the traditional ratemaking zone of reasonableness. OCA St. 1, p. 7. In Mr. Rubin's view, this determination

can be made based on conjecture that an unspecified number of customers might not be "willing and able" to pay an increase, and in any event the Commission was required to reject PECO's request because he believed the Commission "cannot have any certainty" about the FPFTY and other Company data due to the pandemic. OCA St. 1, p. 26. Similarly, CAUSE-PA witness Mitchell Miller claimed (without citation to any authority) that just and reasonable rates must be "reasonably affordable." CAUSE-PA St. 1, p. 8.[8]

In response to the testimony of Mr. Rubin and Mr. Miller, Paul W. Hibbard, the former chairman of the Massachusetts Department of Public Utilities, explained that their proposals to reject PECO's rate increase were extreme, unwarranted, and inconsistent with long-standing principles of ratemaking. PECO St. 11-R, p. 7. As Mr. Hibbard testified (PECO St. 11-R, p. 5):

> "Just and reasonable" is not a concept that varies with one's perspective. It is not a one-sided standard to be interpreted to define a range of rate outcomes acceptable only to the consumer. Mr. Rubin's theory on just and reasonable ignores or understates the fundamental balance established between requiring a utility to safely and reliably meet the needs of current and future customers in exchange for the ability to recover the costs of doing so, including a return on prudently-invested capital sufficient to attract investors.

Mr. Hibbard further described the negative impacts if the Commission were to reject PECO's rate increase, as Mr. Rubin and Mr. Miller proposed (PECO St. 11-R, pp. 25-26):

> There are numerous reasons for ensuring the financial integrity of natural gas utilities like PECO, and sufficiently funding system investment and operations. PECO serves a critical function, providing an essential service needed to support the health and welfare of residents in its service territory, and supporting the

[8] Mr. Miller also contended it was purportedly "impossible to reasonably assess whether low income customers will be able to afford the Company's natural gas service if its rates are increased as proposed" due to the COVID-19 pandemic, and that PECO's existing rates were unaffordable. CAUSE-PA St. 1, pp. 8-9. Mr. Miller's contentions regarding affordability are addressed in Section IX.B.

> operation of businesses vital to the local economy. It has no choice. As a regulated utility it must provide safe and reliable service to customers in its service territory, who have access to its system and who wish to connect.
>
> Residents and businesses in natural gas service territories rely on natural gas for winter heating, hot water, cooking, and other end uses. Safe operation of the natural gas system can prevent accidents or outages that could result in significant costs and disrupt reliable service. In turn, providing a stable and secure revenue environment for such utilities supports local economic activity both through projects funded through utility investments and support of local business activity, and it can help lower the costs incurred by utilities in attracting capital to fund such investments.
>
> If the Commission accepts the recommendation of the OCA and CAUSE-PA, it risks destabilizing the financial conditions for efficient operation of the Company's system, increasing the long-run cost of providing reliable service, depressing local investment in the economy, and increasing the risks of less safe and reliable system operations.

Mr. Hibbard also examined the eight rate cases Mr. Rubin selected to support his contention that utilities were deferring or implementing rate reductions during the COVID-19 pandemic. After noting that Mr. Rubin had admitted that his research was "not exhaustive," Mr. Hibbard explained that Mr. Rubin's examples did not include any gas companies (and did include two companies from outside the United States). Mr. Hibbard then presented his own analysis of all 67 electric and gas utility rate cases either settled or litigated in the United States between March 2020 and December 2020, which he summarized as follows (PECO St. 11-R, pp. 23-24):

> Among the decided rate cases since the start of the pandemic the vast majority have resulted in rate increases. These results are consistent across industries, geographies, and commissions. Since the start of the pandemic, rate increases have been approved widely, across 26 states. This is true in general and in particular for natural gas utilities, for whom the percent of approved rate increases (81 percent) is essentially the same as it has been in

> recent years, prior to the pandemic. Moreover, for gas utilities, the average approved rate increase has been larger during the pandemic than it was prior to the pandemic.
>
> In addition, the approved return on equity has remained virtually unchanged since the start of the pandemic relative to rate cases decided prior to the pandemic, despite the significantly lower level of interest rates during the pandemic than before. Controlling for the reduction in interest rates, approved ROEs would actually be higher during than before the pandemic.

Other cases Mr. Rubin cites similarly provide no support:

- While the court in *Donham* referred to the effects of the Spanish influenza as a factor in evaluating rates to be charged by the utility, it did *not* do so in order to endorse a broad-based "ability to pay" standard. Instead, the court noted that the pandemic was "a factor *seriously affecting receipts* during October and November, 1918" after listing five *other* factors (including wages and the cost of materials).[9]

- Mr. Rubin's reliance on a 1934 decision of this Commission to reduce utility rates based on the effects of the Depression (OCA St. 1, pp. 20-21) ignores the fact that the Commission waited for *four years* after the onset of the Depression to reach that conclusion.

- *Market Street Railway* involved a failing streetcar business overtaken by technological developments and denied a full rate increase where the evidence showed "long-time neglect, mismanagement, and indifference to urgent public need,"[10] which are clearly not applicable to PECO in this proceeding. Moreover, Mr. Rubin relies on the case to buttress his claim that Mr. Hibbard believes utilities are automatically entitled to a rate increase simply if investment returns are lower than expected; in fact, Mr. Hibbard clearly states that rates only provide *an opportunity* to earn a return (PECO St. 11-R, p. 9).

Mr. Rubin's additional reference to the decision of Dominion Energy South (OCA St. 1-SR, pp. 8-9) to delay its rate case to implicitly suggest that PECO do the same is particularly misplaced. As Mr. Rubin acknowledged in his direct testimony, PECO *already* delayed the filing of this proceeding because of the COVID-19 pandemic. OCA St. 1, p. 9. PECO's Chief Financial Officer, Mr. Stefani, explained that if this case had been filed in March 2020 as

[9] *Donham v. Pub. Serv. Comm'n*, 122 N.E. 397, 400 (Mass. 1919) (emphasis added).
[10] *Market St. Ry. Co. v. Railroad Comm'n of State of Cal.*, 324 U.S. 548 (1945).

planned, any changes would have gone into effect during the winter heating season when customers necessarily incur more expense, and that PECO had already experienced six months of earning losses from the delay totaling in the tens of millions of dollars. Hearing Tr. 254-55.

With respect to Mr. Rubin's assertion that the Company's FPFTY data could not be relied upon due to the pandemic, Mr. Hibbard explained why that assertion was also unfounded:

> In any rate case, establishing the validity of historic data and resolving known and measurable differences to use on a going-forward basis is a common-sense, weight of evidence exercise, one that requires the development of sufficient record evidence and the application of reasoned judgment by commissioners on a case-by-case basis. The most important element of the decision-making process is that in the end, a commission has before it sufficient evidence to determine whether or not any proposed adjustments to historic data or forecasts are warranted.
>
> Mr. Rubin would have the Commission short-circuit this process and assume ex ante that this exercise is not possible at this time, without providing any evidence to support his claim. While he talks about all the impacts to people and businesses, he does not connect any of his hyperbolic statements on the impacts of the pandemic to data or analyses in the record that are somehow unknowable or structurally flawed in light of this. The fact that the Company developed its data and forecasts during the pandemic does not invalidate the results; rate cases always rely on forecasts in the face of uncertain future conditions, and Mr. Rubin has not presented any evidence demonstrating how the degree of accuracy in the forecasts used in this case is any different than other rate cases. To the contrary, there is no reason to assume a priori that the impacts of COVID-19 in any way compromise the data and forecasts used by the Company in their filing, and there is no reason for the Commission to conclude that any diminished credence should be assigned to PECO's projections for the FPFTY.

PECO St. 11-R, p. 19.

Subsequent to the testimony in this proceeding, the Commission entered its Opinions and Orders in *Columbia Gas* and *PAWC*, in which the Commission expressly rejected the COVID-19 "no increase" position of the OCA and CAUSE-PA. As the Commission explained in *Columbia*

Gas in considering similar testimony of Mr. Rubin and Mr. Miller regarding the pandemic in that proceeding:

> [W]hile we acknowledge that the COVID-19 pandemic is a significant social-economic event, we disagree with the ALJ's recommendation to completely deny Columbia's requested rate relief due to the pandemic's impact and to forgo a review of the case utilizing the traditional ratemaking methodologies. We note that our continued use of traditional ratemaking methodologies, as discussed *supra*: (1) allow for the factoring in of important ratemaking principles, such as quality of service, gradualism, and rate affordability, in setting just and reasonable rates during this pandemic and (2) require consideration of evidence of the impact of this pandemic in determining the Company's cost of providing service. Thus, in our opinion, the continued use of traditional ratemaking methodologies during this pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards. [11]

Furthermore, the Commission also rejected the ALJ's determination, based on testimony of Mr. Rubin, that Columbia's FPFTY data was unreliable:

> Next, with respect to the ALJ's conclusion that Columbia's entire rate presentation is speculative on the basis that the Company's FPFTY projections are based on historical data that predates the pandemic, we look with favor to Columbia's Exception No. 2. The ALJ does not point to any evidence in the record that Columbia's projections are unreliable. Columbia submits the reason for this lapse is because there is no such evidence of unreliable data in this case. Based on our review of the record, we agree. In our opinion, the question of whether supporting data is unreliable requires a claim-by-claim analysis based on the record evidence rather than a "broad brush" determination.[12]

In light of the similarity of the arguments offered by Mr. Rubin and Mr. Miller in both *Columbia Gas* and *PAWC* and in this proceeding, as well as the additional testimony and analysis provided by Mr. Hibbard, there is no basis for the Commission to reach any different

[11] *Columbia Gas*, p. 40; *see also PAWC*, pp. 44-46.
[12] *Columbia Gas*, p. 52.

result than in prior proceedings in which it has considered a proposed rate increase and the COVID-19 pandemic. The Commission should therefore reject the OCA's and CAUSE-PA's no-increase proposal and apply its traditional ratemaking standards to the evidence in this proceeding, which fully supports the Company's requested rate increase.

IV. RATE BASE

A. Fair Value

As summarized in Appendix A, PECO's proposed rate base, representing its claimed measure of value at fully projected future test year end, equals $2,463,555,000. To develop the level of plant in service at June 30, 2022, the Company adjusted actual plant balances at June 30, 2020, as set forth in its books of account, to reflect those plant additions and retirements forecasted to occur during the FTY and FPFTY (PECO St. 3, pp. 13-14 and PECO Ex. MJT-1 Revised, Sch. C-2). To the resulting amount, PECO added requested allowances for a pension asset, materials and supplies, cash working capital and gas storage inventory, and made the normal ratemaking deductions for, *inter alia*, accrued depreciation, customer contributions, advances and deposits, and deferred income taxes.

B. Utility Plant in Service

1. The Company's Claim

The increase in PECO's utility plant in service since its last gas base rate case in 2010 is the single largest factor driving the Company's need for an increase in revenues. PECO projects that it will need to invest approximately $1.2 billion in new or replacement gas utility plant between July 1, 2020 and June 30, 2024. The overwhelming portion of this investment is required to maintain the safety and reliability of PECO's gas distribution system, including accelerated main and services replacement, meter replacement, regulator replacements, mapping enhancements and security upgrades. *See* PECO St. 1, pp. 5-7, 10, 16-18; PECO St. 2, pp. 2-3.

As previously noted, the Company's rate base claim in this case, as set forth in PECO Exhibit MJT-1 Revised, reflects its projection of the original cost of utility plant that will be in service as of June 30, 2022, and, therefore, includes the original cost of all plant additions and retirements forecasted to occur during the FPFTY. Accordingly, PECO's claims for FPFTY accumulated depreciation and annual depreciation expense are based on its projected plant balances as of June 30, 2022. PECO also projected the balance of its accumulated deferred income taxes ("ADIT") and the regulatory liability for "excess" ADIT as of June 30, 2022, which are reflected in its rate base claim. In addition, PECO reflected an annual amount of plant-related tax deductions, which are included in PECO's calculation of its claimed income tax in this case. *See* PECO St. 3, pp. 13-15, 42-43; PECO St. 3-R, p. 5; PECO Ex. MJT-1 Revised, Schs. C-2, C-3, D-17 and D-18.

Two issues have been presented related to PECO's investment in plant in service during the FPFTY. The OCA challenges PECO's budgeted data for FPFTY plant additions and proposes an allowance only at the Company's forecasted level of plant additions for the FTY, without an allowance for any plant additions during the FPFTY. Second, I&E witness Ethan H. Cline proposes to reduce PECO's claimed plant in service balances for the Natural Gas Reliability project described in Mr. Bradley's direct testimony (PECO St. 1, p. 17) to eliminate investments in gas utility plant that Mr. Cline believes will not be placed in service during the FPFTY. For the reasons discussed below, the OCA's and I&E's objections are without merit.

2. The OCA's Recommended Allowance for Fully Projected Future Test Year Plant Additions

OCA witness Lafayette K. Morgan proposed an adjustment to eliminate the entire allowance for plant additions totaling $305,555,000 that PECO projects will be placed in service in the FPFTY, with corresponding reductions to accumulated depreciation, ADIT and annual

depreciation expense. The net effect of Mr. Morgan's adjustments would be to reduce PECO's rate base by approximately $271 million and to correspondingly reduce PECO's claim for depreciation expense by $7.827 million. Mr. Morgan offered two alleged bases for his proposed adjustments to reduce PECO's FPFTY rate base. First, he claimed that PECO's FPFTY projections are overstated and unreliable because they were based on an "abbreviated" budgeting process. Second, Mr. Morgan attempted to justify his entire proposed adjustment on the fact that certain PECO gas operations construction activities scheduled for the second quarter of 2020 were temporarily delayed as a result of the COVID-19 emergency. *See* OCA St. 2, pp. 7-15; OCA St. 2-SR, pp. 2-10; OCA Sch. LKM-4. Both arguments are wrong.

First, Mr. Morgan is simply attempting to lend support to the OCA's untenable position that the Commission grant no rate increase in the first instance – a rejection of the Company's entire FTY and FPFTY claim for plant in service – or, in the alternative, reject the Company's entire FPFTY claim for plant in service. Contrary to Mr. Morgan's contention, the Company employed a rigorous process to develop its FTY and FPFTY capital and operating budgets, consistent with the process reviewed by the Commission during its Focused Management and Operations Audit of PECO in 2014. As explained by Mr. Stefani, PECO's Senior Vice President, Chief Financial Officer and Treasurer, the Company utilizes a five-year Long Range Plan ("LRP") that is regularly updated on a rolling basis. The budget process for this rate case began in June 2019 and concluded in August 2020. As explained by Mr. Stefani, the process started with the submission of LRPs by individual "responsibility areas," such as Gas Operations and Customer Operations, to PECO's finance group. The finance group then aggregated and analyzed the responsibility area LRPs and submitted them to PECO's senior management for review in September 2019. Following review, the LRP budget was approved by senior

management in January 2020. *See* PECO St. 2, pp. 10-12; PECO St. 2-R, p. 2; Hearing Tr. 249-51.

Typically, that is where the budget process would end. As acknowledged by the OCA's witness Mr. Rubin (OCA St. 1, p. 9), however, PECO delayed the filing of this rate case due to the COVID-19 pandemic. As a result of the delay, in July 2020, the Company took the budget that was already approved by senior management in January 2020 for a March 2020 filing and refreshed it with the most up-to-date information to accommodate the use of a fiscal year ending in June – in other words, a historic test year ending June 30, 2020 – in order to align with the Company's delayed filing. The budget reflected the Company's current information regarding customer load, capital expenses, operating and maintenance ("O&M") expenses, depreciation and amortization expense, and interest and tax expense. In addition, since this update occurred approximately four months into the COVID-19 emergency, the update reflected impacts resulting from the pandemic. The updated budget was finalized in August 2020. *See* PECO St. 2-R, pp. 2-3; Hearing Tr. 249-51. As noted by Mr. Stefani, "the budget process utilized to develop the FTY and FPFTY cost of service was neither abbreviated nor independent of the Company's normal budget process." PECO St. 2-R, p. 3. Mr. Stefani also pointed out that the budget was fully reviewed and authorized by the Company's senior management. Hearing Tr. 251.

In addition to incorrectly asserting that the budgeting process was abbreviated, Mr. Morgan contended that, because the Company developed its FTY and FPFTY budgets in the context of the COVID-19 pandemic, they are unreliable and unreasonable. OCA St. 2, pp. 4-6; OCA St. 2-SR, pp. 5-7. The development of FTY and FPFTY budgets is inherently an exercise in reasonable projections based on typical and normal operating conditions and currently

available information. The Company's FTY and FPFTY budgets reflect "the standard inputs to PECO's well-established gas forecasting process, including weather normalization based on 30-year averages, historical sales and customer growth trends, and economic forecasts provided by PECO's third-party vendor." PECO St. 2-R, p. 3. As the Commission recently concluded in *Columbia Gas* (pp. 52-53) and *PAWC* (pp. 45-46), the proper course is to examine this data, and not to simply reject a requested rate increase due to the pandemic.

Furthermore, it is unreasonable to assume, as Mr. Morgan has, that the Company's FTY and FPFTY claims for plant in service are unachievable due to the COVID-19 pandemic. As both Messrs. Bradley and Stefani noted, some projects were delayed during the HTY, but PECO does not expect the in-service dates of any of the projects it expects to complete in the FTY or FPFTY to be delayed. PECO St. 1-R, pp. 3-4; Hearing Tr. 217-18, 246-47. In addition, the Company's capital expenditures through 2020 demonstrate that the Company mitigated the delays caused by the COVID-19 pandemic. The Company spent approximately $274 million of its $277 million 2020 construction budget – approximately 99% of its target – and anticipates that it will be fully caught up on its construction budget by June 2021. *Id.*

Mr. Morgan conflated certain statements in PECO's testimony and discovery responses to arrive at the erroneous conclusion that the Company's claims are unreliable. *See* OCA St. 2, pp. 6-9; OCA St. 2-SR, pp. 14-15. For example, Mr. Morgan compared PECO's responses to OCA-II-3(a) and OCA-XIII-3 and claimed that the differences between the "Estimated Completion Dates" provided in Attachment OCA-II-3(a) and the "Completion Dates" listed in the response to OCA-XIII-3 show that the Company's projected plant additions for the FTY and FPFTY are unreliable. Mr. Morgan's critique, however, appears to reflect a misunderstanding of the data provided by the Company and not inadequacies with the data itself. As explained by

Mr. Stefani, OCA-II-3(a) requested PECO's capital budgets for the FTY and FPFTY. The broad spending categories and programs presented in the budget do not exactly align with the dollar amounts and completion dates presented in the Company's response to OCA-XIII-3(a), since OCA-XIII-3 is limited to the plant the Company anticipates will be placed into service in the FTY and FPFTY. The Company's broader capital budgets presented in its response to OCA-II-3 contain expenditures for plant that is aggregated as part of larger budget projects, which plant will be completed and placed into service prior to when the projects as a whole (and their associated capital expenditures) will be complete. PECO St. 2-R, pp. 5-7; Hearing Tr. 244-47.

Mr. Morgan also contended that the Company's response to OCA-XIII-3, which stated that none of the projects anticipated to be completed and placed into service in the FTY and FPFTY would be delayed, was at odds with Mr. Bradley's acknowledgment that certain projects had been delayed in the HTY, and therefore, is further evidence that the Company's projected plant additions are unreliable. OCA St. 2, pp. 14-15; OCA St. 2-SR, pp. 3-5. However, Mr. Morgan's contention is entirely refuted by Mr. Bradley's and Mr. Stefani's testimony demonstrating that the Company has already almost entirely caught-up from those delays, and none of its FTY or FPFTY in-service dates have been delayed. Hearing Tr. 217-18 and 246-47.

In summary, Mr. Morgan's conclusion that the Company's FPFTY plant in service projections are unreliable is unsupported and contrary to the substantial evidence presented by the Company. The Commission should reject Mr. Morgan's proposed adjustment to the Company's plant in service claim.

3. I&E's Proposed Adjustment to PECO's Forecasted Plant Additions for the Natural Gas Reliability Project

I&E witness Cline also took issue with PECO's FPFTY claim for plant additions and recommended an adjustment to reduce PECO's forecasted plant-in-service balances for the

Natural Gas Reliability project by $47,624,803. Mr. Cline contends that PECO's claimed plant additions associated with this project are higher than the plant additions placed in service, or to be placed in service, in the FPFTY that he calculated based on data regarding the Company's total investment to date and anticipated completion date identified in PECO's response to Interrogatory I&E-RB-4-D. *See* I&E St. 3, pp. 10-12; I&E St. 3-SR, pp. 4-6; I&E Ex. No. 3, Sch. 2.

As Mr. Bradley explained, the Company's Natural Gas Reliability project consists of three components: (1) the installation of 11.5 miles of gas main; (2) capital upgrades to the Company's West Conshohocken liquified natural gas ("LNG") facility; and (3) the construction of a new gate station, or reliability station. Mr. Cline mistakenly treated the three components of the Natural Gas Reliability project as a single, linear project. In fact, the three components will be constructed, placed into service, and will be able to provide service to customers independently. The new 11.5-mile gas main and new reliability station are scheduled to be in-service and will be used to provide natural gas service to PECO customers by the second quarter of 2022 (i.e., during the FPFTY). While the planned upgrades to the LNG facility will not be completed and placed into service until the end of 2022 (i.e., after the end of the FPFTY), the associated costs of those upgrades are not reflected in the Company's FPFTY claim for plant additions. PECO St. 1-R, pp. 18-20; Hearing Tr. 213-17.

In short, the Company's total plant in service claim related to the Natural Gas Reliability project for the FPFTY – $82,481,428 – only includes costs related to the 11.5 miles of gas main and the new reliability station. Mr. Cline's adjustment is therefore unwarranted and should be rejected.

C. Depreciation Reserve – Annual/Accumulated

PECO's annual depreciation accrual applicable to plant in service at June 30, 2022 is $892,383,000 (PECO Ex. MJT-1 Revised, Sch. C-2). The annual accrual is based upon a detailed depreciation study sponsored by PECO witness Caroline Fulginiti. *See* PECO St. 4, pp. 7-11; PECO Ex. CF-3. No party has contested the service lives or depreciation calculations prepared by Ms. Fulginiti.

Mr. Cline proposed an adjustment to reduce accumulated depreciation by $804,000. I&E St. 3, pp. 14-16. However, this adjustment is concomitant to the adjustment he proposed to the Company's claimed level of plant additions for the Natural Gas Reliability Project. If I&E's proposed adjustment to reduce PECO's FPFTY plant in service balances for the Natural Gas Reliability project from $82,481,428 to $34,856,625 is not adopted, no concomitant rate base adjustment would be necessary.

OCA witness Morgan also challenged PECO's FPFTY plant additions claim, which adjustment carried with it a related disallowance of the Company's depreciation accrual in the amount of ($41,453,000). *See* OCA Sch. LKM-4, p. 2. However, for the reasons discussed in Section IV.B above, the OCA's underlying plant additions adjustment should not be adopted.

D. Additions to Rate Base

In addition to the depreciated original cost of net utility plant in service discussed in Section IV.B above, PECO has included in its claimed rate base its investment in the pension asset, cash working capital, materials and supplies, and gas storage inventory. By the conclusion of the evidentiary hearing, only PECO's claim for rate base recognition of its pension asset remains in dispute.

1. Projected Plant Additions

The Company has addressed projected plant additions in its general discussion of utility plant in service in Section IV.B.

2. Pension Asset

The pension asset arises because of a difference in the calculation of pension costs for ratemaking purposes in Pennsylvania and the calculation of pension costs under GAAP. The Commission has generally required that pension costs for ratemaking purposes should be based upon a utility's cash contribution to its pension fund, while GAAP requires pension costs to be determined on the basis of different rules, which are set forth in the Statement of Financial Accounting Standards No. 87 ("SFAS 87"). Use of these two different procedures results in an annual difference between the amount of pension costs recovered in rates established by the Commission (based on cash contributions) and the amount of pension costs reflected on the accounting records of the Company (based on SFAS 87). PECO St. 3-R, p. 10.

The pension asset represents the accumulated amount of the difference related to the portion of the pension costs that are capitalized and included in utility plant accounts. PECO must capitalize and include in its plant accounts an amount that is based on pension costs calculated on the basis of SFAS 87. This means that the amounts that are assumed for ratemaking to be included in PECO's plant accounts (based on the application of a capitalization rate to the cash pension contribution) necessarily differ from the amounts that are actually capitalized by PECO by applying, as it must, GAAP rules. *Id.*, p. 11.

The pension asset reflects the difference between: (1) the amount of pension cost the Commission's assumes was included in PECO's plant accounts; and (2) the amount of pension costs actually included in PECO's plant accounts. That difference is $35.1 million. The pension asset, therefore, consists of $35.1 million of investor-supplied capital that was actually

contributed to PECO's pension fund and assumed for ratemaking purposes to be included in PECO's plant accounts, but was not recorded in PECO's plant accounts because GAAP rules will not allow it. PECO has included the pension asset in rate base in this case because, unless it is given rate base recognition, PECO will never recover the carrying costs it incurs on those investor-supplied funds. PECO is only proposing to include the pension asset in rate base to recover the associated carrying costs on a prospective basis and is not seeking to recover prior carrying costs in this case. *Id.,* pp. 11-12.

There is no disagreement with respect to the fact that there is a difference between what the Commission requires for ratemaking purposes and GAAP rules. *Id.*, p. 12; I&E St. 1, p. 47; OCA St. 2, pp. 15-16. Nevertheless, both I&E witness D.C. Patel and OCA witness Morgan object to the Company's claim. Mr. Patel asserts that the claim should be disallowed because PECO is undertaking a "switch" in the methodology by which it accounts for the pension asset, and that PECO is earning a return over time on its contribution. I&E St. 1, p. 47. For his part, Mr. Morgan contends that no part of PECO's contributions to its pension funds should be capitalized, that PECO is recovering its contributions through base rates, and inclusion of the pension asset would overstate rate base since it is not amortized. OCA St. 2, pp. 15-19.

As. Mr. Trzaska explained, each of these contentions is flawed. PECO is not "switching" its methodology with respect to the pension asset, and the return on PECO's contribution to its pension funds remain entirely with the funds – it does not accrue to PECO or compensate PECO in any way for its actual contribution. PECO St. 3-R, p. 19. With respect to capitalization, the difference between the pension contribution and other employee costs that are capitalized arises due to the accounting treatment creating a gap between the pension cost excluded from operating expenses and the cost included in plant in service – which will be unrecognized unless the

pension asset is included in rate base. *Id.*, p. 17. PECO's total pension contribution is also reduced by a capitalization rate and only the remaining uncapitalized portion is charged to operating expense, and therefore there is no over-recovery. Furthermore, there is no over-statement of rate base: the pension asset is not amortized, and PECO recovers only a return on the actual, unamortized balance (which can be debited or credited each year depending on pension costs). *Id.*, pp. 17-18.

Notably, the Commission has previously approved three settlements of rate case proceedings for Duquesne Light in which the settling parties agreed to a rate base adjustment for pensions consistent with PECO's approach. *See* PECO St. 3-R, pp. 13-15. While PECO recognizes the limited precedential nature of settlements, the fact remains that the Commission has previously and repeatedly approved an adjustment to rate base that recognizes the pension asset as PECO has proposed. The pension asset-related adjustments to rate base offered by OCA and I&E should be rejected.

3. Uncontested Items

a. Cash Working Capital

Cash working capital represents the funds needed to pay O&M expenses and taxes that, on average, are incurred in advance of the utility's receipt of revenues. PECO calculated its cash working capital requirement using the accepted, PUC-approved lead-lag method. PECO St. 3, pp. 16-22; PECO Ex. MJT-1 Revised, Sch. C-4. No party disputed the methodology that the Company employed or challenged its proposed revenue lag, expense lag or net lag (revenue lag minus expense lag). However, O&M expenses are an input to the calculation of cash working capital. For that reason, I&E and the OCA, which have both proposed adjustments to PECO's expense claims, have also calculated different cash working capital allowances. Those proposed expense adjustments are addressed in Section VI, *infra*, where the Company explains why

neither Mr. Patel's nor Mr. Morgan's various adjustments should be adopted. Nonetheless, if any changes are made to the Company's proposed O&M expenses, its cash working capital would need to be recalculated.

b. Other Non-Contested Rate Base Additions

The Company's rate base claim includes an amount of $31.6 million representing its investment in materials and supplies and gas storage inventory. That amount is the average of PECO's monthly account balances for both items for the thirteen months ended September 30, 2020. PECO St. 3-R, pp. 2-3; PECO Ex. MJT-1 Revised, Schs. C-11 and C-13. No party disagrees with PECO's updated claims for these rate base additions to reflect the most recent thirteen-month historic averages and derivative changes in cash working capital attributable to those updates.

E. Conclusion

The Company's total rate base at June 30, 2022 under present rates is $2,463,555,000. This amount properly reflects PECO's fully forecasted FPFTY plant in service balances totaling $3,537,669,000 and the $35.1 million of investor-supplied funds represented by the pension asset that have not been recovered in the Company's base rates. The OCA's proposal to use the FTY allowance of $3,232,114,000 for the FPFTY plant-in-service balances and associated adjustments to depreciation reserve and ADIT, which translate to a net reduction of nearly $271 million to PECO's rate base claim, should be rejected. I&E's proposed adjustment to reduce PECO's FPFTY plant in service balances for the Natural Gas Reliability project from $82,481,428 to $34,856,625 should also be rejected. Finally, I&E's and the OCA's proposed adjustments to eliminate the pension asset from rate base should be rejected.

V. REVENUES

The Company submitted extensive financial and accounting data depicting the results of its gas operations during the HTY ended June 30, 2020 and as projected for both the FTY and FPFTY. A summary statement of income showing PECO's final revenue and expense claims is provided in Appendix A. The Company developed its claims for pro forma present rate revenue levels by using PECO's budgeted revenue from gas sales for the FPFTY and, in accordance with well-established PUC practice, making appropriate adjustments to (1) remove revenues relating to PECO's portion of off-system gas sales and the margin on sales under PECO Rate IS - Interruptible Service; (2) annualize the effect of changes in the number of customers projected for the FPFTY; and (3) normalize revenue to reflect 365.25 days. All the adjustments made in developing the Company's pro forma revenue claims are described in the direct and rebuttal testimony of Mr. Michael J. Trzaska (PECO Sts. 3 and 3-R) and further detailed in PECO Ex. MJT-1 Revised.

A. Forfeited Discounts

I&E's witness, Mr. Cline, proposed an adjustment that would increase pro forma present rate revenue for the FPFTY by $358,000 (I&E Ex. No. 3, Sch. 11) based on his criticisms of PECO's forecast of revenue from forfeited discounts (late payment charges). *See* I&E St. 3, pp. 24-25. PECO calculated forfeited discount revenue for the FPFTY by first calculating the average forfeited discount revenue for the three years ended December 31, 2019, as a percentage of average past due accounts receivable balances for the same period. The percentage derived from that calculation was applied to PECO's forecast of past due accounts receivable for the FPFTY to develop FPFTY forfeited discount revenue. In addition, PECO reduced its FPFTY level of forfeited discount revenue to account for a permanent waiver of late fees on past due

balances for customers enrolled in the Company's Customer Assistance Program.[13] PECO St. 2-R, pp. 7-9.

In support of his adjustment, Mr. Cline first contends that PECO's pro forma present rate revenue for the FPFTY does not recognize that increased revenue gives rise to increased forfeited discounts. *See* I&E St. 3, p. 25; I&E St. 3-SR, p. 12. To the contrary, as Mr. Trzaska explained, PECO's pro forma revenues reflected this relationship by including a forfeited discount rate in the gross revenue conversion factor that is used to determine the amount of revenue increase required. PECO St. 3-R, p. 21; PECO Ex. MJT-1 Revised, Sch. D-19.

Second, Mr. Cline's adjustment was based on the average ratio of forfeited discounts to total revenues for the three years ended June 30, 2020 and FPFTY distribution revenue. According to Mr. Cline, his recommended approach should be adopted because the use of a three-year historical average is "long enough to smooth out short term variations and short enough to exclude out of date data." I&E St. 3, p. 25. However, as Mr. Stefani pointed out, PECO's approach is reasonable and appropriately reflects the payment characteristics of the Company's current customer base because forfeited discounts are imposed based on past due balances of accounts receivables. Significantly, the linear trend analysis over an eight-year period (2012-2019) presented in Ex. RJS-1-R confirms that forfeited discounts have a much stronger relationship with past due accounts receivable than with overall revenues. This analysis properly excludes calendar year 2020 data in light of the effects of the pandemic on forfeited discounts. *See* PECO St. 2-R, pp. 8-9; PECO Ex. RJS-1-R. Accordingly, I&E's proposal to calculate pro forma forfeited discount for the FPFTY based on a three-year average of the historic relationship with total revenues should be rejected.

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[13] *2019 Amendments to Policy Statement on Customer Assistance Program, 52 Pa. Code §§ 69.261–69.267*, Docket No. M-2019-3012599 (Order entered Nov. 5, 2019). 50 Pa. Bull. at 1691-1695 (Mar. 21, 2020).

VI. EXPENSES

As shown in Appendix A, the Company's pro forma O&M expenses, at present rate levels, equal $243,222,615 for the FPFTY. The reasonableness of all expense claims has been demonstrated through extensive documentation provided in PECO's supporting data and through detailed explanations of all adjustments by Mr. Bradley, Mr. Stefani and Mr. Trzaska (PECO Sts. 1, 2, 2-R, 3 and 3-R). The discussion below addresses only those expense claims that the parties to this case have contested through testimony or exhibits.

A. Payroll and Payroll-Related Expense

PECO's requested payroll allowance for the FPFTY of $42,209,000 was presented by Mr. Trzaska. This figure was developed based upon PECO's authorized and budgeted employee complement for the FPFTY of 639 full-time equivalent ("FTE") positions. PECO also annualized budgeted payroll expenses to reflect wage increases to be granted during the FPFTY. For union and non-union employees, the Company projected 2.5% increases to become effective on January 1, 2022 and March 1, 2022, respectively. Finally, the Company adjusted its FPFTY budgeted data to normalize a one-time cash payment to union employees made in connection with the ratification of PECO's current collective bargaining agreements. *See* PECO St. 3, pp. 34-35; PECO Ex. MJT-1 Revised, Sch. D-6.

OCA witness Morgan and I&E witness Patel each proposed adjustments to reduce PECO's claim for payroll expense. As explained below, those proposed adjustments should be rejected.

1. The OCA's Proposed Adjustments

Mr. Morgan proposed two adjustments that, in aggregate, would reduce PECO's payroll expense claim by $2.477 million. His first adjustment was designed to set the employee complement at the actual level as of September 30, 2020 because, in Mr. Morgan's view, the

Company did not provide adequate support for the total net increase of 37 FTE positions PECO has forecasted by the end of the FPFTY. Second, Mr. Morgan recommends an adjustment that would eliminate PECO's normalized ratification bonus paid to union employees. *See* OCA St. 2, pp. 23-25; OCA St. 2-SR, pp. 16-19; Sch. LKM-11.

Mr. Morgan's proposed employee complement allowance of 604 positions, instead of 639 positions as forecasted by the Company for purposes of its payroll claim, is seriously flawed for two principal reasons. First, the rationale for his proposed adjustment – that 37 additional positions would not be filled by the end of the FPFTY – was thoroughly refuted by Mr. Stefani. As Mr. Stefani explained in his rebuttal testimony, those positions include fifteen mechanics, four senior contract coordinators, five engineers, one gas operating mechanic, two clerks, one damage prevention inspector, one workweek manager, one contractor liaison and several energy technicians, whose allocated FTEs to gas operations will total seven employees. As Mr. Stefani also testified, these positions are in the process of hiring and are expected to be filled by the end of the FPFTY. PECO St. 2-R, pp. 11-12. Under similar circumstances, the Commission has rejected adjustments to a utility's payroll expense to account for as yet unfilled positions and it should do so again in this case.[14]

Second, Mr. Morgan suggested that PECO would be unable to achieve its forecasted employee complement of 639 FTEs by the end of the FPFTY because of the COVID-19 pandemic. Yet, as Mr. Stefani noted in his rebuttal testimony (PECO St. 2-R, p. 11), the Company's headcount was 612 FTE employees as of December 31, 2020. There is no basis to

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[14] *See*, *e.g.*, *Pa. P.U.C. v. PPL Elec. Utils. Corp.*, Docket No. R-2012-2290597 (Opinion and Order entered Dec. 28, 2012) ("*PPL 2012*"), p. 40 ("We agree with the ALJ that PPL is most familiar with its needs in terms of staffing, and that PPL's historical payroll supports a finding that the Company's claim is reasonable. Further, we believe that the basis for the OCA's adjustment, while mathematically accurate, does not envision an appropriate level of staff needed to maintain and manage PPL's system.").

exclude the payroll costs for the eight employees added after September 30, 2020, as Mr. Morgan's proposed adjustment would do. More importantly, as Mr. Stefani testified, PECO intends and expects to staff its full, forecasted employee complement by June 30, 2022 despite impacts from the COVID-19 pandemic that temporarily prevented PECO from hiring all anticipated gas operations personnel (635 positions) by the end of 2020. The primary reason for the lower number of positions in 2020 was the cancellation of PECO's Gas Mechanics School in March 2020 due to the pandemic, and the training program has already been rescheduled for September 2021. PECO St. 2-R, pp. 11-12.

Mr. Morgan's proposal to disallow costs related to the union contract ratification bonus that PECO incurs on a recurring basis should also be rejected. As Mr. Trzaska explained, PECO has consistently paid a ratification bonus to union employees each time it negotiates new union contracts, and there is no reason to believe that PECO will depart from that practice in the FTY and FPFTY. PECO St. 3-R, pp. 21-22. Consistent with Commission practice,[15] PECO's proposal to spread the ratification bonus expense over the average length of the Company's collective bargaining agreements (i.e., six years) is reasonable and appropriate.

2. I&E's Proposed Vacancy Rate Adjustment

Mr. Patel proposed an adjustment to reflect an average of the vacancy rates as of the three years ended June 30, 2020 for PECO's full-time employees (2.1%) that would reduce the Company's payroll-related expense claim by $858,715. I&E St. 1, pp. 12-15; I&E St. 1-SR, pp. 8-10. This adjustment is similar to the "vacancy" adjustment proposed by Mr. Morgan, and it should be rejected for the same reasons.

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[15] *See* James H. Cawley and Norman J. Kennard, *A Guide to Utility Ratemaking* (2018), p. 86 (quoting *Pa. P.U.C. v. York Water Co.*, 78 P.U.R. 3d. 113, 132 (1968) ("Expenses that occur irregularly during an extended period of years, but are certain of eventual recurrence, are a legitimate charge to ratepayers. Therefore, spreading of this expense over years of recurrence is logical.")).

Moreover, Mr. Patel improperly applied his calculated vacancy rate to a total of 639 employees, which consists of the 602 actual employees as of the end of the HTY and the 37 employees that PECO will hire over the FTY and the FPFTY. The fundamental error in Mr. Patel's calculation is that the figure of 602 represents the *actual* filled positions for the HTY and does not include any budgeted "vacant" positions. Therefore, there is no basis for adjusting that figure by a "vacancy" rate. As Mr. Stefani explained, if Mr. Patel's proposed vacancy rate were only applied to the 37 employees that PECO will add by the end of the FPFTY, the Company's payroll-related expense claim would be reduced by $46,200 instead of the $858,715 claimed by Mr. Patel. PECO St. No. 2-R, pp. 10-11.

3. Employee Benefits Expense and Payroll Taxes

Messrs. Morgan and Patel have recommended adjustments to PECO's employee benefits expense and payroll taxes. *See* OCA St. 2, pp. 25-26, 42 and Schs. LKM-12 and LKM-29; I&E St. 1, pp. 16-18. These adjustments, however, are concomitant to their proposed adjustments to payroll expense and, therefore, should be rejected for the reasons previously discussed.

B. Contracting And Materials Expense

The Company is seeking recovery of contracting and materials expense of $42,955,000 in the FPFTY. This is an approximately 3.8% increase over the Company's projected FTY contracting and materials expense of $44,651,000. Three initiatives are the principal drivers in the Company's increase in contracting and materials expense in the FTY and FPFTY: (1) PECO is enhancing its mapping system to improve the Company's ability to locate and track gas distribution facilities and the Company is increasing its investment in its gas mapping project in the FTY; (2) the Company anticipates incremental contracting and materials expense related to PECO's planned activities to reduce its non-emergent leak backlog; and (3) PECO will be required to incur additional security expenses in the FTY for crews working in high-crime areas.

Expenses related to these items are anticipated to result in the Company incurring approximately $8 million in incremental spend over prior years, in each of the FTY and the FPFTY. PECO Ex. MJT-1 Revised, Sch. D-4; PECO St. No. 2-R, p. 17-19; Hearing Tr. 252-53.

I&E witness Patel recommended reducing the Company's claim by approximately $10 million. Mr. Patel contended that the Company failed to adequately explain the increase in contracting and materials expense from the HTY to the FTY, and he asserted that the Company's FPFTY claim is not reliable and reasonable since the FTY increase is reflected in the FPFTY claim. Mr. Patel recommended that the Commission allow the Company to recover only the three-year historical average of its contracting and materials expense. I&E St. 1, pp. 38-40; I&E St. 1-SR, pp. 32-35.

Mr. Patel's recommendation is unreasonable and should be rejected. The actual amount incurred by the Company during the HTY was significantly lower than expected due to temporary impacts from the COVID-19 pandemic. For example, as explained by Mr. Stefani, construction work stoppages in March through June 2020 reduced the need to locate Company facilities, and COVID-related restrictions reduced work levels in the Company's mapping plan and slowed the Company's efforts to repair non-emergent leaks. The Company estimates that these COVID-related impacts reduced its HTY contracting and materials expense by approximately $6 million. This result was an anomaly and not indicative of future levels of the Company's contracting and materials expense. As Mr. Stefani explained at the evidentiary hearing, PECO is already on track with its planned locating and mapping efforts and associated contracting and materials spending in the FTY. In addition, he testified that the Company anticipates that it will be fully caught up on its 2020 construction budget by June 2021 despite

temporary delays caused by the pandemic and will meet its FTY and FPFTY budgets for contracting and materials expenses. *See* Hearing Tr. 251-53.

It would be unreasonable to utilize a three-year average of the Company's historical contracting and materials expense when the Company's HTY actual expense was a materially lower aberration due to impacts from the COVID-19 pandemic, especially when such impacts have already been mitigated and are not intended to impact the Company's FTY and FPFTY contracting and materials expense. Furthermore, Mr. Stefani fully explained and supported the Company's claimed increase in the FTY and FPFTY in his rebuttal testimony (PECO St. 2-R, pp. 17-19). Therefore, the Commission should reject Mr. Patel's recommendation and approve the Company's claim for contracting and materials expense.

C. Outside Services (including Service Company Charges)

PECO is seeking recovery of $22 million in outside services expenses in the FPFTY. This claim is inclusive of PECO's claim related to EBSC expenses. The EBSC was created by Exelon, following the merger of PECO and the former Unicom Corporation, to provide its affiliates with certain functions that it believed could be staffed more efficiently and economically on a centralized basis. Utilization of the EBSC for certain services, such as information technology, finance, human resources, government and external affairs and public policy, and legal services enables PECO to realize economies of scale and scope that it would not be able to realize on a standalone basis. PECO St. 2, pp. 16-21; PECO St. 2-R, p. 15.

I&E witness Patel asserted that the Company did not properly support its proposed increase in outside services expenses from the HTY to the FTY. Mr. Patel argued that because the Company had stated its projected increase in total outside services expense are generally due to inflation adjustments, the Company had not justified its anticipated increase in outside services expenses from the HTY to the FTY and FPFTY. Mr. Patel acknowledged that the use

of inflation factors could be appropriate to determine the Company's projected outside services expenses. However, in place of the Company's proposal, Mr. Patel recommended adjusting the Company's HTY actual outside services expenses for inflation based on Consumer Price Index ("CPI") factors to determine the allowance for these expenses, resulting in a 2.75% increase from the HTY to the FTY, and a further 2.03% increase from the FTY to the FPFTY. I&E St. 1, pp. 19-22; I&E St. 1-SR, pp. 14-17.

However, the data that Mr. Patel utilized as the basis for his analysis is incorrect. Mr. Patel analyzed only the amount in Federal Energy Regulatory Commission ("FERC") Account 923 set forth on PECO Exhibit MJT-1, Schedule D-4. The approximately $16.5 million figure referenced by Mr. Patel is a result of FERC-based allocations based on the Company's 2019 actual results (since the Company does not budget by FERC account) and represents a combination of EBSC contracting charges allocated to Account 923 and PECO contracting charges allocated to Account 923. Mr. Patel should have utilized the GAAP-based projections set forth in PECO Exhibit RJS-1 and Attachment III-A-22(a), included in the Company's initial filing. RJS-2-R, pp. 16-17.

Attachment III-A-22(a) shows that the Company's HTY actual outside services expense was $21,640,000. The Company projected a slight decrease in FTY outside services expenses to $21,093,000, with a slight increase to $22,135,000 in the FPFTY. This represents an approximately 4.9% increase over the FTY, but only an approximately 2.25% increase over the HTY, and which is also lower than the Company's historical three-year average for outside services expense. RJS-2-R, pp. 16-17. Applying Mr. Patel's CPI factors to the HTY date set forth in Attachment III-A-22(a) produces a greater FPFTY amount than is being sought by the

Company. The Commission should therefore reject Mr. Patel's proposed adjustment and approve the Company's outside services expense claim.

OCA witness Morgan also opposed a portion of the Company's outside services claim. Mr. Morgan stated that the Company should not have utilized inflationary adjustments to determine its FPFTY EBSC claim and proposed adjusting only the "Non-Information Technology (IT) Costs" set forth on Attachment III-A-22(a) by utilizing the Company's historical three-year average for such expenses. Mr. Morgan stated that because the EBSC functional areas are managed by Exelon employees, the Company should be able to utilize "proper budget projections" instead of applying an inflation adjustment. This results in a decrease of $997,000 to the Company's FPFTY claim for O&M expenses. OCA St. 2, pp. 36-37; OCA St. 2-SR, pp. 20-22 and Sch. LKM-20.

Mr. Morgan, too, utilizes the wrong data to support his erroneous conclusion that the Company's claim for outside services expense should be adjusted. Mr. Morgan only applied an adjustment to the Non-Information Technology (IT) Costs set forth on Attachment III-A-22(a) and ignored the other elements of the Company's outside services claim, which includes EBSC IT Costs, Non-Utility Charges, and Other Affiliate Charges. If Mr. Morgan had averaged the Company's total outside services expenses over that same period, he would have determined that the Company's three-year average for outside services expense is $22,258,666, which is slightly higher than the Company's FPFTY claim.

PECO's claim for an approximately 2.25% increase from the HTY to the FPFTY is reasonable, and the use of inflationary factors to determine a pro forma expense allowance is consistent with Commission policy.[16] Moreover, adoption of Mr. Morgan's methodology, when

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[16] *See*, *e.g.*, *Pa. P.U.C. v. Phila. Elec. Co.*, 60 P.U.R. 4th 101 (1984).

applied to the Company's total claim for outside services expense, would result in an even greater FPFTY amount than is being sought by the Company. Therefore, the Commission should also reject Mr. Morgan's proposed adjustment.

D. Other Post-Employment Benefits Expense

The Company provides medical-related benefits to eligible retirees through its parent's other post-employment benefits ("OPEB"), and the Company is claiming OPEB expense of $1,050,000 in the FPFTY. This is a significant increase over prior years' OPEB expenses due to the fact that, prior to 2015, the Company provided eligible retirees a Company-sponsored medical plan with a traditional premium cost-sharing arrangement. In 2014, the Company changed its plan design so that, starting in 2015, PECO began to provide eligible retirees a defined contribution that retirees can use to purchase coverage in the individual Medicare marketplace. As Mr. Stefani explained, the 2014 plan amendments resulted in a re-measurement of the Company's OPEB obligation, which resulted in a prior service credit recorded to other comprehensive income. This credit was then amortized over the average remaining service period of the active plan participants. The Company's independent third-party actuary, Willis Towers Watson, confirmed that the amortization period will expire in June 2021 (i.e., at the end of the FTY). The expiration of the prior service credits will result in a marked increase in the Company's FPFTY OPEB expense. However, to keep things in perspective, the Company's FPFTY OPEB expense is still only approximately one-third of what it was in 2010. *See* PECO St. 2, pp. 7-8; PECO St. 2-R, pp. 25-28; Hearing Tr. 231-33; PECO Ex. RJS-1RJ (Confidential), p. 15, PECO Ex. RJS-2RJ (Confidential), p. 15, and PECO Ex. RJS-3RJ (Confidential), p. 3.

I&E witness Patel stated that the Company failed to substantiate its claim. Mr. Patel asserted that the Company did not properly support its claim that it would experience an increase in its FPFTY OPEB expense due to the expiration of the prior service credit. He recommended

allowing the Company to recover its projected FTY OPEB claim of $270,000 for the FPFTY, thereby reducing the Company's OPEB expense claim by $780,000. I&E St. 1, pp. 42-44; I&E St. 1-SR, pp. 37-39.

Mr. Patel's recommendation should be rejected. Mr. Stefani presented extensive testimony explaining how the prior service credit was created following the Company's modification to its retiree benefits plan in 2014, how its amortization over the remaining life of the active plan participants resulted in unusually low OPEB expense in recent years, and that the prior service credit will expire in June 2021, resulting in the increased OPEB expense that the Company is claiming. PECO St. 2-R, pp. 25-28; Hearing Tr. 231-33. Moreover, Mr. Patel has not provided any support as to why the Company's FTY OPEB expense claim is reasonable but its FPFTY OPEB expense claim is not. Therefore, the Commission should approve the Company's claim for OPEB expense.

OCA witness Morgan also asserted that the Company failed to support its claim for FPFTY OPEB expense. In his direct testimony, Mr. Morgan recommended an allowance equivalent to the Company's most recent actual three-year average, resulting in a downward adjustment of $1,085,000. OCA St. 2, pp. 26-27; LKM-13. In his surrebuttal testimony, Mr. Morgan revised his calculation resulting in a recommendation to adjust the Company's claim by $486,000. OCA St. 2-SR, p. 19; OCA Sch. LKM-13. Mr. Morgan's recommendation should be rejected, and the Company's claim should be approved, for the same reasons stated in response to Mr. Patel's OPEB expense recommendation.

E. Costs to Achieve Exelon/PHI Merger

The 2016 merger of PECO's parent, Exelon Corporation, with Pepco Holdings, Inc. resulted in significant cost savings to PECO. As acknowledged by I&E, the merger has already resulted in savings to PECO and its customers of approximately $4.3 million in the last five

years. However, as explained by Mr. Trzaska, Exelon also incurred certain costs to integrate the merged companies in order to produce the merger savings that the Company and its customers continue to realize (the "costs to achieve" the merger, or "CTA" costs). The Company sought recovery of its allocable portion of the CTA expenses, totaling $1,111,000, over a three-year amortization period. PECO St. 3, pp. 40-41; PECO Ex. MJT-1 Revised, Sch. D-15; PECO St. 2-R, p. 12.

Mr. Patel and Mr. Morgan recommended that the Commission disallow the Company's entire CTA claim. Mr. Patel and Mr. Morgan contended that the Company's CTA claim consists of costs incurred prior to the HTY for which the Company did not obtain deferral approval from the Commission, and that approval of recovery in this rate case would constitute improper retroactive ratemaking. Mr. Patel and Mr. Morgan also stated that it would be inappropriate for the Company to recover its CTA when the merger-related savings were realized in prior years and not shared with customers. I&E St. 1, pp. 22-25; I&E St. 1-SR, pp. 18-20; OCA St. 2, pp. 33-36; OCA St. 2-SR, pp. 19-20; OCA Sch. LKM-19.

The Commission should reject Mr. Patel's and Mr. Morgan's proposed disallowance. The Commission may permit recovery of prior period unanticipated, extraordinary, and non-recurring expenses without violating the prohibition against retroactive ratemaking.[17] The Company's CTA is a discrete and limited amount. Moreover, it is appropriate to recognize costs in a given accounting period that produce substantial benefits that extend into future accounting periods.

The Company's allocated CTA expense was not fully known until after the 2018 CTA was determined. Moreover, and more importantly, this expense is tied to merger benefits that

[17] *See Popowsky v. Pa. P.U.C.*, 695 A.2d 448, 452 (Pa. Commw. Ct. 1997).

PECO's customers are continuing to benefit from and which will continue in the future. Mr. Patel's and Mr. Morgan's assertions that the Company's customers have not shared in the benefits from the merger is without merit. The merger-related savings are passed on to customers through reduced costs to Exelon's distribution utilities, including PECO. The fact that the Company has not sought a rate increase since 2010 is in part due to the savings achieved from the merger. These savings are also reflected in the Company's requested increase in this base rate case, which is lower than it would be had the merger not resulted in significant savings to PECO and its customers. *See* PECO St. 2-R, pp. 12-14. Given that PECO's customers have experienced, and will continue to experience, significant merger-related savings as a result of the Exelon/Pepco merger, it is only fair that customers should bear a portion of the costs incurred to produce those savings.

Mr. Patel also contended that the Company's proposed three-year amortization period is inappropriate. I&E St. 2, p. 24; I&E St. 2-SR, p. 19. A three-year amortization period is reasonable because it corresponds to the period that rates established in this rate case are anticipated to be in effect. *See* PECO St. 3, pp. 36, 40-41; PECO St. 3-R, pp. 22-23.

F. Regulatory Commission Expenses (General Assessments)

Mr. Morgan proposed an adjustment to reduce PECO's claim for regulatory commission expenses to the HTY level of general assessments for the Commission, the OCA and OSBA, on the ground that the Company purportedly did not explain in detail the nature of the projected increase of $462,000 in the FPFTY. OCA St. 2, p. 38; OCA Sch. LKM-22. However, as Mr. Stefani explained, the Company's actual 2020-2021 (FTY) general assessments totaling $2,022,423, which is an increase of $288,000 (16.6%) over the HTY level of expense, substantiate the Company's FPFTY claim of $2,197,000. In fact, using the actual percentage increase in general assessments for the FTY to set FPFTY rates would result in a 16.6% increase

in FPFTY general assessments and a $161,000 increase to the Company's original claim. *See* PECO St. 2-R, p. 20; PECO Ex. RJS-2-R. In addition, as previously explained, Mr. Morgan's assertion that the use of inflation factors in PECO's budgeting process are inappropriate is contrary to Commission ratemaking practice. In sum, PECO's well-considered budget estimate for FPFTY general assessments is a reasonable allowance for these expenses and should be approved.

G. Research and Development Expenses

The Company's FPFTY claim of $280,000 for research and development ("R&D") expense was based upon sound budgeting techniques that reviewed NYSearch R&D programs to enhance safety and productivity in the natural gas distribution industry. PECO St. 2-R, p. 20. Mr. Morgan proposed to reduce the Company's claim by $180,000 to reflect what he contends is a normalized level of R&D expense. Specifically, he proposed the use of a three-year average of R&D expense in lieu of the Company's budgeted amount for the FPFTY. Mr. Morgan argues, as the primary basis for his proposal, that PECO's FPFTY claim for R&D expense appears "abnormally high" compared to previous years. *See* OCA St. 2, p. 37; OCA Sch. LKM-21.

Mr. Morgan's proposed adjustment that would reduce the Company's claim to a level even lower than PECO's actual HTY expense should be rejected. The evidence shows that there is no basis to assume, as Mr. Morgan did, that historic averages reasonably reflect PECO's current or likely future R&D expenses. To the contrary, PECO's historic R&D expense level for the years ended June 30, 2018 and 2019 was abnormally low because a significant amount of the Company's R&D budget was redeployed in each of those years to offset higher priority needs to manage gas operating expenses, such as emergent gas leak events. PECO St. 2-R, p. 20.

H. Employee Activity Costs

PECO has proposed to recover the costs of certain employee activities totaling $139,402 that provide important benefits in terms of employee morale and productivity. The Company's annual picnic and other special events in which PECO celebrates its workforce, their accomplishments and strategic goals and initiatives for the upcoming year help make PECO an attractive workplace and incentivize high levels of customer service. PECO St. 2-R, p. 21. Witnesses for I&E and the OCA both proposed adjustments to the Company's FPFTY claim for employee activity costs.

I&E witness Patel proposed to disallow PECO's employee picnic and celebrations claim of $80,933, asserting that those costs for Company sponsored employee events are discretionary expenditures that are not necessary for the provision of safe and reliable utility service. I&E St. 1, p. 26; I&E St. 1-SR, pp. 20-22. Mr. Patel's position is contrary to the Commission's prior decision rejecting similar adjustments. The costs challenged by Mr. Patel relate to employee recognition events, which the Commission has found may properly be included in a utility's operating expenses for ratemaking purposes.[18]

Mr. Morgan questioned whether the employee activity costs that PECO would incur during the FPFTY would be as high as the Company projected because of "uncertainty" caused by the COVID-19 pandemic and contended that PECO's HTY experience should be used to determine the allowance for these expenses. OCA St. 2, p. 40; OCA Sch. LKM-24. In his rebuttal testimony, Mr. Stefani affirmed that PECO experienced abnormally low spending on employee activities during the HTY because of the Commonwealth's response to the COVID-19

[18] *See*, *e.g.*, *Pa. P.U.C. v. Citizens' Elec. Co.*, Docket No. R-2019-3008212 (Opinion and Order entered Apr. 27, 2020), p. 75; *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Opinion and Order entered Oct. 25, 2018) ("*UGI Electric 2018*"), pp. 70-71.

emergency, including stay-at-home orders in effect during the second quarter of 2020, which are unlikely to recur in 2021 and 2022. PECO St. 2-R, p. 22.

For all of the foregoing reasons, the adjustments proposed by I&E and the OCA to PECO's claim for employee activity expenses should be rejected.

I. Travel, Meals and Entertainment

Both I&E and the OCA take issue with the Company's claim for employee travel, meals and entertainment expenses in light of the decline in business travel caused by the COVID-19 pandemic. Mr. Patel proposed to apply inflation factors to PECO's HTY experience to arrive at his allowance of $862,153 for these expenses based solely on his observation that PECO's forecasted level of expenses for the FPFTY reflects a 22.13% increase over its FTY claim. I&E St. 1, pp. 41-42; I&E St. 1-SR, pp. 35-37. Mr. Morgan, in turn, proposes to disallow all but PECO's HTY level of expenses. OCA St. 2, p. 41; OCA Sch. LKM-25.

The allowances for travel, meals and entertainment expenses proposed by Messrs. Patel and Morgan are not appropriate. First, PECO's budgeted data for the FPFTY is more representative of the current and future conditions than the HTY data Mr. Morgan uses, which reflects COVID-19 travel restrictions and stay-at-home orders in place during the second quarter of 2020. In addition, both witnesses ignore the fact that the decline in business travel that forms the basis of their proposed adjustments will be alleviated by increasing vaccinations and other measures to mitigate transmission of COVID-19 during the FPFTY. *See* PECO St. 2-R, pp. 22-23.

J. Membership Dues

The Company claimed membership dues expense of $646,899 in the FTY and $655,897 in the FPFTY. Mr. Patel recommended a reduction of $67,762 in the FPFTY, contending that the Company failed to properly support its claim and recommended that the Commission reduce

the Company's claim by applying inflation factors of 2.75% and 2.03% to the Company's HTY membership dues to determine the FTY and FPFTY expenses. I&E St. 1, pp. 27-29; I&E St. 1-R, pp. 22-25.

PECO's budgeted amounts for membership dues in the FTY and FPFTY are reasonable. As shown on Revised Attachment IE-RE-28-D(a),[19] the Company's actual membership dues expense has fluctuated in the prior three years. PECO's actual expense in July 2017 through June 2018 was $586,041, increasing to $689,986 in July 2018 through June 2019 (an approximately 17.5% increase), and decreasing to $561,005 in the HTY (an approximately 18.5% decrease). In light of those fluctuations, Mr. Patel's proposed adjustment that would reduce PECO's claim below the historic average of actual membership dues (approximately $612,000 over the three years ended June 30, 2020) is inappropriate. *See* PECO St. 2-R, p. 23.

K. Injuries And Damages

The Company's FPFTY claim for injuries and damages expense of $638,000 is derived from a third-party actuarial report obtained by the Company. Mr. Morgan proposed to normalize the Company's claim for injuries and damages expense based on the Company's historical three-year average. This would result in a $464,000 downward adjustment. OCA St. 2, p. 30; OCA St. 2-SR, pp. 23-24; Sch. LKM-16.

The Commission should reject Mr. Morgan's proposed adjustment. As explained by Mr. Stefani, utilization of a three-year average would be unreasonable since the negative $9,000 injuries and damages expense for the twelve months ended June 30, 2019 was due to an actuarial update to the Company's workers' compensation, bodily injury and property damage reserve for that period. The prior year's actual expense for the twelve months ended June 30, 2018 was

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[19] The Company's response to Interrogatory IE-RE-28-D was provided in I&E Exhibit No. 1-SR.

$301,000 and the following year's actual expense for the twelve months ended June 30, 2020 was $231,000. The negative 2019 amount is an aberration that unreasonably skews the Company's three-year average downwards. PECO St. 2-R, p. 24.

The Company's budgeted amounts for FTY and FPFTY injuries and damages expense, on the other hand, are derived from the independent third-party actuarial reports obtained by the Company, and which were shared with the parties. It would be unreasonable to normalize this expense based on a three-year average when one of those three years was abnormally low, and the Company expects a marked increase in this expense based upon its third-party actuarial reports. The Commission should therefore reject Mr. Morgan's proposed adjustment.

L. Property Taxes

The Company's claim for property tax expense was based on the Company's most recent actual property tax bills from 136 municipalities with an adjustment to apply a 2.5% inflation factor. PECO St. 2-R, pp. 24-25. Mr. Morgan adjusted the Company's claim downwards by eliminating the application of the 2.5% inflation factor, solely since he disagrees with the use of adjustments based on inflation escalations. OCA St. 2, pp. 41-42; OCA Sch. LKM-28.

Mr. Morgan's adjustment should be rejected. It is reasonable to assume that the Company's property tax expense will increase consistent with the inflation adjustment utilized by the Company. However, even if the Commission were to determine that an inflation adjustment is not warranted, Mr. Morgan's proposed adjustment should still be rejected.

Mr. Morgan applied his adjustment to PECO's entire budgeted amounts for property taxes in the FTY ($3.594 million) and FPFTY ($3.618 million). However, these amounts are comprised of two components: Public Utility Realty Tax ("PURTA") and real estate tax. PECO's budgeted amounts for PURTA do not reflect an inflation rate since they were derived directly from the 2019 Pennsylvania PURTA Notice of Determination. PECO St. 2-R, pp. 24-

25; PECO Ex. RJS-3-R. Eliminating the 2.5% inflation factor solely from the real estate tax portion of the Company's claim for property taxes (to which it was applied by the Company) would only reduce the Company's claim by $61,395 instead of the $112,000 reduction proposed by Mr. Morgan. However, the Company maintains that its application of a 2.5% inflation factor was reasonable and consistent with Commission practice, and therefore, Mr. Morgan's adjustment should be rejected.

M. Energy Efficiency and Conservation Program Costs

PECO requested $4.5 million in annual funding for its gas energy efficiency and conservation ("EE&C") programs. This funding request would increase the annual budget of the gas EE&C program and allow PECO to expand program offerings to residential customers and income-eligible customers, pursue innovative pilot projects, and support new marketing and outreach to increase customer participation in the program. *See* PECO St. 9, pp. 6-10; *see also* PECO St. 9-R, pp. 4-6. As for the cost-effectiveness of the proposed program, PECO revised its analysis to correct certain calculational errors identified by OCA witness Geoffrey C. Crandall (discussed below in Section IX.D). The Revised Analysis found that the proposed program had a total resource cost ("TRC") of 1.02 and is thus cost effective. *See* PECO St. 9-R, pp. 2-3.

1. I&E Recommendation to Disallow New Program Rebate Costs

I&E witness Patel recommended a disallowance of $1,772,500. This disallowance, if granted, would fund the Company's EE&C program at $2,727,500 per year (a 39% decrease from the Company's request). *See* I&E St. 1, p. 34; *see also* I&E St. 1-SR, pp. 27, 32. Mr. Patel stated that while he did not oppose the introduction of new rebate programs, he believed that the Company could accommodate the cost of these programs within his recommended program budget. *See* I&E St. 1, p. 34. In response, the Company acknowledged that past program participation levels did not meet projections, but more targeted marketing efforts and trade ally

engagement were planned to increase customer participation and justified the full program funding proposed by PECO. *See* PECO St. 9-R, pp. 3-6.

2. OCA Criticisms of the Cost-Effectiveness of the EE&C Program

OCA witness Crandall criticized the cost-effectiveness of the Company's proposed EE&C program.[20] *See* OCA St. 6, pp. 4-6, 11-19. In particular, Mr. Crandall identified an error in PECO's analysis of its smart thermostat program. Mr. Crandall stated that correcting this error would cause the smart thermostat program not to be cost effective and would reduce the cost-effectiveness of the overall EE&C program. *See* OCA St. 6, pp. 17-19. PECO's Revised Analysis corrected this error and made several other adjustments to address Mr. Crandall's recommendations. *See* PECO St. 9-R, pp. 2-3. Under the Revised Analysis, PECO's proposed program was still cost effective, with a TRC of 1.02. *See* PECO St. 9-R, p. 3.

Mr. Crandall agreed with all but one of the changes PECO made in its Revised Analysis. His one disagreement was that PECO included the electricity savings from a high-efficiency gas furnace with electronically commutated motor ("ECM") fans but did not include the incremental measure cost for the ECM fan in its analysis. *See* OCA St. 6-SR, pp. 4-6. In her oral rejoinder testimony, Ms. Masalta explained that the cost of the ECM fan was included in the cost for high-efficiency furnaces in the Revised Analysis, and, therefore, the program remained cost-effective. *See* Hearing Tr. 206-208.

As discussed below in Section IX.D, the Company believes that the Commission should approve its requested allocation for its cost-effective programs. These expanded and enhanced program offerings will provide energy savings for residential and low-income customers and increase overall customer participation.

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[20] Mr. Crandall also recommended the continuation of the EE&C budget from the prior three years with no increase. *See* OCA St. 6, p. 3.

N. Rate Case Expense Normalization

PECO has claimed an allowance for rate case expense in the aggregate amount of $1.6 million and is proposing to amortize this amount over a three-year period, resulting in a normalized claim of $520,000 per year. As explained by Mr. Trzaska, PECO projects that it will need to file another rate case in three years, which formed the basis for the three-year normalization period the Company used in this case. *See* PECO St. 3, p. 36; PECO St. 3-R, p. 22; PECO Ex. MJT-1 Revised, Sch. D-7.

While I&E witness Patel and OCA witness Morgan did not question the amount of PECO's total claimed rate case expense, they suggested that the amortization period should be five years rather than three years. Both witnesses based their proposed five-year normalization period on an approximate average of the historical interval between the filing of the Company's 2008 and 2010 rate cases (two years) and between its 2010 and current base rate cases (ten years). *See* I&E St. 1, pp. 5-11; I&E St. 1-SR, pp. 6-7; OCA St. 2, pp. 30-31; OCA Sch. LKM-17.

The Company's proposed three-year normalization of rate case expense is reasonable and should be adopted. PECO's projected need for rate relief in three years will be driven by the capital requirements of the Company's planned infrastructure improvement programs. Indeed, Mr. Stefani testified that PECO needs to invest approximately $1.2 billion in new and replacement gas utility plant between July 1, 2020 and June 30, 2024. PECO St. 2, p. 3. With that level of investment and even marginal year-over-year increases in operating and maintenance expenses, it is not reasonable to assume, as Messrs. Patel and Morgan have, that PECO could delay a subsequent base rate filing for five years. PECO St. 3-R, p. 22.

Additionally, I&E's and the OCA's exclusive reliance on historical rate case filing intervals to dictate the normalization period to be used in this case is contrary to the

Commission's most recent statement of its policy and practice on this issue. First, in PPL's 2012 rate case, the Commission made it clear that rate case normalization periods should not be backward looking, as I&E and the OCA seem to be proposing, but, instead, should reflect "future expectations." In that case, the Commission stated:

> As previously discussed, this proceeding is premised upon a FTY and, based on that criterion, certain expenses may be now based on future expectations. We believe the normalization period for rate case expense is one of those expenses."[21]

The Commission affirmed that practice for determining the normalization period for rate case expense in *UGI Electric 2018* (pp. 59-60) even though it had been over twenty years since UGI Electric had filed a request for a base rate increase.

O. Regulatory Initiatives

PECO has claimed $47,000 to amortize over a period of three years the O&M and depreciation expenses that the Company incurred to establish a Gas Procurement Charge ("GPC") and Merchant Function Charge ("MFC") pursuant to the Commission-approved settlement of PECO's natural gas unbundling rate proceeding at Docket No. P-2012-2328614 ("Gas Unbundling Settlement"). In its rebuttal case, the Company accepted OCA witness Morgan's proposed adjustment to regulatory initiative expenses that would eliminate the costs that PECO incurred prior to the HTY in this case to implement its Neighborhood Gas Pilot Program. *See* PECO St. 3, p. 40; PECO St. 3-R, pp. 4, 24; PECO Ex. MJT-1 Revised, Sch. D-14.

Mr. Patel did not disagree that PECO's claimed regulatory initiative expenses are proper and recoverable. Nonetheless, he proposed an adjustment to increase the period over which

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[21] *PPL 2012*, pp. 47-48.

these expenses are to be amortized for ratemaking purposes from three years, as the Company proposed, to five years. That change would reduce the annual amortization amount included in operating expenses in this case by $18,800. The only reason Mr. Patel offered for lengthening the amortization period is that doing so would be consistent with his recommendation to normalize rate case expense over five years. *See* I&E St. 1, pp. 30-31; I&E St. 1-SR, pp. 25-27. Mr. Patel's alternative proposed normalization period should be rejected for the reasons discussed in Section VI.J. above.

Mr. Morgan has proposed an adjustment to reduce PECO's regulatory initiative expenses by $20,570 to remove certain O&M expenses related to GPC/MFC implementation, he alleges were not authorized for deferral and recovery. However, Paragraph 39 of the Gas Unbundling Settlement, which is quoted in Mr. Morgan's direct testimony (OCA St. 2, p. 32), expressly authorized PECO to defer costs associated with system changes necessary to establish and implement the GPC and MFC, including information technology ("IT") programming costs, and to seek recovery in the Company's next rate case. In addition to capitalized software costs, PECO incurred $20,570 in operating expenses related to system changes necessary to implement the GPC and MFC, including design, project management and training costs. PECO St. 3-R, pp. 24-25. Mr. Morgan's proposed adjustment that would not recognize those IT-related operating expenses is inconsistent with the Gas Unbundling Settlement and should be rejected.

P. Manufactured Gas Plant Remediation Expense

PECO has undertaken positive efforts to remediate former manufactured gas plant ("MGP") sites in its service territory consistent with the standards established by the Pennsylvania Department of Environmental Protection ("PADEP"). As Mr. Bradley testified, the Company intends to achieve regulatory closure with PADEP for 24 of the 26 presently identified MGP sites by the end of 2023. PECO St. 1, pp. 13-14. PECO has claimed $804,000

to amortize the $7.237 million that the Company will not have recovered through current rates for its MGP remediation liability at June 30, 2021 over a period of nine years. PECO St. 3, pp. 39-40; PECO Ex. MJT-1 Revised, Sch. D-13. The OCA is the only party that has objected to PECO's proposed MGP remediation expense allowance.

While Mr. Morgan did not take issue with PECO's estimated unrecovered MGP remediation liability, he proposed an adjustment to increase the period over which these expenses are to be amortized for ratemaking purposes from nine years, as the Company proposed, to fourteen years. That change would reduce the annual amortization amount included in operating expenses in this case by $287,000. *See* OCA St. 2, pp. 29-30; OCA Sch. LKM-15. As noted by Mr. Morgan, the settlements achieved in PECO's 2008 and 2010 gas base rate proceedings included a cost recovery mechanism for MGP remediation. The 2010 settlement provided that the Company's reset of its MGP remediation expense allowance would be based on a normalized annual level of MGP remediation costs that PECO will incur over the remainder of its remediation program. In light of the estimated dates of completion for all of the MGP projects, PECO believes that nine years (i.e., three subsequent base rate cases) is a reasonable amortization period. PECO St. 3-R, pp. 25-26.

Mr. Morgan also recommended that PECO be required to impute carrying costs on $14.3 million of MGP remediation expenses that he alleges PECO "over-collected" through base rates. OCA St. 2, p. 30. As a threshold matter, PECO has not "over-collected" funds for MGP remediation; the MGP funds PECO has received from customers have been and will be spent on MGP projects. However, PECO has agreed to pay interest on the monthly balance of MGP funds that are not yet spent on remediation activities at the residential mortgage lending rate specified by the Secretary of the Pennsylvania Department of Banking and Securities after July

1, 2021, when new rates will take effect. This interest will accrue and be applied to reduce revenue requirements in PECO's next gas base rate proceeding. *See* PECO St. 3-R, p. 26. Consequently, PECO believes that it has addressed Mr. Morgan's concerns regarding carrying costs on PECO's regulatory asset for MGP remediation.

Q. Depreciation Expense

PECO has claimed an annual depreciation expense allowance of $86,146,000 (PECO Ex. MJT-1 Revised, Sch. D-1) based on depreciation calculations performance by Ms. Fulginiti. As explained in Section IV.C. above, no party in this case disputed the reasonableness of the Company's proposed depreciation rates. Messrs. Morgan and Cline have recommended adjustments to depreciation expense. *See* OCA St. 2, p. 41; OCA Sch. LKM-27; I&E St. 3, pp. 12-14. These adjustments, however, are concomitant to their proposed adjustments to accrued depreciation related to plant additions and, therefore, should be rejected for the reasons discussed in Section IV above.

VII. TAXES[22]

The Company's claims for Federal and State income taxes are set forth in PECO Exhibit MJT-1 Revised, Schedule D-18. No party disputes the manner in which the Company calculated its Federal and State income taxes.

PECO's Federal and State income taxes change based on changes in revenue and expenses (including deductible interest expense) and return. In addition, income taxes will also change based on changes in tax depreciable property due to changes in the depreciation that is deducted in the tax calculation. For this reason, the OCA's proposal to eliminate PECO's rate base claim for FPFTY plant additions would have the concomitant effect of increasing income

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[22] The Company's claims for taxes other than income taxes that have been contested in this case are addressed in Sections VI.A. and VI.L above.

taxes. Mr. Morgan conceded this point in his surrebuttal testimony (OCA St. 2-SR, pp. 10-11) and reflected the concomitant adjustments in OCA Schedule LKM-31.

VIII. RATE OF RETURN

A. Introduction

The legal standards to be used by the Commission in determining what return rate is fair for a utility like PECO are well-established, having been set forth by the United States Supreme Court in *Bluefield* over eighty years ago:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility of its property in violation of the Fourteenth Amendment. (262 U.S. at 690)

The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties (262 U.S. at 693). These principles were applied by the PUC in *UGI Electric 2018* and *PPL 2012*, and have been adopted by Pennsylvania appellate courts, in numerous cases.[23]

The return allowed to investors must also be commensurate with the risk assumed, as the Supreme Court has stated in three landmark opinions. *Bluefield*, *supra*, requires that the rate of return reflect:

> . . . a return on the value of the [utility's] property which it employs for the convenience of the public equal to that generally being made at the same time on investments in other business undertakings which are attended by corresponding risks and uncertainties. . . . (262 U.S. at 692)

Twenty-one years later, the Supreme Court reiterated that standard in *Hope*, as follows:

[23] *See*, *e.g.*, *Lower Paxton Twp. v. Pa. P.U.C.*, 317 A.2d 917 (Pa. Commw. Ct. 1974).

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. (320 U.S. at 603)

Later, in reaffirming *Hope*, the Supreme Court, in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 313-14 (1989) observed that "[o]ne of the elements always relevant to setting the rate under *Hope* is the return investors expect given the risk of the enterprise."

Determining a fair rate of return requires reviewing many factors, including: (1) the earnings necessary to assure confidence in the financial integrity of the company and maintain its credit standing; (2) the need to pay dividends and interest; and (3) the amount of the investment, the size and nature of the utility, its business and financial risks, and the circumstances attending its origin, development and operation.[24]

A key component of a fair rate of return is identification of the appropriate capital structure for ratemaking purposes. The Commission's established policy is to use the company's actual capital structure instead of a hypothetical one unless the evidence supports a finding that the company's capital structure is atypical or too heavily weighted on either the debt or equity side.[25]

A reasonable and fair rate of return for PECO under these standards has been submitted in this case through the testimony and exhibits of Mr. Paul Moul. The Company's capital structure should be set at its actual capital structure of 53.38% common equity and 46.62% long-

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[24] *Pa. P.U.C. v. Pennsylvania Gas and Water Co. - Water Div.*, 19 Pa. Cmwlth. 214, 233, 341 A.2d 239 (1975); *Lower Paxton Twp.*, *supra*.

[25] *See PPL* 2012, p. 68; *Columbia Gas*, p. 116-118.

term debt. The Company's long term cost of debt should be set at 3.84% and its cost of equity at 10.95%. The Company's overall rate of return should be set at 7.64%. *See* PECO St. 5; PECO St. 5-R; PECO Exhibit PRM-1 (updated), Schedule 1.

The methodological positions of OSBA, OCA, and I&E on the rate of return for PECO vary in many respects. However, while there are significant flaws in the rate of return analyses of I&E, which are discussed further *infra*, the rate of return positions advanced by OSBA and OCA are extreme and troubling. OCA proposes a 6.30% rate of return that is wholly inadequate in today's climate, and a return on equity that is more than two hundred basis points below a fair return on equity. OSBA goes further, proposing a return on equity for PECO that approaches three hundred basis points below a fair return on equity.

Adopting a return on equity and overall rate of return that are in the low ranges advocated by these parties would cause great concern within the investment community and make it more difficult for utilities like PECO to attract capital. As Mr. Moul explained:

> The investment community would be very concerned if the Commission were to adopt any of the positions of the OCA or OSBA. If it were to do so, investors would see Pennsylvania regulation as less supportive of the Company at a time of high levels of capital investment. At present, Pennsylvania regulation is currently ranked Above Average/3 by Regulatory Research Associates ("RRA"), which reflects an upgrade that occurred on May 10, 2017. The rating system used by RRA includes three principal categories (i.e., Above Average, Average and Below Average with more refined positions within the categories designated by the numbers 1, 2 and 3).
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> [****]
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> If the Commission were to follow the proposals of OCA or OSBA, the regulatory ranking of Pennsylvania would certainly be jeopardized. The return on equity used by the Commission to set rates should embody in a single numerical value a clear signal of regulatory support for the financial strength of the utilities that it regulates. Although cost allocations, rate design issues, and regulatory policies relative to the cost of service are important considerations, the opportunity to achieve a reasonable return on equity represents a direct signal to the investment community of

> regulatory support (or lack thereof) for the utility's financial strength. In a single figure, the return on equity utilized to set rates provides a common and widely understood benchmark that can be compared from one company to another and is the basis by which returns on all financial assets (stocks – both utility and non-regulated, bonds, money market instruments, and so forth) can be measured. So, while varying degrees of sophistication are required to interpret the meaning of specific Commission policies on technical matters, the return on equity figure is universally understood and communicates to investors the types of returns that they can reasonably expect from an investment in utilities operating in Pennsylvania.

PECO St. 5-R, pp. 13-14.

In the following sections, the Company further explains how the derivation of its proposed capital structure, return on equity, cost of debt, and overall rate of return are set in a fair manner that is consistent with the Commission's standards. The Company also addresses the numerous flaws in the analyses proffered by OCA, OSBA, and I&E.

B. Capital Structure

The Company's capital structure is 53.38% common equity and 46.62% long-term debt, which represents its projected capital structure as of June 30, 2022, the end of the FPFTY. PECO St. 5, pp. 18-19; PECO Ex. PRM-1 (updated), Schs. 1 and 5. Mr. Moul explains that if an operating public utility raises its own debt directly in the capital markets, as PECO does, the operating public utility's own capital structure ratios should be used to determine its overall rate of return. PECO St. 5, p. 18. Accordingly, Mr. Moul started with the Company's actual capital structure as of June 30, 2020, which is the end of the HTY. PECO Ex. PRM-1 (updated), Sch. 5. Then, adjustments were made by Mr. Moul to reflect events that will occur during the FTY and FPFTY and impact the cost of debt, including the Company's plans to issue new long-term debt in March 2021, September of 2021, and March 2022; a debt maturity that will occur in September 2021; planned future equity financings; the build-up of retained earnings; and the redemption of high-cost long-term debt and preferred stock. *See id.*; PECO St. 5, pp. 18-19.

The only party that opposes the Company's proposed capital structure is OCA, as I&E accepted the Company's proposed capital structure and OSBA does not comment on the capital structure ratio. I&E St. 2, p. 12. OCA's witness Kevin W. O'Donnell argued that the Company should use a hypothetical capital structure of 50% equity and 50% long-term debt for ratemaking purposes instead of the Company's actual capital structure. OCA St. 3, p. 44. Mr. O'Donnell references several sources in support of OCA's position: (i) a calculation of the average equity ratio of companies in Mr. O'Donnell's proxy group; (ii) the equity ratio in the capital structure of PECO's parent company, Exelon; (iii) the average equity ratio allowed by state regulators across the country in 2019; and (iv) the average equity ratio allowed by state regulators from 2005-2019. *Id*., pp. 39-42. Mr. O'Donnell asserts that these alternative measures demonstrates that PECO's actual equity ratio of 53.38% is unreasonable for ratemaking purposes. *Id*., p. 43.

OCA's position is refuted in the rebuttal testimony of Mr. Moul. PECO St. 5-R, pp. 5-8. As Mr. Moul explains, Mr. O'Donnell does not substantiate his approach except to demonstrate that it would lead to a lower revenue requirement. Mr. O'Donnell's capital structure proposal has no relationship to the actual financial risk of the Company, but instead represents a generic capital structure that would apply to any and all gas utilities. *Id*., p. 8. Moreover, Mr. O'Donnell advocates a hypothetical debt ratio without using a hypothetical cost of debt related to the rate case decisions he relied upon. *Id*. As a consequence Mr. O'Donnell's proposal would provide PECO with a lower return on equity that is not commensurate with its actual financial risk. *Id.*

Further, OCA's proposal to reference Exelon's capital structure would result in a mismatch between the applied capital structure and PECO's actual financial risk. Exelon's financial risks are different from PECO's because Exelon is a holding company, and its capital

structure thus reflects the financial risk associated with ownership of multiple utilities, a large generation company, and significant unregulated competitive businesses. PECO St. 5-R, p. 8.

There is no basis to adopt OCA's proposal to substitute a hypothetical capital structure for the Company's actual capital structure to set the rate of return in this case. The actual common equity ratio for PECO is well within the range of reasonableness, as the common equity ratios for Mr. Moul's comparison group of utilities include ratios that extend up to 62.4% for the year 2019. PECO St. 5-R, pp. 5-6. Indeed, PECO's actual equity ratio is even within the ranges of the common equity ratios in the comparison groups of OCA witness O'Donnell and I&E witness Christopher Keller, which extend up to 62.30% and 59.01%, respectively. PECO St. 5-R, pp. 6-7; OCA St. 3, p. 40; I&E St. 2, p. 12. On these facts, Commission policy requires the use of the company's own capital structure for ratemaking purposes. The Commission's policy is explained in *PPL 2012*:

> Absent a finding by the Commission that a utility's actual capital structure is atypical or too heavily weighted on either the debt or equity side, we would not normally exercise our discretion with regard to implementing a hypothetical capital structure.[26]

This fundamental policy was reaffirmed by the Commission less than a month ago. As the Commission explained in *Columbia Gas*, the legal standard in Pennsylvania for deciding whether to use a party's proposed hypothetical capital structure in setting rates is that if a utility's actual capital structure is within the range of a similarly situated barometer group of companies, rates are set based on the utility's actual capital structure.[27] In applying this standard in *Columbia Gas*, the Commission found the utility's actual capital structure to be acceptable for ratemaking where its equity ratio fell below the upper most equity ratios of the companies in the

[26] *PPL 2012*, p. 68 (citations omitted).
[27] *Columbia Gas*, p. 116.

barometer group.[28] Here, PECO's equity ratio falls within the ranges of the common equity ratios in the comparison groups of OCA witness O'Donnell and I&E witness Keller, which extend up to 62.30% and 59.01%, respectively. PECO St. 5-R, p. 6; OCA St. 3, p. 40; I&E St. 2, p. 12. Accordingly, it is appropriate to use PECO's actual capital structure for ratemaking purposes.

C. Cost of Long-Term Debt

PECO's proposed embedded cost of long-term debt, updated by PECO witness Moul with data as of December 2020, is 3.84% for the FPFTY. PECO Ex. PRM-1 (updated), Sch. 6, pp. 1-3. Mr. Moul computed the weighted average embedded cost rates of PECO's long-term debt as of the end of the HTY, FTY and FPFTY, respectively. PECO St. 5, pp. 21-22. Mr. Moul then accounted for the Company's early redemption of high cost debt and for the future debt issues of the Company in 2021 and 2022. *Id*. The Company's long-term debt cost of 3.84% is also the basis for the 46.62% long-term debt ratio used in the capital structure. PECO St. 5, p. 22. I&E accepted the Company's proposed cost of long-term debt and OSBA does not comment on the capital structure ratio. OCA initially challenged the Company's original proposed cost of long-term debt, which was 3.97% based on data ending June 2020, but OCA accepts the Company's updated calculation of its long-term debt cost at 3.84%. OCA St. 3-SR, pp. 14-15. Thus, no party opposes the Company's proposed long-term debt cost.

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[28] *Id.*, pp. 117-118.

D. Common Equity Cost Rate

As PECO witness Moul explains, the use of more than one method provides a superior foundation to arrive at the cost of equity because at any point in time, any single method can provide an incomplete measure of the cost of equity depending upon extraneous factors that may influence market sentiment. PECO St. 5, pp. 6-7. Moreover, in considering cost of equity methodologies, the Commission has recognized that "[s]ole reliance on one methodology without checking the validity of the results of that methodology with other cost of equity analyses does not always lend itself to responsible ratemaking."[29] To determine the fair common equity cost rate for the Company, Mr. Moul first determined the barometer group of companies based on their comparable risk to the Company. Next, Mr. Moul calculated the indicated cost of equity using four separate, well-established cost of equity methods: the DCF methodology, the Risk Premium approach, the Capital Asset Pricing Model ("CAPM"), and the Comparable Earnings method. Updated with data as of December 31, 2020, the results of those methods indicated the following equity cost rates:

	Gas Group
DCF	13.46%
Risk Premium	10.00%
CAPM	12.67%
Comparable Earnings	12.00%

PECO Ex. PRM-1 (updated), Sch. 1, p. 2.

[29] *2012 PPL* Order, p. 80.

Mr. Moul determined that the cost of equity in this case should be near the lower end of the range of results shown by the market-based models (i.e., DCF, Risk Premium and CAPM) due to the uncertainty associated with the COVID-19 pandemic. PECO St. 5, p. 7. Mr. Moul concluded that the base cost of equity should be 10.70%, as it rests between the lower end of the range (i.e., 10.25%) and midpoint of the range (i.e., 11.50%). *Id.*, pp. 7-8. The base cost of equity is adjusted by a 25-basis point adder in recognition of the Company's superior management performance. *Id*. This results in PECO's proposed cost of equity, which is 10.95%.

1. Development of the Barometer Group

Mr. Moul developed the barometer group (referred to by Mr. Moul as the "Gas Group") by beginning with the ten gas utilities in The Value Line Investment Survey ("Value Line"), and eliminating UGI Corporation due to its dissimilarities in financial risk to the other companies in the barometer group. PECO St. 5, p. 6. UGI Corporation is more diversified outside of the gas distribution business than the other companies in the Gas Group, as UGI Corporation reports financial results for six separate segments consisting of propane sales, two international liquefied petroleum gas businesses, energy services and electric generation, in addition to its natural gas utility business. *Id*.

Once UGI Corporation is properly excluded, the resulting nine companies in the Gas Group are: Atmos Energy Corp.; Chesapeake Utilities Corp.; New Jersey Resources Corp.; NiSource Inc.; Northwest Natural Holding Company; ONE Gas, Inc.; South Jersey Industries, Inc.; Southwest Gas Holdings, Inc.; and Spire, Inc. PECO Ex. PRM-1, Sch. 3, p. 2. Mr. Moul's Gas Group is identical to the barometer group used in the Bureau of Technical Utility Services'

("TUS") cost of equity models in the Quarterly Earnings Report (Docket No. M-2020-3020940) that was approved by the Commission on January 14, 2021.[30]

2. DCF Methodology

The DCF methodology seeks to explain the value of an asset as the present value of future expected cash flows discounted at the appropriate risk-adjusted rate of return. PECO St. 5, p. 23. The DCF formula is derived from the standard valuation model: P = D/(k-g), where P = price, D = dividend, k = the cost of equity, and g = growth in cash flows. *Id*. These terms are commonly rearranged into the familiar DCF equation: k= D/P + g. *Id*.

Mr. Moul's application of the DCF methodology, using data as of June 30, 2020 and then updated with data as of December 31, 2020, is as follows:

	Dividend (D_1/P_0)	+	Growth Rate (g)	+	Leverage Adj.	=	DCF Result (k)
Original	3.28		7.50		1.96		12.74
Updated	3.79		7.50		2.17		13.46

PECO Ex. PRM-1, Schedule 1, p. 2.

a. Dividend Yield

The dividend yield reveals the portion of investors' cash flow that is generated by the return provided by the dividends an investor receives. PECO St. 5, p. 24. The dividend yield is measured by the dividends per share relative to the price per share. *Id*.

In his original analysis, which covered the period of May 2019 to June 2020, Mr. Moul calculated average dividend yields for the Gas Group based upon a calculation using annualized dividend payments and adjusted month-end stock prices. In his original analysis, Mr. Moul

[30] Bureau of Technical Utility Services, *Report on the Quarterly Earnings of Jurisdictional Companies for the Year ended September 30, 2020*, Docket No. M-2020-3023406, Attachment G (Jan. 14, 2021).

identified a 3.28% dividend yield for the Gas Group. PECO Ex. PRM-1, Sch. 7. In his updated analysis for the period ending December 31, 2020, the twelve-month average dividend yield was 3.36%, the six-month average was 3.65% and the three-month average was 3.65%. PECO Ex. PRM-1 (updated), Sch. 7. However, for the purpose of a DCF calculation, the average dividend yield must be adjusted to reflect the prospective nature of the dividend payments, i.e., the higher expected dividends for the future. PECO St. 5, p. 25. Accordingly, Mr. Moul adjusted the six-month average dividend yield in his update with three different, but generally accepted, manners and calculated the average of the three adjusted values. *Id*. In his updated analysis, this adjustment adds fourteen basis points to the three-month average dividend yield, yielding an adjusted dividend yield of 3.79%. PECO Ex. PRM-1 (updated), Sch. 7.

b. Growth Rate

Mr. Moul used projected earnings per share growth rates taken from analysts' five-year forecasts compiled by IBES/First Call, Zacks, and Value Line, which are reliable authorities that investors use to make buy, sell and hold decisions. PECO St. 5 at 30. For purposes of the DCF model, Mr. Moul selected a growth rate of 7.50% as a reasonable estimate of investor-expected growth for the Gas Group. *Id*., p. 32; PECO St.5-R, p. 21. This value is within the array of analysts' forecasts of five-year earnings per share growth rates and below the midpoint of that data set. PECO St. 5, p. 32.

OCA witness O'Donnell criticizes Mr. Moul's growth rate, arguing that relying solely upon forecasted EPS growth rates without taking into account historical growth rates, produces unrealistically high return on equity numbers. OCA St. 3, p. 100. However, using historic growth rates is inconsistent with the DCF methodology, as Mr. Moul explains. Moreover, historical data is already factored into analysts' forecast of earnings growth, and if analyzed separately, historical data would be double counted. PECO St. 5, p. 28. To properly reflect

investor expectations within the limitations of the DCF model, earnings per share growth, which is the basis for the capital gains yield and the source of dividend payments, must be given greatest weight. PECO St. 5-R, p. 25. The reason that earnings per share growth is the primary determinant of investor expectations rests with the fact that the capital gains yield (i.e., price appreciation) will track earnings growth with a constant price earnings multiple (a key assumption of the DCF model). *Id*. Moreover, Professor Myron Gordon, the foremost proponent of the DCF model in public utility rate cases, has established that the best measure of growth for use in the DCF model are forecasts of earnings per share growth. *Id*., p. 26.

c. Leverage Adjustment

In the regulatory rate setting process, the DCF methodology is applied to the utility's capital structure, which is founded upon the utility's book value capitalization. In actuality, a firm's capitalization, as measured by its stock price, may diverge from its book value capitalization. PECO St. 5, p. 32. In that case, there is a financial risk difference between the capital structures because a market-valued capitalization contains more equity and less debt than a book-value capitalization and, therefore, has less risk than the book value capitalization. PECO St. 5, p. 32. Since the DCF methodology provides a return applicable to the price (P) that an investor is willing to pay for a share of stock, an adjustment must be made when the DCF results are to be applied to a capital structure that is different from the capital structure indicated by the market price. *Id*. This adjustment — i.e., the leverage adjustment — is needed to synchronize the financial risk of the book capitalization with the required return on the book value of the firm's equity. *Id*. at 33.

Mr. Moul calculated a leverage adjustment of 1.96%. PECO St. 5, pp. 35-36; Ex. PRM-1 (updated), Schedule 10. Using the standard Modigliani & Miller formulas, the equity return applicable to the book value common equity ratio is equal to 8.63%, which is the return for the

Gas Group appropriate for a capital structure with no debt (i.e., a 100% equity ratio) plus 4.11% to compensate investors for the risk of a 48.57% debt ratio. *Id*. Under this approach, the parts sum to 12.74% (8.63% + 4.11% + 0.00%). To express this same return in the context of the DCF model, Mr. Moul summed the 3.28% dividend yield, the 7.50% growth rate, and 1.96% for the leverage adjustment in order to arrive at the same 12.74% (3.28% + 7.50% + 1.96%) return. *Id*.

2. Capital Asset Pricing Methodology

The CAPM uses the yield on a risk-free interest-bearing obligation plus a rate of return premium that is proportional to the systematic risk of an investment. PECO St. 5, p. 42. To compute the cost of equity with the CAPM, three components are necessary: (1) a risk-free rate of return ("Rf"); (2) the beta measure of systematic risk ("β"); and (3) the market risk premium ("Rm-Rf") derived from the total return on the market of equities reduced by the risk-free rate of return. *Id*. As shown on Ex. PRM-1, Schedule 1, Mr. Moul's calculation of the CAPM and results are summarized as follows:

	Rf	+	*β*	x	*(Rm-Rf)*	+	*size*	=	*K*
Original	1.75%		1.05		(9.10%)		1.02%		12.33%
Updated	2.00%		1.10		(8.77%)		1.02%		12.67%

The risk-free rate of return (*RF*), updated with data ending December 31, 2020, is 2.00%. Mr. Moul determined the risk-free rate of return based upon Blue Chip forecasts indicating the yields on long-term Treasury bonds during the next six quarters. PECO St. 5, pp. 45-46.

To determine the beta measure (*β*), Mr. Moul began with Value Line betas. However, Value Line betas are reflective of financial risk associated with market value capital structures and accordingly must be adjusted in order to be applicable to a book-value capital structure.

PECO St. 5, p. 43. Mr. Moul used the Hamada formula, which is $\beta l = \beta u\ [1 + (1 - t)\ D/E + P/E]$, to unleverage and re-leverage the Value Line betas and make them suitable for application to a book-value capital structure. *Id*. In the Hamada formula, ßl = the leveraged beta, ßu = the unleveraged beta, t = income tax rate, D = debt ratio, P = preferred stock ratio, and E = common equity ratio. *Id.* Mr. Moul's calculations of the Hamada formula are shown in Ex. PRM-1, Schedule 10, and, updated with data as of December 31, 2020, support a leveraged beta of 1.10 for the book value capital structure of the Gas Group. PECO Ex. PRM-1; PECO St. 5, pp. 43-44.

The market premium (*Rm-Rf*) is derived from historical data and the forecast returns. Mr. Moul calculated a historically-based market risk premium of 9.04% based upon data of historical average large stock returns and average yields on long-term government bonds. PECO St. 5, p. 46-47. Mr. Moul then calculated a market risk premium of 9.16% based on data of the total market return from Value Line data and a DCF return for the S&P 500. *Id*. Averaging the market risk premium based on historic data (9.04%) with the market risk premium using forecasted data (9.16%) yields a market premium of 9.10%. *Id*. When updated based upon data ending December 31, 2020, the market premium declines to 8.77%. PECO Ex. PRM-1 (updated), Sch. 1, p. 2; *id*., Sch. 13, p. 2.

To fully reflect the rate of return on equity, the CAPM must incorporate a size adjustment relating to the size of the company or portfolio for which the calculation is performed. PECO St. 5, p. 47. This is necessary due to the fact that as the size of a firm decreases, its risk and required return increases. *Id*. Without a size adjustment, the CAPM could understate the cost of equity significantly according to a company's size. *Id*. Reviewing historical data of the return in excess of the risk-free rate for mid-cap, low-cap, and micro-cap size firms, Mr. Moul selected a mid-cap

adjustment of 1.02% in light of the market capitalization of the Gas Group. *See id.*, pp. 47-48; PECO Ex. PRM-1, Sch. 13, p. 3.

3. Risk Premium Approach

Under the Risk Premium approach, the cost of equity capital is determined by corporate bond yields plus a premium to account for the fact that common equity is exposed to greater investment risk than debt capital. PECO St. 5, p. 38. The cost of equity (i.e., “k”) is represented by the sum of the prospective yield for long-term public utility debt (i.e., “i”), and the equity risk premium (i.e., “RP”). The Risk Premium approach provides a cost of equity of 10.00%. PECO Ex. PRM-1 (updated), Sch. 1. Mr. Moul’s calculation of the Risk Premium approach is summarized as follows:

	i	+	*RP*	=	*k*
Original	3.50		6.75		10.25
Updated	3.25		6.75		10.00

The long-term public utility debt cost rate (*i*) is developed through estimating the prospective yield on long-term A-rated public utility bonds. PECO St. 5, p. 39-40. Mr. Moul’s analysis of the historical yields on the Moody’s index of long-term public utility debt shows that 1.75% is a reasonable spread for the yield on A-rate public utility bonds over Treasury bonds. *Id*. Mr. Moul then considered forecasted yields on long-term Treasury bonds from Blue Chip Financial Forecasts. Combining the forecasted Treasury bond yield data with the 1.75% spread resulted in values ranging from 3.25% to 3.65% and indicated a 3.50% yield on A-rate public utility bonds to be a reasonable benchmark. *Id.*, p. 40. Updating this calculation with data as of December 31, 2020, Mr. Moul determined that this benchmark declined to 3.25%. Ex. PRM-1 (updated), Sch. 1, p. 2.

To develop an appropriate equity risk premium (*RP*), Mr. Moul analyzed the results from 2020 SBBI Yearbook, Stocks, Bonds, Bills and Inflation. PECO St. 5, p. 41. The historical data demonstrates that the equity risk premium varies according to the level of interest rates, increasing as interest rates decline, and declining as interest rates increase. *Id*. In particular, the equity risk premium was 6.70% when the marginal cost of long-term government bonds was low (i.e., 2.88%), and the equity risk premium was 4.69% when the marginal cost of long-term government bonds was high (i.e., 7.09%). *Id*. Mr. Moul utilized a 6.75% equity risk premium. *Id*. The equity risk premium of 6.75% that Mr. Moul selected is near the risk premiums associated with low interest rates. *Id*. Combining this equity risk premium with the 3.25% prospective yield for long-term public utility debt results in a Risk Premium cost of equity estimate of 10.00%. PECO St. 5, p. 42; PECO St. 5-R, p. 40.

4. Comparable Earnings Method

The Comparable Earnings ("CE") method estimates a fair return on equity by comparing returns realized by non-regulated companies to returns that a public utility with similar risks characteristics would need to realize in order to compete for capital. PECO St. 5 at 48. Since regulation is a substitute for competitively determined prices, the returns realized by non-regulated firms with comparable risks to a public utility provide useful insight into investor expectations for public utility returns. *Id*.

The underlying premise of the CE method is that regulation should emulate results obtained by firms operating in competitive markets and that a utility must be given an opportunity cost of capital equal to that which could be earned if one invested in firms of comparable risk. PECO St. 5-R, pp. 41-42. The CE method is consistent with the United States Supreme Court's holding in *Bluefield Water Works vs. Public Service Commission*, 262 U.S. 679, 692-93 (1923), regarding the return that a utility is entitled to:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Mr. Moul applied the CE Method to non-regulated companies in order to avoid the circular reasoning implicit in the use of the achieved earnings/book ratios of other regulated firms. PECO St. 5 at 49, 51. To ensure that the firms selected for his analysis would have similar risk traits to a public utility, Mr. Moul used the following screening criteria: Timeliness Rank, Safety Rank, Financial Strength, Price Stability, Value Line betas, and Technical Rank. *Id*., p. 50; Exhibit PRM-1 (updated), Sch. 14, p. 3. The firms remaining after application of the screening criteria comprised the "Comparable Earning Group." PECO St. 5, p. 50. PECO witness Moul used historical realized returns and forecasted returns for the firms within the Comparable Earnings Group. PECO St. 5, p. 51. In order to cover conditions over an entire business cycle, Mr. Moul used a ten-year period (five historical years and five projected years). *Id*., p. 51. Mr. Moul then disregarded the results of "highly profitable" firms, which he determined were those that have returns of 20% or greater. *Id*. at 51. Averaging the historical and forecasted rates of return on common equity for the remaining firms yielded a CE Method result of 12.90%, updated to 12.00% with data ending December 31, 2020. *Id*., Exhibit PRM-1 (updated), Sch. 1, p. 2.

E. Business Risks and Management Performance

Section 523 of the Public Utility Code provides for the Commission to consider management effectiveness in setting rates:

> The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.[31]

In prior cases, the Commission also has adjusted upward the cost of equity to reflect management effectiveness.[32]

Mr. Bradley's direct and rebuttal testimony (PECO Sts. 1 and 1-R) details the numerous improvements the Company has made in its service, making it eligible for an enhancement to its return on equity for its management performance. Based on Mr. Bradley's evidence, Mr. Moul concludes that the Company should receive a 0.25% adder for strong management performance. PECO St. 5, p. 52.

As explained in Section VI.P. above, PECO has engaged in substantial efforts to eliminate potential environmental concerns at its former MGP sites. Once remediated, the sites may be used for various beneficial land-use purposes that otherwise would not be permitted. PECO St. 1, pp. 13-14.

PECO has successfully managed its natural gas distribution system in a safe and responsible manner in order to ensure pipeline reliability while meeting or exceeding all requirements of the pipeline safety regulations (49 C.F.R. Part 192) and the applicable provisions of the Pennsylvania Code (Title 52, Chapter 59). *Id.*, p. 15. Looking forward, PECO has implemented a number of important initiatives and technological improvements focused on

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[31] 66 Pa.C.S. § 523(a) (emphasis added).
[32] *UGI Electric 2018*, p. 119; *PPL* 2012, pp. 97-99; *Pa. P.U.C. v. Aqua Pa., Inc.*, Docket No. R-00072711, 2008 Pa. PUC LEXIS 50 at *63 (Jul. 31, 2008) ("*2008 Aqua Order*").

safety and reliability, including: (i) actively enhancing its mapping system using modern technology to integrate with our Geographic Information System ("GIS"); (ii) utilization of marker balls, which are buried alongside underground facilities, to provide an accurate, convenient and long-lasting means to identify specific locations on PECO's gas distribution system, including valves, dead ends, leaks, or places where pipe changes directions; (iii) implementation of improved measures to avoid occurrences of incidental cross-boring with another existing utility; and (iv) recent initiation of a natural gas reliability project in Delaware and Montgomery counties to meet the growing needs and demands of PECO customers. *Id.*, pp. 16-18.

Additionally, Mr. Bradley described several recent PECO initiatives to improve its customer service. For example, PECO expanded its communications capabilities so customers can interact with the Company using mobile devices. PECO deployed a mobile application with features such as slide-to-pay (by credit card and e-check), outage reporting, and the ability to enroll in electronic billing, automatic payments, and budget billing. The Company also added a two-way outage text feature that enables customers to text "OUT" to report an outage and "STAT" to receive an outage status update. *Id.*, p. 20. The Company also has plans to further enhance customer service, including plans for: (i) additional customer service representative coaching and training to improve the customer experience and resolve the customer's questions during the first call ("First Call Resolution"); (ii) an operational metric to track First Call Resolution; and (iii) improved web and mobile capabilities to provide customers additional options for self-service. *Id.*, p. 22.

The effectiveness of PECO's approach to customer service is reflected in the fact that, in 2019, the Company experienced improvements over its 2017 performance in each of the following key metrics:

Metric	2017	2019
PECO's Overall Call Center Satisfaction Index	8.07	8.18
J.D. Power Gas Rating	726	748
Overall Call Center Satisfaction	83.7%	85.8%
Average Speed of Answer	16 seconds	14 seconds
Abandoned Rate	1.2%	1.0%
Web Self Service Transactions	8.6 million	15.7 million
% of Gas Odor Calls Responded to in 1 Hour or Less	99.95%	99.99%

Indeed, the PECO customer experience, as measured by J.D. Power, has improved from a score of 726 to 748, resulting in PECO's customer service ranking among comparative utility companies increasing from 7th out of 12 in 2017 to 4th out of 12 in 2019. PECO St. 1, p. 22.

F. Other Parties' Equity Cost Rate Recommendations and Principal Areas Of Dispute

OSBA does not propose a specific cost of equity return rate for PECO, but argues that, generally, the relative risk of regulated natural gas utilities implies a cost of equity capital well below 8%. OSBA St. 1, pp. 7-8. OSBA witness Robert D. Knecht bases this conclusion upon information that Duff & Phelps lowered its overall average risk cost of equity capital to 8.0 percent, and his opinion that natural gas utilities have a lower than average risk. *Id*. Mr. Knecht declines to offer any analysis using the standard models employed by Mr. Moul. Mr. Knecht also criticizes the DCF model as having significant disadvantages in its use of forecasted growth rates and the inherent perpetual growth rate assumption. *Id*., pp. 9-10.

OSBA's analysis would significantly understate the cost of common equity for PECO. As Mr. Moul explained, OSBA's proposal using returns published by Duff & Phelps have no relationship to PECO and cannot be used to set the cost of equity. PECO St. 5-R, p. 43.

Moreover, Commission precedent has long relied on cost of equity models like the ones used by Mr. Moul, and clearly favors the use of the DCF methodology as a primary tool to be used in setting the cost of equity rate.[33]

a. I&E

I&E recommends an overall rate of return for PECO of 7.32%. I&E St. 2, p. 48. I&E's proposed capitalization is 53.38% common equity and 46.62% long-term debt. I&E proposes a long-term debt cost rate for PECO of 3.97% and a cost of common equity of 10.24%. I&E St. 2, p. 6. To develop the cost of common equity, I&E witness Keller proposes to use the DCF method as the primary method, with the results of the CAPM as a comparison. *Id*. p. 15. Mr. Keller's DCF result is 10.24%. *Id*., p. 20. Mr. Keller's CAPM result is 9.08%. *Id*., p. 27. Mr. Keller chose to exclude the Risk Premium and Comparable Earnings methods from his analysis of the Company's cost of capital. *Id*., pp. 18-19.

PECO's dispute with I&E's analysis of the rate of return is centered on Mr. Keller's analyses of the cost of equity, which are discussed below in Section VIII.F.2.

b. OCA

OCA recommends an overall rate of return for PECO of 6.30%. OCA St. 3, p. 127. OCA witness O'Donnell proposes a capital structure for PECO of 50.00% common equity and 50.00% long-term debt. *Id*., p. 44. Mr. O'Donnell recommends a cost of common equity for PECO of 8.75%. *Id*., p. 88. Mr. O'Donnell's cost of equity analysis is supported by a DCF analysis, CAPM analysis, and Comparable Earnings analysis. OCA witness O'Donnell calculates a DCF range of 7.75% to 10.00%, CAPM results that are between 5.50% and 7.75%,

[33] *See*, *e.g.*, *Columbia Gas*, p. 131 (finding that "the Company's cost of equity in this proceeding should primarily be based upon the use of the DCF methodology and [. . . .] the results of the CAPM analysis should be used as a comparison to the DCF results").

and Comparable Earnings results in the range of 9.25% to 10.25%. OCA St. 3, p. 87 and Exhibit KWO-1.

PECO disagrees with numerous aspects of Mr. O'Donnell's analysis, particularly with regard to the capital structure and cost of common equity. The Company's dispute with the capital structure is discussed above in Section VIII.B, and the Company's dispute with the cost of equity analyses is discussed below in Section VIII.F.2.

2. Principal Areas of Dispute

a. Misapplication of Cost of Equity Models

(i) **Barometer Group**

OCA and I&E used incorrect barometer groups in their calculations of costs of equity for PECO. To develop his barometer group, OCA witness O'Donnell drew upon the ten gas utilities in Value Line, but Mr. O'Donnell erroneously did not exclude UGI Corporation as Mr. Moul did. UGI Corporation is more diversified outside of the gas distribution business than the other companies properly includible in the barometer group. PECO St. 5, p. 6. Separately from his barometer group, Mr. O'Donnell also evaluated Exelon Corporation as a measure of the cost of equity for PECO. However, reference to the parent corporation is inappropriate and inconsistent with Commission policy, which is to use a barometer group analysis to set the return on equity when the utility's own stock is not traded. PECO St. 5-R, p. 18.

I&E witness Keller used a barometer group that is the same as Mr. Moul's Gas Group, except that Mr. Keller excluded New Jersey Resources and Southwest Gas Holdings by application of an additional criteria that excludes companies with less than a certain percentage of revenues devoted to utility operations. Mr. Moul explained why Mr. Keller's additional criteria for exclusions from the Barometer Group are improper:

> This is because the margins on other business segments within Barometer Group companies are generally dissimilar to the utility business. Energy trading is a case in point, which would make revenue comparisons incompatible because of the large revenues and small margins associated with that business, when contained in potential Barometer Group companies. That is to say, energy trading generates large amount of revenues, but little profits because the margins on such trades are very small.

PECO St. 5-R, p. 19.

New Jersey Resources and Southwest Gas Holdings are appropriately included in the Barometer Group because their percentages of utility assets, as is the case for other members of Mr. Moul's Gas Group, are all above 60%, which demonstrates that all of the companies are primarily utility businesses. *Id*., p. 19.

Finally, as further support for using Mr. Moul's Barometer Group, the Commission itself used the same barometer group when applying the cost of equity models in its most recent Quarterly Earnings Report issued on January 14, 2021 at Docket No. M-2020-3023406.

(ii) **DCF**

The growth rate estimate used by I&E in the DCF methodology is flawed. The main problem in the DCF methodology of I&E Witness Keller is caused by an erroneous exclusion of a growth rate estimate. In particular, Mr. Keller excludes a Value Line estimate for Northwest Natural Gas, and then retains growth rates from other sources that are much too low (e.g., 1.65% by Yahoo for NiSource; 3.10% by Yahoo, 3.10% by Zacks and 2.80% by Morningstar for Northwest Natural). PECO St. 5-R, pp. 22-23. The result is that Mr. Keller improperly ignores a high number while retaining unreasonably low numbers for one company, thereby introducing an unwarranted downward bias to his results. Although Mr. Keller asserts that the Value Line's growth rate projection for Northwest is extremely inconsistent, this is incorrect because it rests within the 5.67% to 11.10% range of growth rates for the other members of Mr. Keller's

Barometer Group. PECO St. 5-R, p. 23. On the other hand, the 3.00% growth rates that Mr. Keller did retain for Northwest Natural is well below that range. PECO St. 5-R, p. 23. If Mr. Keller had used the Value Line estimate for Northern Natural Gas as he should have, the growth rate for his barometer group would have been 7.63%, leading to a more reasonable average DCF return of 11.01%. PECO St. 5-R, p. 24.

OCA witness O'Donnell's DCF methodology is flawed due to the errors in his barometer group, discussed *supra*, and because his methodology fails to incorporate a leverage adjustment, which is needed to synchronize the financial risk of the book capitalization with the required return on the book value of the firm's equity. PECO St. 5, p. 43. Both I&E and OCA challenge the Company's leverage adjustments to the DCF and beta component of the CAPM. OCA witness O'Donnell criticizes the Company's leverage adjustment as a "market-to-book" adjustment. However, there is no aspect of the leverage adjustment calculated by Mr. Moul that provides a conversion of a DCF return based upon any particular market-to-book ratio, and this is true for the CAPM as well. PECO St. 5-R, p. 31.

I&E witness Keller states that he opposes a leverage adjustment because the rating agencies use book value in their analysis. I&E St. 2, p. 42. However, this argument has no merit. The credit rating agencies are only concerned with the interests of lenders, and with a company's ability to make timely payments of principal and interest; the rating agencies do not measure the market-required cost of equity for a company. PECO St. 5-R, pp. 28-29. In opposing the leverage adjustment, Mr. Keller also references several rate cases where the Commission declined to adopt a leverage adjustment. I&E St. 2, p. 4. Yet, the cases cited by Mr. Keller do not stand for a categorical rule excluding leverage adjustments. The Commission has accepted the leverage adjustment in a number of cases, including *Pa. PUC v. PPL Gas*

Utilities Corp., Docket No. R-00061398 (Order dated Feb. 8, 2007). In the *Aqua Pennsylvania* case cited by Mr. Keller, the Commission did not repudiate the leverage adjustment, but instead arrived at an 11.00% return on equity for Aqua by including a separate return increment for management performance. As Mr. Moul explains, the *City of Lancaster* case referenced by Mr. Keller is distinguishable because the leverage adjustment denied by the Commission in that case was calculated in an unsound manner by erroneously applying the Hamada formula to the DCF and Risk Premium methods. PECO St. 5-R, p. 30.[34]

(iii) **CAPM**

The CAPM analyses of OCA and I&E significantly understate the cost of equity due to several errors: (i) I&E witness Keller's use of the yield on 10-year Treasury notes rather than longer-duration Treasury offerings, (ii) OCA witness O'Donnell's consideration of historical geometric means to calculate total market return, (iii) the failure of Messrs. Keller and O'Donnell to use leverage adjusted betas, and (iv) the failure of Messrs. Keller and O'Donnell to make a size adjustment. In addition, OCA witness O'Donnell's application of the CAPM is flawed due to its lack of a prospective yield on Treasury bonds and the derivation of a market risk premium that is unreflective of investor-expected returns.

First, with respect to I&E witness Keller's use of 10-year Treasury notes rather than longer-duration Treasury offerings, Mr. Moul explains that long-term rates, such as those revealed by 30-year Treasury bonds, should be used to measure the risk-free rate of return. PECO St. 5-R, p. 32-33. The flaw in using 10-year Treasury notes is that they are more susceptible to monetary policy actions taken by the Federal Open Market Committee. *Id*. In contrast, 30-year Treasury bonds are more a reflection of investor sentiment of their required

[34] The Hamada formula "plays a role in the CAPM, [but] it is not applicable to the DCF or the Risk Premium measures of the cost of equity." PECO St. 5-R at 30.

returns. *Id*. Furthermore, Mr. Keller's analysis significantly understates the risk-free rate of return because he incorrectly gives the same weight to the yield on 10-year Treasury notes for the first, second, third and fourth quarters of 2021 as he does for the entire five-year period 2022 through 2026. PECO St. 5-R, p. 33.

Second, with respect to OCA's CAPM analysis, Mr. O'Donnell incorrectly used the geometric mean in his historic analysis of the total market returns. OCA St. 3, p. 83. As Mr. Moul explained, the theoretical foundation of the CAPM requires that the arithmetic mean be used because it conforms to the single period specification of the model and it provides a representation of all probable outcomes and has a measurable variance. PECO St. 5-R, pp. 36-37. The necessity for an arithmetic mean is also recognized by Ibbotson. *Id.*, pp. 37-38. Use of the geometric mean, which Mr. O'Donnell advocates, consists merely of a rate of return taken from two data points which would have no measurable variance. *Id*., p. 37.

As noted above, neither the OCA nor the I&E CAPM analyses incorporate a leverage adjustment to the CAPM beta, which is needed because the information underlying the betas are reflective of financial risk associated with market value capital structures. Accordingly, they must be adjusted in order to be applicable to a book-value capital structure. PECO St. 5, p. 43.

The OCA and I&E also incorrectly exclude a size adjustment in their CAPM analyses. I&E witness Keller disagrees with the size adjustment based upon his mistaken inference that Mr. Moul's calculation of a size adjustment did not take into account the public utility industry. However, Mr. Moul explains that this is incorrect and that he did consider the utility industry in his adjustment. PECO St. 5-R, p. 35; PECO St. 5-SR, p. 2.

OCA witness O'Donnell also disregards the size adjustment, asserting that it results in double-counting. OCA St. 3, pp. 113-115. This is incorrect. The size adjustment is necessary

because the financial impact of changes in specific dollar amounts of revenues and costs have a magnified influence on a small company because there are fewer dollars over which those revenues or costs can be spread. PECO St. 5-R, p. 39. The inability of the simple, unadjusted CAPM to reflect the return associated with small size is recognized by financial experts. *Id*. Moreover, the size adjustment is accepted as necessary by regulatory agencies with expertise in this area, such as the FERC.[35]

b. Exclusion of Other Cost of Equity Models

The Commission usually expresses its cost of equity determination in the context of the DCF model. However, as Mr. Moul acknowledged, the Commission also considers other methods as well. In *PPL 2012* (p. 80), the Commission stated:

> Sole reliance on one methodology without checking the validity of the results of that methodology with other cost of equity analyses does not always lend itself to responsible ratemaking. We conclude that methodologies other than the DCF can be used as a check upon the reasonableness of the DCF derived equity return calculation.[36]

I&E's and the OCA's criticisms of methodologies other than the DCF and CAPM are without merit. I&E witness Keller asserts that the Risk Premium method does not measure the current cost of equity as directly as the DCF, but this is incorrect; Mr. Moul incorporated current interest rates when he developed his Risk Premium cost of equity of 10.25%, and 10.00% as updated. PECO St. 5-R, p. 40.

Mr. Keller claims the Risk Premium methodology is a simplified version of the CAPM, is subject to the same faults as CAPM, and "does not recognize company-specific risk through

[35] *See, e.g., Ass'n of Businesses Advocating Tariff Equity*, Opinion No. 569-A, 171 FERC 61,154 at P 75 (2020) ("the size adjustment is necessary to correct for the CAPM's inability to fully account for the impact of firm size when determining the cost of equity.").
[36] *PPL 2012*, p. 80 (citing *Pa. PUC v. PPL Electric Utilities Corp*., Docket No. R-00049255, at 67 (Order entered December 22, 2004)).

beta". I&E St. 2, pp. 18-19. OCA witness O'Donnell similarly finds fault with the Risk Premium methodology and declines to use it. Mr. Moul's testimony refutes these objections. Mr. Moul explains that the Risk Premium methodology is an approach that provides a direct and complete reflection of a utility's risk and return because it considers additional factors not reflected in the beta measure of systematic risk. PECO St. 5-R, pp. 40-41. Further, the Risk Premium approach provides for direct reflection of prospective interest rates in the model and therefore should be given weight in determining the equity cost rate in this case. *Id*.

The criticisms of the Comparable Earnings approach by I&E and OCA are also unfounded. As discussed in Mr. Moul's testimony, the Comparable Earnings approach satisfies the comparability standard established in the *Hope* case that specifies that the return to the utility should provide it "with returns on investments in other enterprises having corresponding risks." PECO St. 5-R, p. 42. In addition, the financial community has expressed the view that the regulatory process must consider the returns that are being achieved in the non-regulated sector to ensure that regulated companies can compete effectively in the capital markets. *Id*. Moreover, the financial literature effectively demonstrates that ROEs from non-regulated companies provide better assessment of investor requirements than those available for regulated utilities. *Id*.

c. Management Performance

In response to Mr. Bradley's testimony regarding PECO's exemplary management performance and Mr. Moul's recommendation of a related increase in allowed return for that performance, I&E witness Keller asserted that PECO should not be rewarded for simply providing the service it is required to do by law. OCA witness O'Donnell went further, asserting

that PECO's performance did not rise to an exemplary level and was driven in part by settlement commitments. I&E St. 2-SR, pp. 34-36; OCA St. 2-SR, pp. 5-11.

At the evidentiary hearing, Mr. Bradley specifically addressed these contentions:

> First, I certainly agree that we are required to provide reasonable, adequate and safe service as required by law, and we do that every day. But what we also do is deliver exemplary performance for our customers in several ways which Mr. O'Donnell simply ignores. He does not address our success in keeping annual growth in operation and maintenance expenses below 1.9 percent for a decade, 1.3 percent if increases in gas mapping and locating expense are removed, and that's without filing for a rate case, nor does he acknowledge our success in addressing gas odor responses or introducing new technologies across our operations. Contrary to his testimony, our deployment of these technologies is not due to the Penrose Lane settlement, where we have met all of our commitments. The settlement incorporated innovations that we were already developing and have been able to accelerate.
>
> Second, with respect to J.D. Power scores, I certainly recognize that our significantly improved scores have not placed us at the top of the J.D. Power rankings. But I believe our success to date firmly demonstrates an exemplary approach of continued improvement with results that benefit our customers throughout our operations, and should be appropriately recognized by the Commission.[37]

IX. CUSTOMER PROGRAMS AND MISCELLANEOUS ISSUES

A. Recommendations Related to The COVID-19 Emergency

PECO has been proactive in seeking to assist customers throughout the COVID-19 pandemic. As detailed by PECO witness Kelly A. Colarelli, the Company has implemented offerings benefitting all residential customers as well as those who participate in universal service programs. Since March 2020, PECO has offered all residential customers the opportunity to enter into a 24-month payment agreement. The Company has utilized multiple

[37] Hearing Tr. 218-219.

strategies to inform customers about this special payment agreement and facilitated enrollment through automated processes. With respect to its universal service programs, on December 17, 2020, the Commission approved PECO's proposal to temporarily modify the eligibility requirements for the Company's hardship fund (the Matching Energy Assistance Fund or "MEAF") to expand the number of customers who may qualify for assistance.[38] The Company also filed a COVID-19 relief proposal on June 26, 2020, that included, among other things, a bill credit for CAP customers, temporary waivers of certain requirements for CAP enrollment and recertification, and a transfer of unspent Low-Income Usage Reduction Program ("LIURP") funds to a summer cooling initiative.[39] The relief proposal remains pending before the Commission. Finally, in accordance with Commission orders at Docket No. M-2020-3019244, the Company implemented a variety of COVID-19 relief measures, including a moratorium on termination of service and waiver of connection fees and deposits for reconnection of service. *See* PECO St. 10-R, pp. 3-4.

OCA witness Roger D. Colton recommended an Emergency COVID-19 Relief Program for residential customers who are in arrears, are not eligible for or participating in CAP, and provide proof of unemployment benefits or receipt of the first federal COVID-19 relief check. The Relief Program would have four primary benefits: (1) access to a long-term payment arrangement; (2) screening for CAP and MEAF eligibility; (3) suspension of collection efforts; and (4) a one-time bill credit of up to $400. *See* OCA Sch. RDC-1; OCA St. 5, p. 27.

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[38] *Petition of PECO Energy Company (PECO) to temporarily amend its current 2016-2018 Universal Service and Energy Conservation Plan (2016 USECP)*, Docket Nos. P-2020-3022124 and M-2015-2507139 (Secretarial Letter issued Dec. 17, 2020).

[39] *Petition of PECO Energy Company for Public Meeting August 6, 2020 Expedited Approval of Temporary Universal Service Measures To Address COVID-19 Related Economic Hardship And Provide Additional Opportunities For Electric Usage Reduction*, Docket No. P-2020-3020555.

The Company does not believe that Mr. Colton's recommendations are necessary or appropriate in light of the Company's existing COVID-19 response and the Commission's continuing direction on collections matters during the pandemic. As examples, the Company is already providing *all* residential customers with access to a payment agreement with a term up to 24 months and *any* residential customer that identifies a financial difficulty is provided with information about PECO's universal service programs. As to collections activity, the Company believes it is appropriate to continue to act consistently with the Commission's directives at Docket No. M-2020-3019244, which the Commission issued after extensive consideration of the views of many stakeholders. *See* PECO St. 10-R, p. 5.

B. Universal Service Programs

PECO's proposed 2019-2024 Universal Service and Energy Conservation Plan ("2019-2024 USECP") is pending before the Commission at Docket No. M-2018-3005795. The 2019-2024 USECP contains the Company's proposed universal service program terms, budgets and customer outreach and educations plans. Significantly, the 2019-2024 USECP changes the format of PECO's Customer Assistance Program ("CAP") from a Fixed Credit Option ("FCO") to a Percentage of Income Payment Plan ("PIPP"). Under the PIPP, a CAP customer would receive a bill credit based upon his or her annual income and the applicable energy burden ("EB") percentage. PECO has proposed to adopt recommended EBs from the Revised CAP Policy Statement[40] for customers at 0-50% and 51-100% of the federal poverty level ("FPL") and maintain PECO's existing EBs for customers at 101-150% of the FPL. The PIPP also incorporates reduced minimum bill amounts and new customer notifications if a customer approaches maximum credit amounts. *See* PECO St. 10-R, p. 8.

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[40] *2019 Amendments to Policy Statement on Customer Assistance Program, 52 Pa. Code § 69.261–69.267*, Docket No. M-2019-3012599 (Order entered Nov. 5, 2019). 50 Pa. B. No. 12 at 1691-1695 (Mar. 21, 2020).

PECO expects the PIPP to improve bill affordability for all CAP income groups as compared to the current FCO. Subject to minimum bill and maximum credit amounts, a CAP customer's credit would increase under the PIPP to ensure the customer continued to pay no more than the applicable EB. Given the time that will be required to transition to a PIPP, PECO has also sought Commission approval to utilize the recommended EBs from the Revised CAP Policy Statement as part of the FCO until the Company transitions from the FCO to its PIPP.[41] *See* PECO St. 10-R, pp. 8-9.

In this proceeding, both OCA witness Colton and CAUSE-PA witness Miller expressed concern that the percentage of low-income customers enrolled in CAP is too low. *See* OCA St. 5, pp. 33-36; CAUSE-PA St. 1, pp. 22-23. As explained by Ms. Colarelli, however, these concerns are misplaced because PECO's CAP participation rate, as defined by the Commission, is 77.5% and the highest of any Pennsylvania natural gas distribution company. *See* PECO St. 10-R, pp. 5-6; PECO Ex. KC-1-R. In addition, the Company has proposed an expanded outreach and education program for gas and electric customers as part of its 2019-2024 USECP. *See* PECO St. 10-R, p. 10.

Mr. Miller also had multiple recommendations for PECO's CAP, LIURP and MEAF. While the Company has provided specific responses to these recommendations, as detailed below, PECO believes that proposed changes to its universal service programs should be considered in the 2019-2024 USECP proceeding and not in a base rate proceeding. All parties would benefit from having a complete view of the Company's universal service proposals, including all program-specific details and budgets.

[41] *See* Docket No. P-2020-3022154.

Mr. Miller recommended the following changes to PECO's CAP: (1) adopt the EBs in the Revised CAP Policy Statement; (2) adjust the credit under the FCO to immediately account for any base rate increase;[42] (3) develop a plan to increase CAP enrollment by 50% by 2025; (4) move arrears from CAP customers into pre-program arrearage forgiveness; (5) waive all late fees and reconnection fees; and (6) waive income certification requirements until the pandemic is over. *See* CAUSE-PA St. 1, pp. 30-34, 39-41.

Ms. Colarelli explained that most of the CAP issues identified by Mr. Miller are either pending before the Commission or already being implemented by the Company. As noted earlier in this section, PECO has made specific EB proposals for both the remaining period of the FCO and the PIPP in the 2019-2024 USECP proceeding. Consistent with the Commission's recent findings in *Columbia Gas*, PECO believes that EB and CAP credit calculation issues should not be considered separately from other parts of the Company's universal service programs.[43] Similarly, with respect to Mr. Miller's CAP enrollment concerns, the 2019-2024 USECP proceeding already includes the Company's proposal for an expanded outreach and education program. Enrollment plans, along with other CAP issues such as arrearage forgiveness, are better suited for the 2019-2024 USECP proceeding than a gas base rate proceeding.[44] Finally, regarding Mr. Miller's remaining issues, the Company is already waiving late fees and reconnection fees in accordance with Commission Orders at Docket No. M-2020-

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[42] As Mr. Miller acknowledges, the Company explained in detail how the FCO credit would be adjusted on a quarterly basis in response to a base rate increase. *See* CAUSE-PA St. 1, pp. 23-24. Mr. Miller also states, however, that he was "advised by counsel" that a more immediate reflection of a base rate increase into the FCO credit is "consistent with the terms of a March 2015 Settlement agreement establishing PECO's CAP FCO." *Id.* at 34. PECO notes that the issue of how and when to reflect a base rate increase into the FCO credit is the subject of detailed testimony in Docket No. C-2020-3021557 and is pending before Administrative Law Judge Mary D. Long.
[43] *Columbia Gas*, p. 160 (finding that a utility's EB levels "should not be considered separately from other parts of [the utility's] CAP and universal service programs but should be considered as part of [the utility's] entire universal service plan, including the need for changes and associated costs").
[44] Notably, PECO's gas-only CAP population (300 customers) is a very small part of its total gas and electric CAP population (114,000). *See* PECO St. 10-R, p. 10.

3019244, the Company no longer assesses late fees to CAP customers in accordance with the Revised CAP Policy Statement, and PECO's proposal to temporarily waive written income documentation requirements remains pending before the Commission. *See* PECO St. 10-R, pp. 9-10.

Mr. Miller recommended the following changes to LIURP: (1) increase the budget by $2 million for an annual budget of $4,250,000; (2) establish a per-job $2,000 health and safety budget to remediate health and safety issues that prevent LIURP services; (3) make the Company's heating pilot program a permanent part of the LIURP at the current annual funding level of $700,000; (4) adopt a lower high usage threshold for multifamily units; and (5) adopt a policy of rolling over any unspent LIURP funds to the next year. *See* CAUSE-PA St. 1, pp. 34-37.

Ms. Colarelli explained that PECO's LIURP proposals, including overall program funding, spending limitations and high-usage thresholds are all pending before the Commission at Docket No. M-2018-3005795. In addition, almost doubling the budget, as Mr. Miller proposes, is unrealistic and would not change the size of PECO's eligible customer pool. Finally, any decision about making the *electric* heating pilot permanent is premature without final data, and, in any event, should not be made in a *gas* base rate proceeding. *See* PECO St. 10-R, p. 11. The Company's position is consistent with *Columbia Gas*, where the Commission adopted the presiding ALJ's finding that funding for Columbia's health and safety pilot should not be changed until the effectiveness of the program can be evaluated.[45]

Finally, Mr. Miller recommended that PECO waive the MEAF requirement that grant recipients achieve a zero balance, provide grant recipients with a payment arrangement for any

[45] *Columbia Gas*, p. 174.

remaining balance, and utilize pipeline refunds to increase MEAF funding by $2 million. *See* CAUSE-PA St. 1, pp. 38-39.

As previously discussed in Section IX.A, the Company has already implemented several temporary modifications to MEAF requirements to expand the number of customers who may qualify for assistance. In addition, PECO does not believe the zero-balance requirement should be waived because MEAF is not intended to be a supplemental grant program but rather a means to address collections risk by achieving a zero balance. Finally, the Company believes its current MEAF budget is appropriate and does not support the diversion of pipeline refunds to MEAF. Those refunds are currently applied to reduce the Purchased Gas Cost ("PGC") and, therefore, the diversion proposed by Mr. Miller would increase the PGC paid by non-shopping PECO customers, including residential customers. *See* PECO St. 10-R, pp. 11-12.

C. Neighborhood Gas Pilot Rider

The Company is proposing to extend the NGPR for five years beginning July 1, 2021, and to increase the annual NGPR cost to $7.5 million. *See* PECO St. 9, pp. 12-14. The Company is also proposing to modify the NGPR in two ways. First, the Company will provide the first 40 feet of gas main extension to each prospective residential natural gas customer at no cost, subject to unanticipated ground conditions or unusual permit requirements. Second, the Company will modify the calculation of the contribution in aid of construction ("CIAC") by assuming that 66% of prospective customers would take service during the first year of the extension. This differs from the current program where the Company assumes that 66% of prospective customers will join over 20 years. *See* PECO St. 9, pp. 10-13; *see also* PECO St. 8, p. 13.

Mr. Keller agreed with the Company's proposal to provide 40 feet of main extension per contracted customer at no cost with certain limitations for abnormal underground conditions or

unusual permit requirements. *See* I&E St. 2, pp. 49-50. But Mr. Keller also recommended that the CIAC calculation remain the same i.e., assume 66% of customers join over 20 years instead of in year one. Mr. Keller based his objection to changing the CIAC calculation on the fact that the Company had spent just $15 million of its $25 million spending limit during the first five years of the NGPR, and because COVID-19 may impact customer willingness to pay for natural gas service. *See* I&E St. 2, pp. 50-51. For these reasons, Mr. Keller also recommended that the cost of the NGPR remain at $5 million per year. *See* I&E St. 2, p. 50.

Mr. Keller's recommendations are unsupported and should be rejected. First, the Company has seen rapid uptake of natural gas service by potential customers. This shows that the assumption that 66% of customers will take service over 20 years should be updated to better align with NGPR data. Second, the Company continued to see strong interest in the NGPR in 2020 despite the impacts of the COVID-19 pandemic. Based on customer interest in the NGPR, the Company expects installed projects to increase by 25 neighborhoods per year under the revised program. This projected growth would require the full $7.5 million budget requested by the Company in this case. *See* PECO St. 9-R, pp. 10-12. For these reasons, the Company's request should be approved.

D. Energy Efficiency And Conservation Programs

PECO requested $4.5 million in annual funding for its EE&C program. As discussed by Ms. Masalta, the Company requested an increase in the EE&C budget to expand program offerings for both residential and low-income customers, fund pilot projects for emerging technologies, and use targeted marketing and customer outreach to increase customer participation in the program. *See* PECO St. 9, pp. 6-8; *see also* PECO St. 9-R, pp. 4-6. The following summarizes PECO's proposed EE&C program, responds to specific concerns raised

by I&E witness Patel and OCA witness Crandall, and explains why the Commission should approve the Company's requested allocation.

The Company proposed three new offerings for residential customers: an ENERGY STAR®+ furnace rebate, rebates for faucet aerators and showerheads, and a smart thermostat rebate. The Company also proposed doubling the existing rebate for ENERGY STAR® storage hot water heaters. *See* PECO St. 9, pp. 6-7. Mr. Patel did not oppose "[the] introduction of new rebate programs." *See* I&E St. 1, p. 34; OCA St. 6, pp. 19-21. Mr. Crandall fully supported the proposed low-flow aerator and showerhead programs at PECO's requested budget level. *See* OCA St. 6, p. 33. Mr. Crandall also supported PECO's ENERGY STAR® furnace and smart thermostat rebate programs, but with a reduced budget. *See* OCA St. 6, pp. 31-33. And Mr. Crandall opposed the residential boiler and storage hot water heater programs and claimed that these individual measures fail the TRC test for cost-effectiveness. *See* OCA St. 6, pp. 31-32.

For low-income customers, the Company proposed a new Safe and Efficient Heating Program. This program would serve low-income customers who are not currently eligible for a Low-Income Usage Reduction Program ("LIURP") heating audit. The program would include a site visit and unit inspection, provide information on unit maintenance along with extra filters, and install a carbon monoxide detector. PECO would also replace a limited number of furnaces and boilers as part of this program. *See* PECO St. 9, pp. 7-8. Mr. Crandall fully supported this program at PECO's requested budget of $1,000,000 per year. *See* OCA St. 6, pp. 33-34. Mr. Patel stated that he did not oppose new programs but did not address this program specifically. *See* I&E St. 1, p. 34.

The Company's requested allowance also included funds for pilot projects to pursue emerging technologies that would reduce gas consumption, improve safety, or both. *See* PECO

St. 9, p. 8. Although Mr. Crandall recognized that pilot programs are "potentially useful," he recommended not funding this program. *See* OCA St. 6, p. 34. As stated, Mr. Patel did not oppose this or any new programs. *See* I&E St. 1, p. 34.

As discussed above in Section VI.M, Mr. Patel recommended a disallowance of $1,772,500 and that the Company's EE&C program budget be set at $2,727,500 per year (a 39% decrease from the Company's request). *See* I&E St. 1, p. 34; *see also* I&E St. 1-SR, pp. 27, 32. Mr. Crandall recommended that the Company's request for new funding be denied and that EE&C program funding remain at $2,008,000 per year. Messrs. Patel and Crandall both argued that the Company's requested increase was not needed because past program participation did not meet expectations and the Company only spent 74% of its annual collection. *See* I&E St. 1, pp. 34-36; I&E St. 1-SR, 29-30; OCA St. 6, pp. 27-29; OCA St. 6-SR, pp. 12-14. The Company disagrees.

The Company recognizes that past customer participation levels have not met projections and that program expenditures have been less than budgeted amounts. The Company's proposed budget, however, will support expanded program offerings to encourage customer participation by giving them more ways to participate and includes funding for targeted marketing campaigns that, while more expensive, the Company believes will increase customer participation. *See* PECO St. 9, pp. 6-9; PECO St. 9-R, pp. 4-7. The Company's EE&C program is also cost effective at the portfolio level, with a TRC of 1.02. *See* PECO St. 9-R, pp. 3-4. Finally, if less than $4.5 million is spent, the unspent funds will be returned to customers. *See* PECO St. 9, p. 10. For these reasons, the Company believes that the Commission should approve its requested allowance for the EE&C program.

E. Quality of Service

1. Distribution Integrity Management Program

PECO manages its natural gas distribution system in a safe and reliable manner that meets or exceeds federal and state pipeline operational requirements. To ensure safe and reliable pipeline operations, PECO complies with pipeline safety regulations under 49 C.F.R. Part 192 and the applicable provisions of the Pennsylvania Code under Title 52, Chapter 59. The federally-mandated Distribution Integrity Management Program ("DIMP") is PECO's company-specific plan used to identify and resolve risks to the distribution system. The DIMP provides a rigorous framework for analyzing, ranking, and mitigating threats, and evaluating the effectiveness of those risk mitigation actions. PECO St. 1, pp. 14-15.

The implementation of the DIMP plan is based on the following seven areas of focus: (1) System Knowledge; (2) Threat Identification; (3) Risk Evaluation and Ranking; (4) Identification and Implementation of Measures to Address Risks; (5) Performance Measurements, Results Monitoring and Evaluation of Effectiveness; (6) Periodic Evaluation and Improvement; and (7) Reporting Results. DIMP activities in each of these focus areas play a critical role in driving PECO's risk reduction and safety and reliability improvement initiatives. PECO St. 1, p. 15. In particular, the Company monitors its compliance with each prescribed element of the DIMP plan in order to evaluate PECO's performance in meeting the applicable standards and to reassess threat levels and mitigation measures in light of new information and evolving conditions on the Company's system. Additionally, the Company regularly reviews and assesses the many factors affecting its distribution system to identify risk and determine the best mitigation strategy.

As noted above, a key component of the DIMP is Risk Evaluation and Ranking. The Company performs the evaluation by evaluating a number of risk categories in its risk model. The Company calculates scores for those categories and creates a relative risk ranking to measure the performance of one group of assets compared to another. PECO St. 1-R, p. 5. The DIMP identified the following top ten risks to its gas distribution system: ***** BEGIN CONFIDENTIAL*****

*** END CONFIDENTIAL***

In her direct and surrebuttal testimony, Ms. Bozhko expressed concerns that PECO has been ineffective at reducing corrosion risk on bare steel main and services. ***** BEGIN CONFIDENTIAL*****

*** END CONFIDENTIAL***

Moreover, PECO uses a widely accepted industry damage rate metric for benchmarking that includes the total locate tickets received as part of the calculation, consistent with federal regulations. A closer review of the 2015 to 2019 period better reflects the impact of PECO's damage reduction approaches. ***** BEGIN CONFIDENTIAL*****

***** END CONFIDENTIAL*****

X. RATE STRUCTURE

Every rate proceeding consists of two parts. First, the overall revenues to which a utility is entitled must be determined. The second part of the process must determine how much of the total revenue requirement each rate class should bear. The allocation of revenue responsibility can be one of the more contentious parts of a rate proceeding because it is a "zero sum" exercise

among the non-utility parties – any revenue responsibility not borne by a particular rate class must be borne by one or more other rate classes. While cost of service studies are the touchstone for reasonable allocations of revenue responsibility among rate classes,[46] the Commission has often stated that cost of service and revenue allocation analyses must reflect the exercise of judgment and are as much a matter of art as of science.[47] For that reason, Pennsylvania appellate courts have repeatedly held that the Commission, in crafting a reasonable rate structure, is "invested with a flexible limit of judgment" and may establish just, reasonable and non-discriminatory rates within a "range of reasonableness."[48]

Preceding sections of this brief addressed the amount of the revenue increase that PECO should be allowed. This section addresses the allocation of that increase among customer classes and rate design issues.

A. Cost of Service

1. PECO's Class Cost of Service Study

Jiang Ding, a Principal Regulatory and Rates Specialist for PECO, prepared a class cost of service study ("COSS") for the Company to use as a guide in allocating its proposed revenue increase among its customer classes.[49] COSSs are designed to identify the costs that different classes of customers impose on a utility system and to quantify the revenue requirement associated with providing service to each class. The revenue requirement for a rate class is the portion of a utility's total cost-of-service attributed to that rate class in accordance with principles of cost causation. PECO St. 6, p. 6.

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[46] *See Lloyd v. Pa. P.U.C.*, 904 A.2d 1010 (Pa. Commw. Ct. 2006).
[47] *See Pa. P.U.C. v. Philadelphia Suburban Water Co*., 75 Pa. P.U.C. 391, 440 (1991).
[48] *U.S. Steel Corp. v. Pa. P.U.C.*, 390 A.2d 865, 872 (Pa. Commw. Ct. 1978).
[49] Ms. Ding submitted Direct Testimony (PECO St. 6) and accompanying exhibits (PECO Ex. JD-1 through JD-6) and Rebuttal Testimony (PECO St. 6-R) and accompanying exhibits (PECO Ex. JD-1R through JD-8R).

Certain costs are incurred solely to provide service to a single customer and, therefore, can be directly assigned to that customer. However, the vast majority of the costs incurred by a utility are shared across all customer classes and, therefore, must be allocated among those classes based on allocation factors.[50] For that reason, central to cost-of-service analysis is the determination of appropriate allocation factors based on the causal relationships that exist between, on the one hand, customer demands, load profiles and usage characteristics, and, on the other hand, the costs incurred by the utility to meet the service requirements imposed by the demands, load profiles and usage characteristics of each customer class. Identifying those causal relationships requires an understanding of how a utility's system is designed and how that design correlates with the characteristics of the customers the system serves. *Id*. at 6.

PECO, like most natural gas utilities, designs its gas distribution system to meet three primary objectives:

(1) To extend distribution service to all customers;

(2) To meet the aggregate design peak-day capacity requirements of all customers entitled to receive service on the design peak day; and

(3) To deliver the total volume of natural gas needed to meet customers usage requirements.

Id. at 6-7.

[50] PECO's COSS allocated costs among nine major customer classes: (1) GR (General Service – Residential); (2) GC (General Service - Commercial and Industrial); (3) L (Large High Load Factor Service); (4) MV-F (Motor Vehicle Service-Firm); (5) MV-I (Motor Vehicle Service-Interruptible); (6) IS (Interruptible Service); (7) TCS (Temperature Controlled Service); (8) TS-F (Gas Transportation Service-Firm); and (9) TS-I (Gas Transportation Service-Interruptible). In the COSS, the rate class OL (Outdoor Lighting) is combined with rate class GC because the usage of rate class OL is very small. In addition, customers participating in PECO's Customer Assistance Program ("CAP") are combined with rate class GR because their usage characteristics are the same as other rate class GR customers and because CAP rates were designed to reference rate class GR rates.

The allocation methods used in a cost-of-service study must properly reflect the objectives that the distribution system is designed to achieve so that the allocation of plant investment and operating expenses properly aligns with cost-causation factors. Other factors, such as incentives to influence customer behavior (e.g., conservation or demand reduction) or to temper the impact on customers of rate changes, are more appropriately considered in the revenue allocation and rate design phase. *Id.* at 7.

Cost-of-service analysis consists of three principal steps: functionalization, classification and allocation. In the functionalization step, costs are separated by the utility's basic service characteristics, such as, for example, production, storage, commodity supply and distribution. In the classification step, functionalized costs are separated according to the system design or operating characteristics that cause those costs to be incurred to determine if they are driven by, and vary in relation to, the number of customers, the amount of natural gas commodity supplied, or the capacity required to meet customers' peak demand. In the allocation step, costs that have been functionalized and classified are allocated among rate classes based on appropriate causal relationships that consider how the utility system is designed and operated; class-specific cost data derived from the utility's accounting records; and usage and demand data both for the system overall and for specific customer classes. PECO St. 6, pp. 8-10.

In her Direct Testimony, Ms. Ding summarized the manner in which each major category of plant investment and each major category of operating costs were functionalized, classified and allocated. *Id.* at 12-23. The largest component of PECO's plant investment and associated fixed costs consists of mains. As Ms. Ding explained, the costs of the Company's mains are part of its distribution function and were classified as capacity-related.

While a portion of the cost of the Company's mains (approximately 1%) was directly assigned, the balance of the cost of mains was allocated using the Average and Excess Demand ("A&E") method as described in the treatise *Gas Rate Fundamentals* published by the American Gas Association (1987 edition). *Id*. at 13-14. This is the same method PECO used in its last gas base rate case at Docket No. R-2010-2161592. Under the A&E method, the portion of the cost of mains equal to the system average load factor is allocated among the rate classes based on their average daily deliveries (annual deliveries divided by 365 days). The balance of mains costs is allocated based on excess demand, which is the amount by which the design peak demand exceeds average demand for each class. The excess demand is allocated among rate classes in proportion to each class' peak demand over its average demand. *Id.*

After the Company submitted its supporting data in this case, it uncovered a formula error in the model used to develop its COSS. Specifically, the revenue increase needed for each rate class to achieve its cost of service should have been calculated to produce the system average rate of return.[51] Because of the formula error in the COSS, that did not occur. This error resulted in the COSS incorrectly calculating the class revenue increases needed to achieve each class' revenue requirement. Most notably, the revenue increase needed for Rate GR to match its revenue requirement was understated by approximately $24.1 million (i.e., $47.1 million rather than the correct figure of $71.2 million). PECO St. 6-R, p. 3.

PECO prepared a revised and corrected COSS that the Company provided to all parties in its responses to the OSBA's Interrogatories (Set I) Nos. 1 and 2, which was also submitted by Ms. Ding as PECO Exhibit JD-7R accompanying her Rebuttal Testimony. In addition to

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[51] This formula error related only to equalized proposed rate of return at the proposed class revenue requirement. The cost allocation methodology employed in the model was unaffected and the calculation of class rate of return at present rates was largely unaffected.

correcting the formula error described above, Ms. Ding made four other revisions to the COSS to correct other relatively small errors she had identified and to update the revenue requirement data to reflect changes in the revenue requirement calculation between PECO's initial filing and its rebuttal case. *Id*. at 4-5. The Company's revised COSS was used by PECO witness Joseph A. Bisti to develop a revised revenue allocation as part of the Company's rebuttal case, as explained in PECO Statement No. 7-R and discussed in Section X, B. *supra*.

2. Other Parties Positions Regarding Cost of Service and PECO's COSS

Because of the magnitude of the cost of mains, other parties that addressed cost of service focused principally on the allocation of those costs. I&E witness Cline accepted and adopted the methodology and results of PECO's revised COSS. PAIEUG witness Billie LaConte explained that she believed a portion of the total cost of mains was related to the number of customers because a distribution system must be designed to connect all of a gas utility's customers. However, she acknowledged the practical impediments – lack of sufficient data – to identifying and quantifying the customer-cost component needed for a customer-based allocation. Accordingly, Ms. LaConte accepted the results of PECO's revised COSS as an appropriate guide for allocating the revenue increase in this case.

OSBA witness Robert D. Knecht, like Ms. LaConte, contended that a theoretically correct allocation of mains costs should recognize a customer component. However, he acknowledged Commission precedent rejecting any customer-based allocation of mains costs for gas utilities. Mr. Knecht also disagreed with the theoretical underpinnings of the A&E method because "mains costs are not causally related to average use." Accordingly, Mr. Knecht would have preferred to use a methodology that allocates a portion of mains costs using a customer component and allocates the balance of such costs using a "peak demand allocator." OSBA St. 1, pp. 21-23.

Despite his theoretical opposition to the A&E method, Mr. Knecht acquiesced to the weight of relevant Commission precedent that adopted and approved the use of the A&E method in litigated base rate cases for PPL Gas Utilities Corporation and the Philadelphia Gas Works decided in 2007.[52] For the same reason, Mr. Knecht, seeking to remain consistent with his perception of prior Commission decisions, proposed weighting the "average" demand and "excess" demand components of the A&E method equally (50% each) in lieu of weighting those elements based on PECO's system load factor (25.23% average demand/74.77% excess demand). Thus, despite his position that average demand should not be reflected at all in the allocation of mains costs, Mr. Knecht subordinated his theoretical opposition to recognizing average demand to his interpretation of prior Commission precedent[53] and, therefore, proposed a 50% weighting of average demand instead of the lower weighting PECO used in its COSS:

> Consistent with Commission precedent, I accepted the Company's use of an A&E allocation factor. However, while I disagree that mains costs are causally related to average demands, I modified the Company's A&E allocation factor to implicitly include an average demand component. In particular, I modified the A&E allocator to be consistent with the Commission-approved practice at the Philadelphia Gas Works ("PGW"), wherein the average and excess components are weighted at 50 percent.[54]

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[52] *Pa. P.U.C. v. PPL Gas Util. Corp.*, Docket No. R-00061398 (Feb. 8, 2007); *Pa. P.U.C. v. Phila. Gas Works*, Docket No. R-00061931 (Sept. 28, 2007). Mr. Knecht noted (OSBA St. 1, p. 23) that the Commission accepted the Peak and Average method in a 1994 base rate case for National Fuel Gas Distribution Corporation. However, the continuing precedential value of that decision is questionable – and likely minimal – because it pre-dated the enactment of the Natural Gas Choice and Competition Act in 1999, which restructured the gas utility industry in Pennsylvania, unbundled the supply and sale of gas from regulated distribution rates and introduced competition and customer choice for obtaining gas commodity supply.
[53] Mr. Knecht acknowledged that the Commission approved a 40% average demand and 60% excess demand weighting in *Pa. P.U.C. v. PPL Gas Util. Corp.*, *supra*, but asserted that those figures were "not based on system load factor" (OSBA St. 1, p. 23). While Mr. Knecht claims he has inside knowledge of how those figures were developed, the Commission's Order clearly summaries the record evidence, as follows: "PPL Gas stated that the 40% for commodity [average demand] was based upon system average load factors for 2004 and 2005 of 39.1% and 39.8% respectively. (PPL Gas St. 8-R at 4).").
[54] OSBA St. 1, p. 24.

In summary, Mr. Knecht is in general agreement with the COSS methodology used by PECO. He accepts, for this case, the use of the A&E method. His flawed understanding of Commission precedent led to his erroneous belief that the Commission established a *per se* rule requiring average and excess demand to be weighted equally, when it did not. PUC precedent, properly interpreted, does not proscribe PECO's use of system load-factor weighting, as the treatise *Gas Rate Fundamentals* specifies. As noted, Mr. Knecht objects to recognizing *any* average demand in the allocation of mains costs. Therefore, removing the constraint on the weighting factor he inaccurately read into prior PUC decisions, it is clear that PECO's COSS approach (which reduces the weighting of average demand below 50%, but not all the way to zero as Mr. Knecht would prefer) is actually closer to the allocation methodology Mr. Knecht advocates as theoretically correct based on cost-causation principles.

OCA witness Glenn A. Watkins was the only witness that opposed using the A&E method to allocate the cost of mains, advocating instead the Peak and Average Demand method ("P&A"). OCA St. 4, 9-10, 21-23. The A&E method allocates mains costs based in part on average demand and in part on the portion of peak demand that exceeds average demand. In contrast, the P&A method allocates mains costs based in part on average demand and in part on each class' total peak demand (not just the portion that exceeds average demand). As a consequence, the P&A method implicitly double-counts average demand – once in the "average" demand component and a second time as part of the composition of total peak demand (which includes average demand). PECO St. 6-R, p. 7; PAIEUG St. 1-R, p. 8. This double-counting creates an unacceptable bias in favor of low-load factor customers who are major contributors to peak demands that drive the cost of mains.

Mr. Watkins ignored the Commission's acceptance of the A&E method in *Pa. P.U.C. v. PPL Gas Util. Corp.* and *Pa. P.U.C. v. Phila. Gas Works*, opting, instead, to rely upon the Recommended Decision in *Columbia Gas*.[55] Since Mr. Watkins submitted his Direct Testimony, the Commission has entered a final order in Columbia's case adopting the Administrative Law Judge's recommendation on cost of service allocation. However, Mr. Watkins' characterization of that case is flawed and incomplete, and the Commission's holding is not an endorsement of the use of the P&A method. Rather, the Commission was forced to choose one COSS from those that had been developed in the record, which did not include a COSS using the A&E method.

Columbia submitted three COSSs. The first allocated a portion of mains costs based on a customer component and the balance based solely on peak demand. The second used the P&A method and a 50%/50% weighting of average and peak demand. The third, which Columbia promoted, was an "average" of the first two methods. No party supported Columbia's preferred "average" COSS, and I&E affirmatively and strenuously opposed it. But, because I&E did not conduct its own COSS, it chose the least-bad alternative, which was the P&A-based COSS that Columbia presented, but did not rely upon. OSBA witness Knecht advocated the use of the A&E method, but also did not perform or present his own COSS. In its final order, the Commission accepted the only COSS approach left standing after Columbia's customer/demand and "average" COSS alternatives were rejected as facially contrary to well-established precedent disapproving customer-based allocations of any part of the cost of gas utility mains. However, in so doing, the Commission clearly signaled that its decision to rely on the P&A COSS in Columbia's case was not a rejection of the A&E method that it had previously approved in the PPL Gas Utilities and Philadelphia Gas Works cases: "Based on our review of the Orders

[55] *Pa. P.U.C. v. Columbia Gas of Pa., Inc.*, R-2020-3018835A (Recommended Decision issued Dec. 4, 2020), p. 12.

proffered by the Parties, regarding the OSBA's position, we find that the Average & Excess is of no significance here in that none of the Parties have submitted this type of methodology for our consideration." In short, there was no head-to-head contest between the P&A method and the A&E method in the Columbia case. The most that can be said of the PUC's decision is that, absent a properly developed COSS using the A&E method, the Commission was forced to choose the "second best," which happened to be the P&A-based COSS.

Mr. Watkins also criticized PECO's application of the A&E method, claiming that Ms. Ding departed from the rules established by *Gas Rate Fundamentals* because no "excess" demand was allocated to interruptible rate classes. OCA St. 4, p. 18. Mr. Watkins' reading of the instructions for the A&E method in *Gas Rate Fundamentals* is not correct. The treatise states that an analyst should have discretion to determine how much excess demand costs should be allocated to interruptible customers. This is not surprising, since the extent of such an allocation of excess demand is inextricably tied to how a gas utility designs and constructs its system. As Ms. Ding explained, PECO designs and sizes its capacity to reflect design peak day conditions that assume – correctly – that interruptible customer will not be contributing to peak demand at the time of the design day peak. PECO St. 6-R, pp. 8, 24-25. Moreover, Mr. Watkins himself conceded the theoretical correctness of Ms. Ding's approach because, in applying the P&A method, he also did not allocate peak demand costs to interruptible customers in order to recognize that "Interruptible service is inferior to Firm natural gas service." OCA St. 4, pp. 21-22.

3. Other Cost of Service issues

a. OCA Witness Watkins – Forfeited Discounts/Non-Base Rate Revenues and Storage Plant

OCA witness Glenn A. Watkins alleged that Ms. Ding did not "appropriately reflect non-base rate revenues nor the additional forfeited discount revenues that will be generated as a result of the Company's proposed overall increase." OCA St. 4, p. 20. As explained by Ms. Ding, Mr. Watkins misinterpreted the data presented in PECO's exhibits developing its base rate revenue requirement and, therefore, erroneously concluded that PECO had not properly reflected forfeited discount revenue and non-base rate revenue in calculating its proposed increases. PECO properly credited all of those amounts in developing its proposed increase. PECO St. 6-R, pp. 12-14. In his surrebuttal testimony, Mr. Watkins did not address, and appears to have accepted, Ms. Ding's explanation that $1,528,000 of what Mr. Watkins refers to as "non-base rate revenue" and the Company identified as "Other Operating Revenue" has been properly reflected in the development of the Company's proposed increase. Mr. Watkins addressed, and continues to disagree with, Ms. Ding's explanation that forfeited discounts, which total $88,000, were not properly reflected (i.e., used to reduce the revenue increase). As Ms. Ding explained in her rebuttal testimony (PECO St. 6-R, pp. 13-14), a proper apples-to-apples comparison of base distribution revenues provides arithmetic proof that the proposed increase credits the $88,000 of forfeited discounts to the benefit of customers.

Mr. Watkins also disagreed with PECO's allocation of the cost of gas storage plant. OCA St. 4, p. 22. These costs reflect PECO's investment in LNG facilities used to meet design day peaks and other short-term needs of firm sales customers and, accordingly, have been functionalized to "storage," classified to demand and allocated among rate classes based on design peak-day send-out. PECO St. 6-R, p. 11. Mr. Watkins contended that storage plant

should be allocated based on the storage allocator Ms. Ding used to assign natural gas storage expenses in PECO Ex. JD-6.

Mr. Watkin's alternative allocation is incorrect because storage plant is used to meet design peak day and short-term needs of firm sales customers. Using the allocator Mr. Watkins proposes would improperly assign storage costs to interruptible customers under rate classes such as Rate TS-I. Notably, all transportation customers already incur additional costs if they do not balance deliveries within 10% of their daily usage as provided in PECO's Retail Gas Tariff. *Id*. at 12.[56] Moreover, as Ms. Ding also explained, the impact of changing this allocator is immaterial to any and all customer classes in the overall allocation of cost of service. Nonetheless, Mr. Watkins' proposed change is incorrect and should be rejected.

b. OSBA Witness Knecht

Rate GR and GC Design Day Peak Demand. Based on his observation that the design day load factors for Rate GR and Rate GC customers are allegedly "virtually identical," Mr. Knecht assumed that the Company "has not made any independent evaluation of the load patterns of the various rate classes, but simply split the Small Firm design day demands between residential and all other based on volumes." In an attempt to address what he viewed as a deficiency in the Company's analysis of class-specific demands, Mr. Knecht tried to develop "design day demand load factors using a statistical analysis of monthly class loads and heating degree days" which he then "applied design day conditions to the statistical analysis." OSBA St. 1, p. 28. The results of his analysis are shown in the table at page 28 of his direct testimony. As evidenced by those data, the differences between the design day load factors used by PECO and those Mr. Knecht proposed to use (in the column "RDK GCOSS") are not material for Rate GR

[56] *See also* PECO Energy Company Gas Service Tariff, Sixth Revised Page No. 67, section 2.4.

(20.9% versus 20.1%) and Rate GC (20.9% versus 22.5%). In fact, Mr. Knecht conceded the point: "As shown, the load factor for the GC class is modestly higher than that for the GR class based on my analysis of actual weather sensitivity." *Id.* And, when those data were run through the entire COSS calculation, they yielded – along with other changes Mr. Knecht proposed – no change in the class rate of return at existing rates for Rate GR and only a 0.8 percentage point change for Rate GC. *Id*. at 34, Table IEc-3. Mr. Knecht conceded this point as well, noting: "My changes have only modest impacts on allocated costs for the major firm service classes, namely GR, GC and TS-F." *Id*., p. 35.

Despite the amount of attention Mr. Knecht gave to this issue, in the final analysis, its impact on Rates GR and GC – the presumptive basis for Mr. Knecht to embark on his alterative analysis – is inconsequential from a practical cost-of-service and rate design standpoint, as Mr. Knecht acknowledged. Nonetheless, PECO disagrees with the premise that prompted Mr. Knecht's alternative analysis. The Company performed a reasonable analysis of the various rate classes as the basis for segregating "small firm" design-day demand among its firm service classes. PECO St. 6-R, p. 19. Tellingly, except for Mr. Knecht's largely academic exercise, which produced immaterial differences, no other party's expert found PECO's approach insufficiently rigorous to yield design day demand data that are well within the limits of precision generally accepted for use in performing a COSS. Mr. Knecht's criticisms should be disregarded and PECO's revised COSS should be adopted for use as a guide in allocating the revenue increase in this case.

Rate L and Rate TS-F. By way of background, PECO witness Ding explained the historic, PUC-approved relationship that has existed for many years between Rate L and Rate TS-F:

> Rate L – Large High Load Factor Service is available to provide firm sales service to large, high load factor customers. Currently, there are four customers that employ Rate L in this capacity as their primary form of service. Rate L also serves another function for the Company and its customers. With the prior approval of the Commission (reaffirmed in numerous subsequent base rate cases up to the present), the Company made Rate L available to customers on Rate TS-F – Gas Transportation Service-Firm as Standby Sales Service. As Standby Sales Service, Rate L serves two purposes.
>
> First, if a Rate TS-F customer's transportation supply cannot be delivered to PECO's city gate (either because of a gas supply shortage or because the interstate pipelines transporting the customer's gas do not have sufficient capacity), the customer can purchase gas from PECO under Rate L as Standby Sales Service.
>
> Second, by engaging PECO to provide Standby Sales Service, a Rate TS-F customer is able to preserve its right to return to traditional sales service. In this way, if a Rate TS-F customer desires to discontinue transportation service, it can seamlessly and automatically resume purchases from PECO under Rate L as its primary form of service. A Rate TS-F customer that does not engage PECO to obtain Standby Sales Service runs some risk that PECO may not be immediately able to resume sales service if a shortage of gas supply or interstate pipeline capacity should arise.
>
> As indicated in the rebuttal testimony of Mr. Richard A. Schlesinger (PECO Statement No. 8-R, page 6), Rate L has been available as Standby Sales Service for many years, and a number of Rate TS-F customers obtain Rate L Standby Sales Service. Those customers understand the purpose Rate L serves, are familiar with its operation and its relationship to their transportation service, and they have come to rely upon Rate L in its existing form for their Standby Sales Service.

PECO St. 6-R, pp. 15-16.

Mr. Knecht expressed two concerns relating to Rates L and TS-F and their relationship to each other. First, Mr. Knecht alleged that PECO had not include design day demands for "pure" Rate L customers (i.e., those that do not use Rate L for Standby Sales Service). Ms. Ding explained how PECO developed the design day demand, which includes the demand of "pure" Rate L customers. PECO St. 6-R, p. 17. In addition, Ms. Ding explained that Mr. Knecht was

expressing concern about an issue that does not have a material impact on design day demand or usage, which is verified by the quantitative analysis Ms. Ding performed in her Rebuttal Testimony (p. 17). While Mr. Knecht did not accept Ms. Ding's explanation that "pure" Rate L demand had been properly recognized by PECO, he conceded Ms. Ding's point that this issue is academic and has no practical effect on the COSS results and adopted the Company's design day demands for Rate L. OSBA St. 1-S, p. 9.

Mr. Knecht's second concern takes issue with the long-standing Commission-approved relationship between Rate L and Rate TS-F for transportation customers served on Rate TS-F that voluntarily elect to obtain Standby Sales Service from PECO. Mr. Knecht contended that allowing a Rate TS-F customer to choose Standby Sale Services under Rate L "requires the customer to pay a transportation rate for backup utility supplies from a different rate class" because, according to Mr. Knecht, TS-F customers who choose to obtain Standby Sale Service under Rate L "must deliver that gas at a different rate than if their own gas supplier had provided the gas." OSBA St. 1, pp. 26-27.

To address his concern, Mr. Knecht recommended removing the demands associated with Standby Sales Service from the Rate L class and, instead, combining those sales-service demands with the demands of customers receiving only transportation service under Rate TS-F.[57] Mr. Knecht claims that including Standby Sales Service demands with the rest of the sales-service demand the Company serves under Rate L produces an "unusually low load factor" for

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[57] Mr. Knecht also made a second recommendation, specifically, that PECO cease providing Standby Sales Service under Rate L entirely and, instead, adopt a fundamentally different approach under which PECO would offer to sell back-up gas supplied to Rate TS-F customer as a completely stand-alone service and deliver those unbundled back-up supplies as PECO's regular TS-F rates. This recommendation was addressed by PECO witness Schlesinger (PECO St. 8-R, pp. 4-5). This proposal by Mr. Knecht is addressed in Section X.D., *infra*, although Mr. Knecht appears to have ceased pressing for adoption of this proposal in this case. *See* OSBA St. 1-S, pp. 22-26.

Rate L overall because "the demands for the standby [sales] load come with relatively little volume."

Mr. Knecht's proposal to remove Standby Sales Service demands from the Rate L class and combine them with the transportation-based demands of the Rate TS-F class blurs the distinction between sales service and transportation service. That distinction lies at the heart of the long-standing relationship between Rate L, as Standby Sales Service, and firm transportation service under Rate TS-F, which the Commission has approved in numerous prior base rate cases over many years. It is also a relationship between Rate L and Rate TS-F that PECO's customers understand, accept and rely upon. Standby Sale Service under Rate L is voluntary – Rate TS-F customers can choose that service or not. To a significant extent, customers have expressed their preference to continue the existing relationship between Rate L as Standby Sales Service and Rate TS-F transportation service by electing to receive Standby Sales Service. PECO St. 6-R, pp. 21-22.

Mr. Knecht tries to justify blurring the distinction between sales service and transportation service based solely on his observation that keeping all of the sales service demands ("pure" Rate L and Standby Sales Service demands) within the Rate L classification produces an "unusually low load factor." However, assigning sales demands to transportation service simply to raise the load factor of Rate L is a result-oriented approach to demand classification that, contrary to Mr. Knecht's contentions, misrepresents each class' costs. Mr. Knecht's recommendation should, therefore, be rejected.

Rates TS-F Design Day Demand. Mr. Knecht observed that the Company obtained the design day demand of 68,000 mcf/day for Rate TS-F from its PGC filing and noted that it does not appear the Company adjusted that figure to remove demands related to customers served by

directly-assigned meters, as it did for the Rate TS-F total through-out volumes.[58] The Company agreed that the design day demand should have been reduced by the demand relating to one customer served with directly-assigned meters and made that change in the revised COSS submitted with Ms. Ding's Rebuttal Testimony. The impact on the resulting allocation factors used in the revised COSS was not material, as shown by the data provided in Table 3 of PECO Statement No. 6-R at page 23.

Rates TS-F and TS-I Annual Volumes Rate Differential. Mr. Knecht contended that the Rates TS-F and TS-I have an unacceptably large differential in the volumetric charges for customers above and below annual volumes of 18 mmcf. Mr. Knecht observed that these rate classes represent a "not-insignificant amount" of base rate revenues (approximately 7%) and contended that there was not apparent cost allocation justification for the rate differential. Mr. Knecht made two recommendations for addressing his concerns. From a customer classification standpoint, he recommended creating separate "large" (over 18 mmcf per month) and "small" (18 mmcf and under per month) rate schedules for customer currently on Rates TS-F and TS-I. This would produce separate rate classes that would have to be separately analyzed as such in PECO's COSS. Alternatively, Mr. Knecht recommended narrowing the differential in the volumetric charges for usage above and below the 18,000 mmcf per month breakpoint reflected in the existing Rate Schedule TS-F and TS-I.

PECO strongly opposed creating separate rate classification for customer with usage above and below 18,000 mmcf per month. As Ms. Ding explained, a number of factors other than usage alone must be considered in establishing separate rate classifications. PECO St. 6-R, pp. 23-24. A proper consideration of all of those factors does not support the creation of the

[58] OSBA St. 1, p. 27.

separate, usage-based classifications Mr. Knecht recommended. However, PECO did accept Mr. Knecht's alternative recommendation to narrow the differential in the volumetric charges for usage above 18,000 mmcf and 18,000 mmcf and below and reflected those changes in the rate design for Rates TS-F and TS-I proposed in the Rebuttal Testimony of PECO witness Bisti (PECO St. 7-R, pp. 15-16 and PECO Ex. JAB-4 Revised (Corrected)).

Interruptible Rate Classes – MV-I, IS and TCS. In his Direct Testimony, Mr. Knecht contended that customers served under interruptible Rates MV-I, IS and TCS do not offer any material distribution service benefits because, for Rate MV-I, there has been no interruption for at least five years and the Rate TCS class has been interrupted only once in the past five years. Mr. Knecht also contended that Rate IS service is interruptible for gas supply reasons, not because it produces distribution system benefits. For these reasons, Mr. Knecht's cost-of-service study assigned design day demands, and associated demand costs, to the MV-I, IS, and TCS rate classes.

PECO opposed Mr. Knecht's proposal because he fundamentally misunderstood the benefits of the ability to interrupt these customers if a design day peak were to be reached on PECO's system. PECO's system is designed to operate at a design day without these customers being on-line (i.e., PECO doesn't incur the costs to size its system to meet the demands of these customers at the time of a design day peak). Assigning peak day demands to these classes, therefore, imposes costs on these customers for a level of service they will not receive and do not expect to receive. In his Surrebuttal Testimony, Mr. Knecht, while not necessarily agreeing with PECO's explanation of the theoretically basis for its COSS approach, agreed that these classes should not be assigned demand costs.[59]

[59] OSBA St. 1-S, p. 10.

B. Revenue Allocation

The Company's proposed revenue allocation is based primarily upon four factors: (1) the results of the Company's COSS; (2) moving all rate classes closer to the cost of service indicated by the COSS; (3) adjusting certain class distribution revenues based on proposed changes to PECO's GPC and MFC uncollectible write-off factors; and (4) customer impacts. The Company also considered its obligation under the Commission-approved Joint Petition for Settlement of PECO's 2008 gas base rate case at Docket No. R-2008-2028934 ("2008 Settlement") to eliminate the remaining difference between the system average rate of return and the class rates of return for Rate GC and Rate L. In weighing that commitment against the ratemaking principle of gradualism, the Company initially proposed to more closely align the class rates of return for Rate GC and Rate L with the proposed system average rate of return, without completely eliminating the remaining difference, while limiting the degree to which rates for other classes diverged from their indicated cost of service. PECO St. 7, pp. 3-5, 10-11. The Company's initial revenue allocation proposal was presented by Mr. Bisti and is set forth in PECO Exhibit JAB-1.

1. PECO Revised Revenue Allocation

The development of a revised COSS, described further in Section X.A.1, *supra*, necessitated updates to the Company's proposed revenue allocation. The Company developed a revised revenue allocation proposal, which is set forth in PECO Ex. JAB-1 Revised (Corrected). The Company's revised revenue proposal also completely eliminated the remaining difference between the system average rate of return and the class rates of return for Rate GC and Rate L as required under the terms of the 2008 Settlement. PECO St. 7-R, pp. 2-5; PECO Ex. JAB-1 Revised (Corrected).

2. Opposing Party Alternative Revenue Allocations

I&E witness Cline, PAIEUG witness LaConte, and OSBA witness Knecht proposed alternatives to the Company's revised revenue allocation. Mr. Cline asserted that PECO's revised revenue allocation is not reasonable because (1) the proposed increase for Rate L is excessive and inequitable in light of PECO's recommendation to decrease rates for other classes, and the Rate L increase should be limited to 2.5 times the system average increase of 17.5%; and (2) I&E's alternative revenue allocation proposals for Rate TS-I and Rate TS-F will move the relative rate of return to or closer to 1.0. I&E St. 3-SR, pp. 17-21.

Ms. LaConte contended that the Company's proposed revenue allocation is unreasonable since Rate TS-F will not move closer to cost. Ms. LaConte stated that this will result in firm transportation customers providing higher subsidies, which will be greater for customers taking service on tariff rates than those receiving negotiated rates. Ms. LaConte proposed an alternative revenue allocation that would move all rate classes closer to cost while limiting all increases to 1.5 times the system average, except for Rate GC and Rate L, which Ms. LaConte moved to cost. PAIEUG St. 1-S, pp. 2-6.

Mr. Knecht agreed with PECO's proposed revenue allocation to Rate GC, but recommended that no rate decrease be assigned at the full revenue requirement to reflect gradualism and COVID-19 considerations. Mr. Knecht also agreed with PECO's proposed allocation to Rate L, if the Commission accepts the Company's proposal to retain Rate L as a bundled standby service rate class. However, Mr. Knecht stated that the Company did not provide proper support for its proposed allocations to Rate IS, Rate MV-I, Rate TCS, and Rate TS-F. Mr. Knecht provided alternative allocations to these rate classes. OSBA St. 1-S, pp. 10-14.

Ultimately, as PECO witness Bisti observed, "[t]here are many ways to allocate the increase [i.e., the proposed revenue allocation] that purport to give due consideration to cost of service and the principle of gradualism, as illustrated by the various proposals advanced in this case." PECO St. 7-R, p. 5. However, the Company's proposal is reasonable as it was calculated utilizing the Company's COSS, moves all rate classes closer to the cost of service indicated by the COSS, eliminates the remaining difference between the class rates of return for Rates GC and L and the system average rate of return, and properly considers customer impacts, including gradualism. The Company's proposal is also substantially within the range of alternative proposals raised by the other parties. Therefore, the Commission should approve the Company's proposed revenue allocation.

3. Scale Back of Rates

Subject to the specific differences discussed below, the parties are in general agreement with the Company about the scale back that should occur if the Commission grants less than PECO's requested revenue increase.

I&E witness Cline recommended excluding, from any scale back of rates, rate classes that receive no increase or receive a rate decrease from any scale back of rates. He also recommended that the residential customer charge be included in any proportional scale back of rates. I&E St. 3, p. 37; I&E St. 3-SR, pp. 13-14, 25-26. OCA witness Watkins recommended excluding Rates GC, OL, MV-I, and TCS from an otherwise proportional scale back of rates. OCA St. 4, p. 29. OSBA witness Knecht expressed concern that a proportional scale back would lead to an inequitable result in the event this proceeding resulted in a significant reduction in the Company's claimed revenue requirement. Mr. Knecht recommended that the Commission adopt a "hybrid approach to a scaleback," in which the rate reduction would be scaled back partly

based on the proportional scale back method, and half based on current rate revenues. OSBA St. 1-R, pp. 15-20.

The Company believes that a proportional scale back is the most reasonable approach, as it would maintain the relative rate increases among rate classes. In addition, the Company's proposed customer charges should not be subject to any scale back. As explained in Section X.D, *infra*, the customer costs identified in Ms. Ding's COSS support customer charges higher than those proposed by PECO. Reducing the proposed customer charges as Mr. Cline recommends would move them further away from the indicated cost of service.

C. Allocation of Universal Service Program Costs

Universal service costs are currently allocated to the residential customer class, and PECO did not propose any change to the allocation of such costs in this proceeding. *See* PECO Exhibit JAB-2. Both OCA witness Colton and CAUSE-PA witness Miller recommended that the Company allocate universal service costs to all customer classes (*see, e.g.,* OCA St. 5, pp. 56-90; CAUSE-PA St. 1, pp. 48-54), while OSBA witness Knecht and PAIEUG witness LaConte opposed that recommendation, *see* OSBA St. 1-R, pp. 21-30; PAIEUG St. 1-R, pp. 10-13. PECO believes this gas distribution base rate case is not the appropriate place to consider broad universal service cost allocation proposals, particularly when, as explained earlier, PECO's gas-only CAP population is an exceedingly small part of its total CAP population. Furthermore, in *Columbia Gas* (pp. 258-261), the Commission recently rejected proposals to reallocate universal service costs to non-residential gas customers. The Company does not support a change in universal service cost allocation as part of this proceeding but, as Ms. Colarelli explained, intends to address the allocation of universal service costs in its next electric base rate proceeding. *See* PECO St. 10-R, p. 12.

D. Tariff Structure

1. Residential Customer Charge

The Company's current residential customer charge is $11.75 per month and has been in place since rates went into effect following the Company's 2010 gas base rate case. This is the lowest residential customer charge among all of Pennsylvania's major gas distribution companies and is far below the residential customer-related costs identified in the Company's COSS prepared in connection with this rate case (i.e., $30.26 per month). The Company proposed to increase the residential customer charge to $16.00 per month. PECO St. 7, pp. 12-14; PECO St. 7-R, p. 6; *see also* PECO Ex. JD-4R, p. 4.

The increase was proposed to reduce the disparity between the Company's current residential customer charge and the residential customer-classified costs identified in the COSS that should be recovered through the customer charge. The Company's customer charges are intended to recover costs that can be identified and allocated by customer class, subject to consideration of the principle of gradualism. Customer-classified costs are costs that vary based on the number of customers and not usage. For example, the Company can attribute the cost of meters, customer service lines, billing, and meter reading by customer-class. As explained by Mr. Bisti, "[a] utility should, to the extent practicable, avoid including customer-classified costs in variable distribution charges because to do so would make the recovery of customer-related costs a function of customers' gas usage, which they are not." Recovering customer costs through variable distribution charges can have adverse consequences, such as creating inappropriate intra-class subsidies or resulting in the Company under- or over-recovering due to variations in customer usage. PECO St. 7, pp. 13-14.

The Company's proposed $16.00 residential customer charge would still fall within the range of the residential customer charges of the other major gas distribution companies in

Pennsylvania and remains below the residential customer-classified costs identified in the Company's COSS. *Id.*

The OCA opposes any increase in the Company's fixed customer charge for residential gas customers. In the alternative, if the Commission does grant a rate increase, the OCA recommended that, the residential charge increase should be limited to $13.00. In support of these recommendations, OCA witnesses Watkins and Colton claimed that PECO's proposed increase to the customer charge violates the principle of gradualism, is contrary to the goal of promoting energy conservation, and would disproportionately impact low-income customers, particularly because the Company's CAP and federal assistance ("LIHEAP") will not sufficiently mitigate the impacts of the increase. OCA St. 4, pp. 30-31; OCA St. 5, pp. 29-32, 55; OCA St. 5-SR, pp. 4-6.

The Commission should reject Mr. Watkins's proposal to deny the Company's proposed increase to its residential customer charge due to the financial impacts of the COVID-19 pandemic. As the Commission recently noted in its decision in *Columbia Gas*, "the continued use of traditional ratemaking methodologies during this pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards ."[60] Traditional ratemaking methodology dictates that a utility should be permitted to recover fixed customer class-related charges through fixed customer charges. While Mr. Watkins maintains that the Company's residential customer charge should be capped at $13.00, an approximately 10% increase, OCA has not provided any evidentiary support as to why a $13.00/10% cap is appropriate. The Company's proposed residential customer charge should not constitute "rate

[60] *Columbia Gas*, p. 42.

shock," as it still falls below the residential class' customer-related costs, and would be within a reasonable range of the residential customer charges of other major Pennsylvania gas utilities. Mr. Watkins also failed to properly support his contention that increasing the Company's customer charge is contrary to energy conservation. Denying PECO the ability to move its residential customer charge closer to the residential class-related customer costs identified in the COSS would be unreasonable.

Furthermore, while Mr. Colton contends that the Company's proposal will disproportionately impact low-usage, low-income customers, Mr. Colton fails to acknowledge that the Company's proposal to increase the residential customer charge will provide a relative benefit to high-use, low-income customers by lessening the impact of the overall rate increase. The Company believes that its proposal to provide a relative benefit to high-usage, low-income customers, who are more likely to experience higher monthly bills, is reasonable.[61] The Company also believes that Mr. Colton's arguments relative to LIHEAP are irrelevant since LIHEAP is a federal program and PECO is not involved in establishing its funding levels. PECO St. 7-R, p. 10.

Mr. Miller also recommended that the Commission deny the Company's proposed increase to its residential customer charge. Mr. Miller disagreed that the Company's proposed customer charge would be within the range of charges of other natural gas distribution companies since the Company would be imposing the increase in one rate case. In support, he incorrectly claimed that Columbia Gas increased its residential customer charge over a series of rate cases between 2010 and 2018. CAUSE-PA St. 1-SR, p. 2. Mr. Miller also stated that the increase

[61] Mr. Colton mischaracterized when he asserted that Mr. Bisti stated that low-income customers are more likely to be high usage. *See* OCA St. 5-SR, p. 5. Mr. Bisti stated that low-income high usage customers are more likely to experience high monthly bills and will therefore benefit from the Company's proposed increase of the residential customer charge. PECO St. 7-R, p. 10.

would undermine the Company's LIURP since a higher fixed fee would reduce the amount of bill reduction attainable through LIURP measures and undermine energy efficiency efforts. CAUSE-PA St. 1, pp. 41-44; CAUSE-PA St. 1-SR, pp. 2-3.

Mr. Miller's recommendation should be rejected for the same reasons set forth in response to Mr. Watkins and Mr. Colton. The Company's proposal is based on traditional ratemaking principles and will more closely align residential customer-related costs with the residential customer charge. The Company also notes that Columbia Gas Company's current residential customer charge was established as a settlement in Docket No. R-2012-2321748, which *decreased* the residential customer charge of $18.73 that had been in effect. Columbia's residential customer charge did not increase in subsequent rate cases. Mr. Miller also failed to support his assertions that the Company's proposed increase to its residential customer charge will impair energy efficiency efforts or undermine the Company's LIURP. The increased customer charge will not prevent customers from making improvements in energy efficiency.

For all of the foregoing reasons, the Commissions should grant the Company's proposed increase to its residential customer charge and deny the recommendations made by the OCA and CAUSE-PA.

2. Non-Residential Customer Rate Design

a. Rate GC Customer Charge

The Company's current Rate GC customer charge is $28.55. The Company initially proposed an increase to this charge, *see* PECO St. No. 7, pp. 14-15, but revised its position and is now proposing to maintain the Rate GC customer charge at its current rate. PECO St. 7-R, pp. 14-15; JAB-4 Revised (Corrected). This is consistent with Mr. Knecht's recommendation related to the Company's initial proposal (*see* OSBA St. 1, pp. 48-49), and no parties oppose the Company's proposal to keep the Rate GC customer charge at its current rate (*see* OSBA St. 1-S,

pp. 18-19). Therefore, the Commission should approve the Company's proposed Rate GC customer charge.

b. Rate GC Declining Block Volumetric Charge Differential

The Company's Rate GC contains a declining block volumetric charge. Mr. Knecht contended that the declining block tariff is not necessary. He recommended that the Company reduce the volumetric charge differential by applying a larger percentage rate increase to the tail block charge. OSBA St. 1, pp. 50-51. The Company concluded this proposal is reasonable and incorporated Mr. Knecht's proposed differential into its proposed rate design. PECO St. 7-R, p. 15. No other parties opposed this proposal. The Commission should therefore approve PECO's proposed Rate GC declining block volumetric differential.

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

As previously noted, Mr. Knecht recommended that the Company reduce its Rate TS-F and Rate TS-I volumetric charge differentials and Mr. Bisti adopted Mr. Knecht's proposed differential (subject to further changes to the Company's proposed rates), and incorporated the differentials into its proposed rate design. Mr. Knecht stated that he agreed with the Company's revised proposal for Rate TS-F, but that the proposal set forth in PECO St. 7-R and PECO Ex. JAB-4 Revised did not incorporate Mr. Knecht's proposal regarding Rate TS-I. The Company's acknowledged this oversight and further modified Rate TS-I in PECO Exhibit JAB-4 Revised (Corrected) to fully incorporate Mr. Knecht's recommendation. *See* PECO Ex. JAB-4 Revised (Corrected).

PAIEUG witness LaConte objected to Mr. Knecht's proposal. She alleged that the data provided by Mr. Bisti to determine if the Company's load factor analysis is correct, in response to a PAIEUG discovery request, was not provided in a workable format. Ms. LaConte also contended that the Company's recommended volumetric rate would disproportionately impact

large Rate TS-F customers, resulting in large Rate TS-F customers receiving a 56.2% increase in volumetric rates, contrary to the principle of gradualism. Ms. LaConte recommended that the Commission reject the Company's proposed Rate TS-F differential and maintain the current Rate TS-F differential. PAIEUG St. 1-S, pp. 6-8.

The Commission should approve the Company's proposed rate design for Rate TS-F and Rate TS-I. The Company incorporated Mr. Knecht's recommendation related to Rate TS-I and no other party has challenged the volumetric differentials presented by the Company. With respect to Rate TS-F, the Company disagrees with Ms. LaConte's representation that the Company failed to provide the requested information related to Rate TS-F in a workable format. In response to Ms. LaConte's request for the Company's workpapers utilized to derive its revised Rate TS-F and TS-I rates, the Company provided (1) corrected versions of the Company's proof of revenues for Rate TS-I and TS-F in Excel format (consistent with PECO Ex. JAB-4 Revised (Corrected)); and (2) the version history of volumetric distribution charges under proposed rates for both classes. No other party challenged the "workability" of these materials. Further, the Company does not believe that its proposal will result in "rate shock" to the large Rate TS-F customers. As acknowledged by Ms. LaConte, the large Rate TS-F customers are large commercial and industrial users that have enjoyed the benefit of no rate increase since new rates went into effect after the Company's 2010 base rate case. Mr. Knecht's recommended approach to minimizing the differential between small and large Rate TS-F customers reflects a reasonable balance in rate design that takes into account the needs of all customers. The Commission should reject Ms. LaConte's proposal and approve the Company's proposed rate design.

d. Rate L and Standby Sales Service

In his direct testimony, Mr. Knecht also proposed to eliminate Standby Sales Service under Rate L and to require PECO to provide stand-alone unbundled gas commodity sales

service to back-up Rate TS-F customers' regular gas supplies. As Mr. Schlesinger explained (PECO St. 8-R, pp. 5-6), total Rate L revenues under existing rates are approximately $75,000, and only a portion of those revenues relate to Standby Sales Service. PECO therefore believes that there is no need at this juncture to reshape the long-standing, customer-accepted relationship between Rate L and Rate TS-F to make incremental changes in revenues, or to incur substantial IT costs to implement this change. It appears that Mr. Knecht believes the end result of his proposal is consistent with Company's proposal. OSBA St. 1-S, pp. 24-25.

e. Elimination of Rate IS Margin Sharing

The Company's Rate IS is an interruptible service that is keyed to a customer's cost of alternative fuel. Customers that take service under Rate IS are charged a customer charge plus a rate per Mcf that is (1) no less than PECO's commodity cost of gas for the month plus three cents; and (2) no more than the price, on an equivalent BTU basis, of the alternative fuel the customer is capable of consuming. PECO subtracts, from that price, its weighted average cost of flowing gas. The remainder, which is PECO's gross margin, is divided between PGC customers and shareholders: 75% is credited to purchased gas costs and returned to PGC customers and 25% is retained by the Company. PECO St. 7, pp. 9-10.

Mr. Knecht and Mr. Watkins recommended that the Company eliminate this margin sharing mechanism. *See* OSBA St. 1, pp. 43-44; OCA St. 4, pp. 28-29. Both witnesses stated that the sharing mechanism is no longer appropriate in the context of a competitive natural gas supply market. *Id.* Mr. Knecht also stated that the sharing mechanism results in an improper subsidization of utility gas supply service customers by PECO transportation-only customers and contended that the structure has not been successful in attracting new customers given that there are currently only two Rate IS customers. OSBA St. 1, pp. 43-44.

The Company agreed to propose eliminating the disputed Rate IS sharing mechanism on or before December 1, 2021 as part of its next annual PGC reconciliation filing, and updated its revenue requirement, COSS, revenue allocation and proof of revenues to reflect this change. No other party disputed this sharing mechanism. The Company believes this is a reasonable compromise that will enable it to probably phase out the sharing mechanism. The Commission, therefore, should reject the OCA's and OSBA's recommendation to eliminate the Rate IS sharing mechanism as part of this base rate case.

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

Mr. Knecht recommended that the Company eliminate Rate IS, Rate MV-I, and Rate TCS. He primarily asserted that none of these interruptible rates provide any "obvious benefit" to firm base rate customers. OSBA St. 1, pp. 43-46. Mr. Knecht also noted there are only two customers that take service under Rate MV-I, natural gas vehicles do not appear to be a "winning technology" that continues to justify its own rate, and that Rates MV-I and TCS are anti-competitive in that they are designed to provide lower-cost delivery service to customers taking service from the Company than customers served by competitive natural gas suppliers. Mr. Knecht also observed that PGW abandoned similar mechanisms.

The Company opposes the elimination of these rate classes. Maintaining interruptible customers is essential to protecting firm customers, including residential customers, from system interruptions during extreme weather conditions. Interruptible customers also enable the Company to avoid investments that might otherwise be necessary to bolster reliability if all customers were firm. The Company and its customers still benefit from interruptible customers, even if those customers are interrupted sparingly. The minimal number of times the Company has needed to interrupt its interruptible customers is a testament to PECO's superior planning and operational management of its system. Mr. Knecht did not provide any evidence that

eliminating any of these rates will provide a greater benefit to the Company's distribution system and customers than keeping these interruptible rates in place. Further, comparisons to PGW and unsupported prognostications regarding certain industries are irrelevant. PECO St. 7-R, pp. 16-19.

The Company sees no benefit to eliminating Rate IS, Rate MV-I, or Rate TCS at this time, and upon review, Mr. Knecht acknowledged that any potential negative aspects of retaining these rates are likely to be minimal, and that they can be addressed by the Company over a longer term. The Commission should therefore reject OCA's recommendation to eliminate Rate IS, Rate MV-I and Rate TCS.

3. Distribution System Improvement Charge ("DSIC") Cost Allocation

In his direct testimony, OSBA witness Knecht expressed concerns regarding the allocation of costs to Rate GC customers under PECO's existing DSIC mechanism. According to Mr. Knecht, the Company's allocation of DSIC-eligible costs among rate classes based on volumetric charge revenue does not comport with cost causation principles or the Commission-approved cost allocation method for the DSIC. *See* OSBA St. 1, pp. 46-48. Contrary to Mr. Knecht's contention, the Company's DSIC cost allocation methodology is consistent with Act 11 of 2012 and the Commission's Final Implementation Order at Docket No. M-2012-2293611.

As Mr. Bisti explained in his rebuttal testimony (PECO St. 7-R, p. 13), PECO's DSIC charges to customers are capped at 5% of the amount billed to customers for distribution service, consistent with Section 1358(a)(1) of the Code,[62] Commission requirements and the Company's tariff. After reviewing Mr. Bisti's rebuttal testimony, Mr. Knecht conceded that his claim that

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[62] *See* 66 Pa.C.S. § 1358(a)(1) ("[T]he distribution system improvement charge may not exceed 5% of the amount billed to customers under the applicable rates of the wastewater utility or distribution rates of the electric distribution company, natural gas distribution company or city natural gas distribution operation.").

PECO's DSIC charges to Rate GC customers appear to exceed the 5% statutory cap is incorrect. OSBA St. 1-S, p. 18. Nonetheless, after carefully considering Mr. Knecht's testimony on this issue, the Company concluded that it would adopt the OSBA's recommendation to modify PECO's budgetary cost allocation procedures to distribute DSIC-eligible costs among the rate classes based on total rate base revenues, including both customer charge and volumetric revenues. PECO St. 7-R, pp. 13-14; PECO Ex. JAB-4 Revised (Corrected).

4. Negotiated Gas Service

The Company's current Commission-approved tariff permits the Company to offer negotiated (i.e., discounted) gas service to customers under specified circumstances pursuant to the Company's Rate NGS. To be eligible for service under Rate NGS, a customer must: (1) either have a history of at least 18,000 Mcf of annual natural gas usage billed by the Company, or, if a new customer, establish that the facilities to be served are likely to consume at least 18,000 Mcf of annual natural gas usage; (2) document a viable, currently available competitive alternative to service under Rates GC, L, TS-F, or TS-I; and (3) execute an NGS agreement that comports will all provisions set forth in Rate NGS. *See* PECO Ex. JAB-2, pp. 76-77.

Six of the Company's customers currently take service under Rate NGS. I&E, OCA, and OCA contended that PECO did not establish that all of these customers are still eligible to receive service under Rate NGS.

OCA witness Watkins recommended that the Company reevaluate the terms and rates for ***** BEGIN CONFIDENTIAL***** [redacted] *****END CONFIDENTIAL***** including performing an analysis of the customers' ability to use alternative fuels and a supporting financial analysis for proposed negotiated rates on a going-forward basis. Mr. Watkins stated that these findings should be provided to the Commission and OCA on, or before,

the Company's next base rate case filing. OCA St. 4, pp. 32-34. In support of his recommendation, Mr. Watkins noted that PECO has been providing service to three of its Rate NGS customers for a significant period and that the Company could not provide the original financial analysis supporting the discounted rate to these customers.

I&E witness Cline recommended that the Company, at all future base rate case filings, be required to provide an updated analysis for any Rate NGS customer that has not had its alternative fuel source, or opportunity for pipeline bypass or relocation, as applicable, verified for a period of five years or more, and that the Company cease providing service to any customer under Rate NGS that does not have a verified alternative to Company service. I&E witness Cline also recommended that, in future base rate cases, PECO separate the costs and revenues of customers that take service under discounted or reduced rates in their own class in the Company's COSS. I&E St. 3, pp. 33-36; I&E St. 3-SR, pp. 22-25.

OSBA witness Knecht stated that the Company failed to demonstrate the eligibility and reasonableness of rates, under Rate NGS, for ***** BEGIN CONFIDENTIAL***** [redacted] *****END CONFIDENTIAL***** OSBA St. 1, pp. 39-42; OSBA St. 1-R, pp. 13-15; OSBA St. 1-S, pp. 16-17.

The Company agreed with Mr. Watkins' request and stated it would provide the requested information with its next base rate case filing. PECO St. 7-R, p. 23. However, the Commission should reject Mr. Cline's and Mr. Knecht's recommendations. With respect to Mr. Cline's recommendation that the Company be required to evaluate Rate NGS customers'

alternative fuel sources every five years, the Company's Commission-approved tariff for Rate NGS does not require the Company to re-evaluate customer eligibility for Rate NGS at any specified time, except when a customer initially applies for service. At that time, PECO and its customers generally evaluate the potential benefits of a Rate NGS service agreement over a lengthy period, even decades in the case of a bypass alternative or relocation opportunity. Requiring the Company to review the eligibility of its Rate NGS customers every five years would potentially create instability for the Company's Rate NGS customers and make it less likely that customers would enter into competitive agreements with the Company. Such customers might be more likely to pursue alternatives to PECO service, ultimately resulting in a risk of lost revenues that would negatively impact all PECO gas customers. PECO St. 7-R, pp. 22-23. While PECO is amendable to providing the analyses requested by Mr. Watkins, the Company believes that requiring it to regularly re-evaluate Rate NGS customers' eligibility, regardless of the Company's contractual terms, will hinder its ability to enter into NGS agreements and potentially increase costs to other customers.

The Commission should also reject Mr. Knecht's recommendations. *****BEGIN CONFIDENTIAL***** *****END CONFIDENTIAL***** *See* PECO St. 7-R, pp. 19-25. In addition, the OSBA's argument (supported by I&E witness Cline in his surrebuttal testimony) that the Commission should require PECO's investors to bear the difference between tariffed

rates and the discounted rates provided to Customers 3, 5 and 6 should be rejected. For the reasons discussed in Section VIII.A. above, that recommendation would violate shareholders' constitutional right to a fair return on and of their investment.

5. Theft/Fraud Investigation Charge

In the Company's existing Tariff, Rule 17.6 establishes reconnection fees for terminations associated with non-payment, as well as fees for investigation and remediation of theft or fraud. PECO originally proposed to separate these two fees into distinct tariff rules, with the new Rule 17.7 including a $460 fee for investigation and remediation of theft or fraud. *See* PECO St. 8, pp. 8-9. The Company later clarified that: (1) proposed Rule 17.7 would only be applied in cases of confirmed active gas theft; (2) the $460 fee was consistent with the average cost to investigate and remediate theft only; and (3) the term "fraud" should be stricken from the proposed rule. *See* PECO St. 8-R, pp. 2-3; Hearing Tr. 202.

OCA witness Colton opposed proposed Rule 17.7, expressing concern about (1) the breadth and vagueness of rule language; (2) the application of the rule to "applicants"; and (3) the inclusion of "allocated overheads and administrative costs" in the proposed fee and the potential for double recovery of costs by the Company. *See* OCA St. 5, pp. 109-113; OCA St. 5-SR, pp. 7-9.

Mr. Schlesinger addressed each of Mr. Colton's areas of concern. First, Mr. Schlesinger clarified that proposed Rule 17.7 will apply in the case of confirmed active gas theft only and therefore all references to fraud will be stricken from the rule. *See* PECO St. 8-R, pp. 2-3; Hearing Tr. 202. He also explained that PECO does not believe it is prudent to provide a specific definition of theft in the Company's tariff because the means by which tampering occurs evolves over time. *See* PECO St. 8-R, p. 3.

Second, Mr. Schlesinger explained the circumstances under which an "applicant" could be properly assessed a fee under the proposed rule. If, for example, PECO confirms that "Person A" is tampering, the Company would terminate service to that customer and apply the $460 fee under proposed Rule 17.7. "Person A" could then apply for gas service at a different property without paying the $460 fee. Person A is now an "applicant" because he or she is not currently a customer, but, the past charges for theft should continue to be applied to Person A at his or her new service address. Hearing Tr. 203.

Finally, in response to Mr. Colton's concerns about double-recovery of "allocated overheads and administrative costs," Mr. Schlesinger explained that the Company had made a $10,000 revenue adjustment for "budgeted theft fee revenue" that was based on the actual 2019 gas revenues collected under existing Rule 17.6 related to the investigation and remediation of theft. *See* PECO St. 8-R, p. 3; Hearing Tr. 202. For all these reasons, the Company has demonstrated that proposed Rule 17.7 is appropriate and should be approved by the Commission.

E. Summary and Alternatives

As described above, PECO's COSS reflects a reasonable balance between the costs incurred by the Company to meet customers' service requirements and the allocation of those costs to customer classes respecting cost causality. PECO's proposed revenue allocation in this case also provides an appropriate balance of the competing interests of the Company's major classes and makes reasonable progress in moving all classes closer to their cost of service consistent with well-accepted ratemaking principles. In addition, PECO has accepted a variety of non-residential rate design proposals recommended by I&E and the OSBA. Accordingly, PECO's proposed rate structure fairly and reasonably allocates the increase in gas revenues among PECO's customer rate classes and should be approved.

XI. CONCLUSION

For the reasons set forth above, the Commission's Investigation at Docket No. R-2020-3018929 should be terminated, the various Complaints consolidated therewith dismissed, and the proposed rates permitted to become effective.

Respectfully submitted,

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Dated: March 3, 2021

Counsel for PECO Energy Company

Appendix A

TABLE I
Company Name
INCOME SUMMARY
R-2020-3018929

	Pro Forma Present Rates (1)	Company Adjustments (1)	Pro Forma Present Rates (Revised) (1)	ALJ Adjustments	ALJ Pro Forma Present Rates	ALJ Revenue Increase	Total Allowable Revenues
	$	$	$	$	$	$	$
Operating Revenue	589,779,563	234,749	590,014,312	0	590,014,312	65,976,052	655,990,364
Expenses:							
O & M Expense	371,100,877	(966,082)	370,134,794	0	370,134,794	229,093	370,363,887
Depreciation	88,958,628	0	88,958,628	0	88,958,628	0	88,958,628
Taxes, Other	7,545,489	0	7,545,489	0	7,545,489	203,223	7,748,712
Income Taxes:							
State	(14,368,706)	500,729	(13,867,978)	4,723	(13,863,255)	6,547,819	(7,315,436)
Federal	(4,415,601)	264,641	(4,150,959)	8,936	(4,142,023)	12,389,143	8,247,120
Total Expenses	448,820,687	(200,712)	448,619,975	13,659	448,633,634	19,369,278	468,002,912
Net Inc. Available for Return	140,958,876	435,461	141,394,337	(13,659)	141,380,678	46,667,183	188,047,861
Rate Base	2,461,938,790	1,616,239	2,463,555,028	0	2,463,555,028		2,463,555,028
Rate of Return	5.73%		5.74%				7.63319100%

(1) Company Main Brief

TABLE I(A)
Company Name
RATE OF RETURN
R-2020-3018929

	Structure	Cost	After-Tax Weighted Cost	Effective Tax Rate Complement	Pre-Tax Weighted Cost Rate
Total Cost of Debt			1.78808100%		
Long-term Debt	46.62%	3.84%	1.78808100%		1.79%
Short-term Debt	0.00%	0.00%	0.00000000%		
Preferred Stock	0.00%	0.00%	0.00000000%	0.711079	0.00%
Common Equity	53.38%	10.95%	5.84511000%	0.711079	8.22%
	100.00%		7.63319100%		10.01%
Pre-Tax Interest Coverage	5.60				
After-Tax Interest Coverage	4.27				

TABLE I(B)
Company Name
REVENUE FACTOR
R-2020-3018929

100%	1.00000000
Less:	
Uncollectible Accounts Factor (*)	0.00347237
PUC, OCA, OSBA Assessment Factors (*)	0.00308026
Gross Receipts Tax	0.00000000
Other Tax Factors	-0.00128765
	0.99473502
State Income Tax Rate (*)	0.09990000
Effective State Income Tax Rate	0.09937403
Factor After Local and State Taxes	0.89536099
Federal Income Tax Rate (*)	0.21000000
Effective Federal Income Tax Rate	0.18802581
Revenue Factor (100% - Effective Tax Rates)	0.70733518

(*) Company Main Brief

TABLE II
Company Name
SUMMARY OF ADJUSTMENTS
R-2020-3018929

Adjustments	Rate Base	Revenues	Expenses	Depreciation	Taxes-Other	State Income Tax	Federal Income Tax
	$	$	$	$	$	$	$
RATE BASE:							
CWC:							
Int. & Div. (Table IV)	(IV!B38)						
Taxes (Table V)	(V!P34)						
O & M (Table VI)	(VI!B42)						
REVENUES:							
		0				0	0
EXPENSES:							
			0			0	0
			0			0	0
			0			0	0
			0			0	0
			0			0	0
			0			0	0
			0			0	0
			0			0	0
			0			0	0
			0			0	0
			0			0	0
			0			0	0
TAXES:							
Interest Synchronization (Table III)						4,723	8,936
TOTALS	0	0	0	0	0	4,723	8,936

TABLE III
Company Name
INTEREST SYNCHRONIZATION
R-2020-3018929

	Amount $
Company Rate Base Claim	2,463,555,028
ALJ Rate Base Adjustments	0
ALJ Rate Base	2,463,555,028
Weighted Cost of Debt	1.78808100%
ALJ Interest Expense	44,050,359
Company Claim (1)	45,545,868
Total ALJ Adjustment	1,495,508
Company Adjustment	1,448,233
Net ALJ Interest Adjustment	47,276
State Income Tax Rate	9.99%
State Income Tax Adjustment	4,723
Net ALJ Interest Adjustment	47,276
State Income Tax Adjustment	4,723
Net ALJ Adjustment for F.I.T.	42,553
Federal Income Tax Rate	21.00%
Federal Income Tax Adjustment	8,936

(1) Company Main Brief

TABLE IV
Company Name
CASH WORKING CAPITAL - Interest and Dividends
R-2020-3018929

Accrued Interest	Long-Term Debt	Short-Term Debt	Preferred Stock Dividends	
Company Rate Base Claim	$2,463,555,028	$2,463,555,028	Company Rate Base Claim	$2,463,555,028
ALJ Rate Base Adjustments	$0	$0	ALJ Rate Base Adjustments	$0
ALJ Rate Base	$2,463,555,028	$2,463,555,028	ALJ Rate Base	$2,463,555,028
Weighted Cost of Debt	1.78808100%	0.00%	Weighted Cost Pref. Stock	0.00000000%
ALJ Annual Interest Exp.	$44,050,359	$0	ALJ Preferred Dividends	$0
Average Revenue Lag Days	43.17	43.2	Average Revenue Lag Days	43.2
Average Expense Lag Days	91.25 (a)	91.3	Average Expense Lag Days	91.3
Net Lag Days	-48.1	-48.1	Net Lag Days	-48.1
Working Capital Adjustment				
ALJ Daily Interest Exp.	$120,686	$0	ALJ Daily Dividends	$0
Net Lag Days	-48.1	-48.1	Net Lag Days	-48.1
ALJ Working Capital	($5,802,331)	$0		$0
Company Claim (1)	($5,802,327)	$0	Company Claim (1)	$0
ALJ Adjustment	($4)	$0		$0
Total Interest & Dividend Adj.	($4)			

(1) Company Main Brief.

(a) Reflects lag days for interest payments only. See PECO Exhibit MJT-1 REVISED, Schedule C-4, page 29.

TABLE V
Company Name
CASH WORKING CAPITAL -TAXES
R-2020-3018929

Description	Company Proforma Tax Expense Present Rates	ALJ Adjustments	ALJ Pro forma Tax Expense Present Rates	ALJ Allowance	ALJ Adjusted Taxes at Present Rates	Daily Expense	Net Lead/ Lag Days	Accrued Tax Adjustment
PUC Assessment	$2,197,394	$0	$2,197,394	$203,223	$2,400,617	$6,577.03	5.63	$37,043
Public Utility Realty	$2,049,670	$0	$2,049,670		$2,049,670	$5,615.53	-77.83	($437,045)
Capital Stock Tax	$0	$0	$0		$0	$0.00	0.00	$0
Use Tax Accrued	$151,998	$0	$151,998		$151,998	$416.43	0.00	$0
Real Estate Tax Accrued	$1,567,969	$0	$1,567,969		$1,567,969	$4,295.81	71.17	$305,742
Payroll Tax Accrued	$3,775,852	$0	$3,775,852		$3,775,852	$10,344.80	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
	$0	$0	$0		$0	$0.00	0.00	$0
State Income Tax	$0 (a)	$4,723	$4,723	$6,547,819	$6,552,542	$17,952.17	14.92	$267,884
Federal Income Tax	($10,248,741) (a)	$8,936	($10,239,805)	$12,389,143	$2,149,338	$5,888.60	7.17	$42,234
	($505,858)	$13,659	($492,199)	$19,140,185	$18,647,986			

ALJ Allowance	215,858
Company Claim (1)	217,840
ALJ Adjustment	(1,982)

(1) Company Main Brief

(a) Reflects current state and federal income taxes only.

TABLE VI
Company Name
CASH WORKING CAPITAL -- O & M EXPENSE
R-2020-3018929

Description	Company Pro forma F.T.Y. Expense (a)	ALJ	ALJ Pro forma Expenses	Lag Days	Lag Dollars
Service Company	$0	$0	$0	0.00	$0
Chemicals	$0	$0	$0	0.00	$0
Group Insurance	$0	$0	$0	0.00	$0
Insurance, Other	$0	$0	$0	0.00	$0
Labor	$0	$0	$0	0.00	$0
Leased Equip./Rent	$0	$0	$0	0.00	$0
Leased Vehicles	$0	$0	$0	0.00	$0
Miscellaneous	$0	$0	$0	0.00	$0
Natural Gas	$428,805,516	$0	$428,805,516	37.27	$15,982,324,865
Power	$0	$0	$0	0.00	$0
Purchased Water	$0	$0	$0	0.00	$0
Telephone	$0	$0	$0	0.00	$0
Waste Disposal	$0	$0	$0	0.00	$0
Post Retirement Benefits	$0	$0	$0	0.00	$0
Pensions	$0	$0	$0	0.00	$0
	$428,805,516	$0	$428,805,516	37.30	$15,982,324,865

ALJ Average Revenue Lag	43.2	
Less: ALJ Avg. Expense Lag	37.3	
Net Difference	5.9	Days
ALJ Pro forma O & M Expense per Day	$1,174,810	
ALJ CWC for O & M	$6,898,587	
Less: Company Claim (1)	$6,930,271	
ALJ Adjustment	($31,684)	

(1) Company Main Brief

(a) Data on this page reflects a FPFTY.

Appendix B

FINDINGS AND CONCLUSIONS

I. INTRODUCTION AND OVERVIEW

1. PECO Energy Company ("PECO" or "the Company") is a Pennsylvania public utility that furnishes service to approximately 1.6 million electric customers and 534,000 natural gas customers through its certificated service area, which includes all or portions of five counties and encompasses approximately 2,100 square miles in southeastern Pennsylvania with a population of approximately four million people. *See* PECO St. 1, pp. 2-5.

2. On September 30, 2020, the Company initiated this rate case pursuant to 66 Pa.C.S. § 1308(d)[1] by filing Tariff Gas – Pa. P.U.C. No. 4 ("Tariff No. 4") requesting an increase in its total annual operating revenues to become effective November 29, 2020.

3. In its initial filing, the Company proposed a base rate increase of $68.7 million, or 8.9% of PECO's total Pennsylvania jurisdictional gas operating revenues anticipated for the fully projected future test year ("FPFTY") ending June 30, 2022. *Id.*, p. 5.

4. The Pennsylvania Public Utility Commission ("Commission" or "PUC") initiated an investigation of the Company's existing and proposed rates by Order entered October 29, 2020.

5. Pursuant to Section 1308(d), the Company's rate request was suspended by operation of law to June 29, 2021.

6. In addition to the Commission's Bureau of Investigation and Enforcement ("I&E"), several parties participated actively in this proceeding: the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Coalition for

[1] Hereafter all references to a "Section" are to the Pennsylvania Public Utility Code ("Code"), 66 Pa.C.S. §§ 101 *et seq*., unless indicated otherwise.

Affordable Utility Services and Energy Efficiency in Pennsylvania ("CAUSE-PA") and the Philadelphia Area Industrial Energy Users Group ("PAIEUG").

7. A total of two public input hearings and one day of evidentiary hearings were held, generating 262 pages of transcript.

II. OVERALL POSITION ON RATE INCREASE

8. PECO has not filed a gas base rate case since March 31, 2010.

9. PECO delayed the filing of this proceeding because of the COVID-19 emergency. OCA St. 1, p. 9; Hearing Tr. 254-55.

10. PECO's Chief Financial Officer, Mr. Stefani, explained that if this case had been filed in March 2020 as planned, any changes would have gone into effect during the winter heating season when customers necessarily incur more expense, and PECO had already experienced six months of earning losses from the delay totaling in the tens of millions of dollars. Hearing Tr. 254-55.

11. Among the 67 electric and gas utility rate cases either settled or litigated in the United States between March 2020 and December 2020, the vast majority have resulted in rate increases. PECO St. 11-R, p. 23.

12. The percent of approved rate increases (81 percent) is essentially the same as it has been in recent years, prior to the pandemic. Moreover, for gas utilities, the average approved rate increase has been larger during the pandemic than it was prior to the pandemic. *Id.*

13. The approved return on equity has remained virtually unchanged since the start of the pandemic relative to rate cases decided prior to the pandemic, despite the significantly lower level of interest rates during the pandemic than before. Controlling for the reduction in interest rates, approved returns on equity would actually be higher during the pandemic than they were before. *Id.*, pp. 23-24.

III. RATE BASE

A. Fair Value

14. PECO's final rate base claim as of June 30, 2022 at present rates is $2,463,555,000 (Appendix A) and consists of the depreciated original cost of utility plant to be in service at June 30, 2022, together with miscellaneous rate base additions and deductions made in accordance with accepted ratemaking procedures. PECO St. 3, pp. 13-27; PECO Ex. MJT-1 Revised, Sch. C-1.

B. Utility Plant in Service

15. The increase in PECO's utility plant in service since its last base rate case is the single largest factor driving the Company's need for an increase in revenues. PECO St. 1, pp. 5-7.

16. PECO projects that it will need to invest approximately $1.2 billion in new or replacement gas utility plant between July 1, 2020 and June 30, 2024. *See* PECO St. 1, pp. 5-7, 10, 16-18; PECO St. 2, pp. 2-3.

17. The Company's final claim for the original cost of utility plant in service at June 30, 2022 is $3,537,669,000. From this amount, PECO deducted customer contributions, advances and deposits, deferred income taxes and accrued depreciation excluded from rate base. PECO Ex. MJT-1 Revised, Schs. C-1 and C-2.

18. PECO's rate base claim for the FPFTY reflected its balances of plant projected to be in service and retirements as of June 30, 2022. PECO St. 3, pp. 13-14; PECO St. 3-R, p. 5; PECO Ex. MJT-1 Revised, Sch. C-2.

19. Similarly, the Company's annual depreciation expense claim for FPFTY is based on the projected plant balances and retirements as of June 30, 2022, and its FPFTY accrued depreciation reflects the accrued depreciation that would be recorded during the year ending June

30, 2022. PECO St. 3, pp. 13-14; PECO St. 3-R, p. 5; PECO Ex. MJT-1 Revised, Schs. C-2, C-3 and D-17.

20. In addition, in calculating its FPFTY income tax expense, the Company reflected the annual amount of plant-related tax deductions for the year ending June 30, 2022. PECO St. 3, pp. 42-43; PECO St. 3-R, p. 5; PECO Ex. MJT-1 Revised, Sch. D-18.

21. The OCA's witness Lafayette K. Morgan claimed that PECO's budgeted data for FPFTY plant additions are overstated and unreliable. On that basis, Mr. Morgan proposed an allowance only at the Company's forecasted level of plant additions for the FTY of $3,232,114,000, without an allowance for any plant additions during the FPFTY, and recommended corresponding reductions to accumulated depreciation, accumulated deferred income taxes ("ADIT"), and annual depreciation expense. The net effect of the OCA's proposed adjustments would be to reduce PECO's rate base by approximately $271 million and to correspondingly reduce PECO's claim for depreciation expense by $7.827 million. OCA St. 2, pp. 7-15; OCA St. 2-SR, pp. 2-10; OCA Sch. LKM-4

22. The Company employed a rigorous budgeting process to develop its FTY and FPFTY capital and operating budgets, consistent with the process reviewed by the Commission during its Focused Management and Operations Audit of PECO in 2014. *See* PECO St. 2, pp. 10-12; PECO St. 2-R, p. 4; Hearing Tr. 249-51.

23. The Company took the budget that was already approved by senior management in January 2020 for a March 2020 filing and refreshed it with the most up-to-date information to accommodate the use of a fiscal year ending in June (i.e., a historic test year ending June 30, 2020) – to align with the Company's delayed filing. The budget reflected the Company's current information regarding customer load, capital expenses, operating and maintenance ("O&M")

expenses, depreciation and amortization expense, and interest and tax expense. Since the update occurred approximately four months into the COVID-19 emergency, the update also reflected impacts resulting from the pandemic. The updated budget was finalized in August 2020. *See* PECO St. 2-R, pp. 2-3; Hearing Tr. 249-51.

24. The budget process utilized by the Company was neither abbreviated nor independent of its normal budget process. PECO St. 2-R, p. 3.

25. The Company's budget was fully reviewed and authorized by its senior management. Hearing Tr. 251.

26. The development of FTY and FPFTY budgets is inherently an exercise in reasonable projections based on typical and normal operating conditions and currently available information. The Company's FTY and FPFTY budgets reflect "the standard inputs to PECO's well-established gas forecasting process, including weather normalization based on 30-year averages, historical sales and customer growth trends, and economic forecasts provided by PECO's third-party vendor." PECO St. 2-R, p. 3.

27. It is unreasonable to assume that the Company's FTY and FPFTY claims for plant in service are unachievable due to the COVID-19 pandemic. As both Messrs. Bradley and Stefani noted, some projects were delayed during the HTY, but PECO does not expect the in-service dates of any of the projects it expects to complete in the FTY or FPFTY to be delayed. PECO St. 1-R, pp. 3-4; Hearing Tr. 217-18, 246-47.

28. In addition, the Company's capital expenditures through 2020 demonstrate that the Company mitigated the delays caused by the COVID-19 pandemic. The Company spent approximately $274 million of its $277 million 2020 construction budget – approximately 99%

of its target – and anticipates that it will be fully caught up on its construction budget by June 2021. *Id.*

29. Mr. Morgan conflated certain statements in PECO's testimony and discovery responses to arrive at the erroneous conclusion that the Company's claims are unreliable. *See* OCA St. 2, pp. 6-9; OCA St. 2-SR, pp. 14-15.

30. I&E witness Ethan H. Cline proposed an adjustment to reduce PECO's forecasted plant in service balances for the "Natural Gas Reliability" project described in the direct testimony of PECO witness Bradley (PECO St. 1, p. 17) from $82,481,428 to $34,856,625 to eliminate investments in gas utility plant that Mr. Cline believes will not be placed in service during the FPFTY. I&E St. 3, pp. 10-12; I&E St. 3-SR, pp. 4-6; I&E Ex. No. 3, Sch. 2.

31. As Mr. Bradley explained, the Company's Natural Gas Reliability project consists of three components: (1) the installation of 11.5 miles of gas main; (2) capital upgrades to the Company's West Conshohocken liquified natural gas ("LNG") facility; and (3) the construction of a new gate station, or reliability station. PECO St. 1-R, pp. 18-20; Hearing Tr. 213-17.

32. Mr. Cline mistakenly treated the three components of the Natural Gas Reliability project as a single, linear project. In truth, the three components will be constructed, placed into service, and will be able to provide service to customers independently. The new 11.5-mile gas main and new reliability station are scheduled to be in-service and will be used to provide natural gas service to PECO customers by the second quarter of 2022 (i.e., during the FPFTY). While the planned upgrades to the LNG facility will not be completed and placed into service until the end of 2022 (i.e., after the end of the FPFTY), the associated costs of those upgrades are not reflected in the Company's FPFTY claim for plant additions. *Id.*

C. Depreciation Reserve

33. PECO's claim for accrued depreciation related to utility plant in service at June 30, 2022 is $892,383,000. PECO Ex. MJT-1 Revised, Sch. C-2.

34. No party has contested the service lives or depreciation calculations sponsored by PECO witness, Caroline Fulginiti (PECO St. 4, pp. 7-11 and PECO Ex. CF-3).

35. I&E witness Cline and OCA witness Morgan proposed reductions to the Company's claimed accrued depreciation as of June 30, 2022 that are concomitant to their proposed adjustments to plant in service balances as of June 30, 2022. I&E St. 3, pp. 14-16 OCA St. 2, p. 15; OCA Sch. LKM-4, p. 2.

36. However, for the reasons discussed in Section IV.B. of PECO's Main Brief, I&E's and the OCA's underlying adjustments to FPFTY plant additions should not be adopted.

D. Additions to Rate Base

37. In addition to the depreciated original cost of net utility plant in service, PECO has made additions to rate base for its investment in the pension asset, cash working capital, materials and supplies, and gas storage inventory.

38. The pension asset arises because of a difference in the calculation of pension costs for ratemaking purposes in Pennsylvania and the calculation of pension costs under GAAP. The Commission has generally required that pension costs for ratemaking purposes should be based upon a utility's cash contribution to its pension fund, while GAAP requires pension costs to be determined on the basis of different rules, which are set forth in the Statement of Financial Accounting Standards No. 87 ("SFAS 87"). Use of these two different procedures results in an annual difference between the amount of pension costs recovered in rates established by the Commission (based on cash contributions) and the amount of pension costs reflected on the accounting records of the Company (based on SFAS 87). PECO St. 3-R, p. 10.

39. The pension asset consists of $35.1 million of investor-supplied capital that was actually contributed to PECO's pension fund and assumed for ratemaking purposes to be included in PECO's plant accounts, but was not recorded in PECO's plant accounts because GAAP rules will not allow it. PECO St. 3-R, pp. 11-12.

40. PECO is only proposing to include the pension asset in rate base to recover the associated carrying costs on a prospective basis and is not seeking to recover prior carrying costs in this case. *Id*.

41. Cash working capital represents the funds needed to pay O&M expenses and taxes that, on average, are incurred in advance of the utility's receipt of revenues. PECO calculated its cash working capital requirement using the accepted, PUC-approved lead-lag method. PECO St. 3, pp. 16-22; PECO Ex. MJT-1 Revised, Sch. C-4.

42. No party disputed the methodology the Company employed or challenged its proposed revenue lag, expense lag or net lag (revenue lag minus expense lag).

43. I&E witness Patel and OCA witness Morgan proposed adjustments to the Company's requested cash working capital that are concomitant to their proposed adjustments to O&M expenses. I&E St. 1-SR, pp. 45-46; OCA St. 2, pp. 19-20; OCA Sch. LKM-6. For the reasons set forth in Section VI of PECO's Main Brief, none of Mr. Morgan's and Mr. Patel's adjustments should be adopted.

44. None of PECO's other additions to rate base have been disputed.

IV. REVENUES

45. The Company's pro forma revenues under present rates for the future test year ("FTY") ending December 31, 2021 and FPFTY are $346,391,000 and $361,576,000, respectively. PECO St. 3-R, p. 2; PECO Ex. MJT-2, Sch. A-1; PECO Ex. MJT-1 Revised, Sch. A-1.

46. Forfeited discounts (late payment revenue) are the only element of PECO's revenues that are contested.

47. PECO calculated forfeited discount revenue for the FPFTY by first calculating the average forfeited discount revenue for the three years ended December 31, 2019, as a percentage of average past due accounts receivable balances for the same period. The percentage derived from that calculation was applied to PECO's forecast of past due accounts receivable for the FPFTY to develop FPFTY forfeited discount revenue. In addition, PECO reduced its FPFTY level of forfeited discount revenue to account for a permanent waiver of late fees on past due balances for customers enrolled in the Company's Customer Assistance Program. PECO St. 2-R, pp. 7-9.

48. I&E witness Cline proposed an adjustment to increase forfeited discount revenue by $358,000 based on the average ratio of forfeited discounts as a percentage of average past due accounts receivable balances for the three years ended June 30, 2020 and FPFTY distribution revenue. I&E St. 3, pp. 24-25; I&E Ex. No. 3, Sch. 11; I&E St. 3-SR, p. 12.

49. Forfeited discounts have a much stronger relationship with past due accounts receivable than with overall revenues. This analysis properly excludes calendar year 2020 data in light of the effects of the pandemic on forfeited discounts. PECO St. 2-R, pp. 8-9; PECO Ex. RJS-1-R.

50. PECO's pro forma revenues properly reflect a forfeited discount rate in the gross revenue conversion factor that is used to determine the amount of revenue increase required. PECO St. 3-R, p. 21; PECO Ex. MJT-1 Revised, Sch. D-19.

51. PECO's approach to calculate its forfeited discount revenue claim for the FPFTY is reasonable and should be adopted.

V. OPERATING AND MAINTENANCE EXPENSES

52. The Company's pro forma O&M expenses, at present rate levels, for the twelve months ending June 30, 2022 are $466,638,912. PECO Ex. MJT-1 Revised, Sch. A-1.

53. Adjustments to PECO's O&M expense claims were proposed by I&E and the OCA, which are addressed individually below.

A. Payroll and Payroll-Related Costs

54. PECO's payroll claim for the FPFTY is $42,209,000. This figure was developed based upon PECO's authorized and budgeted employee complement for the FPFTY of 639 full-time equivalent ("FTE") positions. Wage rates and salaries were also annualized to reflect the effect of increases to become effective during the FPFTY. *See* PECO St. 3, pp. 34-35; PECO Ex. MJT-1 Revised, Sch. D-6.

55. OCA witness Morgan and I&E witness D.C. Patel each proposed adjustments to reduce PECO's claim for payroll expense. *See* OCA St. 2, pp. 23-25; OCA St. 2-SR, pp. 16-19; OCA Sch. LKM-11; I&E St. 1, pp. 12-15; I&E St. 1-SR, pp. 9-10.

56. The OCA's proposed adjustment to reflect employee complement allowance of 604 positions, which was PECO's actual level of employees as of September 30, 2020, assumes that the Company will not achieve the total net increase of 37 FTE positions forecasted by the end of the FPFTY. That claim is refuted by PECO's actual headcount as of December 31, 2020 (612 FTE employees), as well as evidence that the 37 positions are in the process of hiring and are expected to be filled by the end of the FPFTY. PECO St. 2-R, pp. 11-12.

57. PECO intends and expects to staff its full forecasted employee complement by June 30, 2022 despite impacts from the COVID-19 pandemic that temporarily prevented PECO from hiring all anticipated gas operations personnel (635 positions) by the end of 2020. The primary reason for the lower number of positions in 2020 was the cancellation of PECO's Gas

Mechanics School in March 2020 due to the pandemic, and the training program has already been rescheduled for September 2021. *Id.*

58. Mr. Patel's proposed adjustment improperly applied his calculated vacancy rate to a total of 639 employees, which consists of the 602 actual employees as of the end of the HTY and the 37 employees that PECO will hire over the FTY and the FPFTY. The 602 HTY employees represents the *actual* filled positions as of June 30, 2020 and does not include any budgeted "vacant" positions. PECO St. 2-R, pp. 10-11.

59. If Mr. Patel's proposed vacancy rate were only applied to the 37 employees that PECO will add by the end of the FPFTY, the Company's payroll-related expense claim would be reduced by $46,200 instead of the $858,715 claimed by Mr. Patel. *Id.*

60. The Company's proposal to normalize costs related to the union contract ratification bonus that PECO incurs each time it negotiates new union over the average length of those agreements (i.e., six years) is reasonable and appropriate. PECO St. 3-R, pp. 21-22.

61. Apart from the OCA/I&E concomitant adjustments, no party disputes PECO's claims for employee benefits and payroll taxes or the manner in which they were calculated.

B. Contracting And Materials Expense

62. The Company is seeking recovery of contracting and materials expense of $42,955,000 in the FPFTY. This is an approximately 3.8% increase over the Company's projected FTY contracting and materials expense of $44,651,000. Three initiatives are the principal drivers in the Company's increase in contracting and materials expense in the FTY and FPFTY: (1) PECO is enhancing its mapping system to improve the Company's ability to locate and track gas distribution facilities and the Company is increasing its investment in its gas mapping project in the FTY; (2) the Company anticipates incremental contracting and materials expense related to PECO's planned activities to reduce its non-emergent leak backlog; and

(3) PECO will be required to incur additional security expenses in the FTY for crews working in high-crime areas. Expenses related to these items are anticipated to result in the Company incurring approximately $8 million in incremental spend over prior years, in each of the FTY and the FPFTY. PECO Ex. MJT-1 Revised, Sch. D-4; PECO St. No. 2-R, p. 17-19; Hearing Tr. 252-53.

63. I&E witness Patel recommended reducing the Company's claim for contracting and materials expense by approximately $10 million. Mr. Patel contended that the Company failed to adequately explain the increase in contracting and materials expense from the HTY to the FTY, and he asserted that the Company's FPFTY claim is not reliable and reasonable since the FTY increase is reflected in the FPFTY claim. Mr. Patel recommended that the Commission allow the Company to recover only the three-year historical average of its contracting and materials expense. I&E St. 1, pp. 38-40; I&E St. 1-SR, pp. 32-35.

64. Construction work stoppages in March through June 2020 reduced the need to locate Company facilities, and COVID-related restrictions reduced work levels in the Company's mapping plan and slowed the Company's efforts to repair non-emergent leaks. The Company estimates that these COVID-related impacts reduced its HTY contracting and materials expense by approximately $6 million. This result was an anomaly and not indicative of future levels of the Company's contracting and materials expense. As Mr. Stefani explained at the evidentiary hearing, PECO is already on track with its planned locating and mapping efforts and associated contracting and materials spending in the FTY. In addition, he testified that the Company anticipates that it will be fully caught up on its 2020 construction budget by June 2021 despite temporary delays caused by the pandemic and will meet its FTY and FPFTY budgets for contracting and materials expenses. *See* Hearing Tr. 251-53.

65. It would be unreasonable to utilize a three-year average of the Company's historical contracting and materials expense when the Company's HTY actual expense was a materially lower aberration due to impacts from the COVID-19 pandemic, especially when such impacts have already been mitigated and are not intended to impact the Company's FTY and FPFTY contracting and materials expense.

C. Outside Services

66. PECO is seeking recovery of $22 million in outside services expenses in the FPFTY. This claim is inclusive of PECO's claim related to Exelon Business Services Company ("EBSC) expenses. PECO St. 2, pp. 16-21; PECO St. 2-R, p. 15.

67. I&E witness Patel asserted that the Company did not properly support its proposed increase in outside services expenses from the HTY to the FTY. Mr. Patel argued that because the Company had stated its projected increase in total outside services expenses are generally due to inflation adjustments, the Company had not justified its anticipated increase in outside services expenses from the HTY to the FTY and FPFTY. Mr. Patel acknowledged that the use of inflation factors could be appropriate to determine the Company's projected outside services expenses. In place of the Company's proposal, Mr. Patel recommended adjusting the Company's HTY actual outside services expenses for inflation based on Consumer Price Index ("CPI") factors to determine the allowance for these expenses, resulting in a 2.75% increase from the HTY to the FTY, and a further 2.03% increase from the FTY to the FPFTY. I&E St. 1, pp. 19-22; I&E St. 1-SR, pp. 14-17.

68. The data that Mr. Patel utilized as the basis for his analysis is incorrect. Mr. Patel analyzed only the amount in Federal Energy Regulatory Commission ("FERC") Account 923 set forth on PECO Exhibit MJT-1, Schedule D-4. The approximately $16.5 million figure referenced by Mr. Patel is a result of FERC-based allocations based on the Company's 2019

actual results (since the Company does not budget by FERC account) and represents a combination of EBSC contracting charges allocated to Account 923 and PECO contracting charges allocated to Account 923. Mr. Patel should have utilized the GAAP-based projections set forth in PECO Exhibit RJS-1 and Attachment III-A-22(a), included in the Company's initial filing. RJS-2-R, pp. 16-17.

69. Attachment III-A-22(a) shows that the Company's HTY actual outside services expenses were $21,640,000. The Company projected a slight decrease in FTY outside services expenses to $21,093,000, with a slight increase to $22,135,000 in the FPFTY. This represents an approximately 4.9% increase over the FTY, but only an approximately 2.25% increase over the HTY, and which is also lower than the Company's historical three-year average for outside services expenses. RJS-2-R, pp. 16-17. Applying Mr. Patel's CPI factors to the HTY date set forth in Attachment III-A-22(a) produces a greater FPFTY amount than is being sought by the Company.

70. OCA witness Morgan stated that the Company should not have utilized inflationary adjustments to determine its FPFTY EBSC claim and proposed adjusting only the "Non-Information Technology (IT) Costs" set forth on Attachment III-A-22(a) by utilizing the Company's historical three-year average for such expenses. Mr. Morgan stated that because the EBSC functional areas are managed by Exelon employees, the Company should be able to utilize "proper budget projections" instead of applying an inflation adjustment. This results in a decrease of $997,000 to the Company's FPFTY claim for O&M expenses. OCA St. 2, pp. 36-37; OCA St. 2-SR, pp. 20-22 and OCA Sch. LKM-20.

71. Mr. Morgan, however, only applied an adjustment to the Non-Information Technology (IT) Costs set forth on Attachment III-A-22(a) and ignored the other elements of the

Company's outside services expenses claim, which includes EBSC IT Costs, Non-Utility Charges, and Other Affiliate Charges. If Mr. Morgan had averaged the Company's total outside services expenses over that same period, he would have determined that the Company's three-year average for outside services expenses is $22,258,666, which is slightly higher than the Company's FPFTY claim.

72. The Company's outside services expenses claim is reasonable and should be adopted.

D. Other Post-Employment Benefits

73. The Company provides medical-related benefits to eligible retirees through its parent's other post-employment benefits ("OPEB"), and the Company is claiming OPEB expense of $1,050,000 in the FPFTY. This is a significant increase over prior years' OPEB expenses due to the fact that, prior to 2015, the Company provided eligible retirees a Company-sponsored medical plan with a traditional premium cost-sharing arrangement.

74. In 2014, the Company changed its plan design so that, starting in 2015, PECO began to provide eligible retirees a defined contribution that retirees can use to purchase coverage in the individual Medicare marketplace. As Mr. Stefani explained, the 2014 plan amendments resulted in a re-measurement of the Company's OPEB obligation, which resulted in a prior service credit recorded to other comprehensive income. This credit was then amortized over the average remaining service period of the active plan participants. The Company's independent third-party actuary, Willis Towers Watson, confirmed that the amortization period will expire in June 2021 (i.e., at the end of the FTY). The expiration of the prior service credits will result in a marked increase in the Company's FPFTY OPEB expense. *See* PECO St. 2, pp. 7-8; PECO St. 2-R, pp. 25-28; Hearing Tr. 231-33; PECO Ex. RJS-1RJ (Confidential), p. 15, PECO Ex. RJS-2RJ (Confidential), p. 15, and PECO Ex. RJS-3RJ (Confidential), p. 3.

75. I&E witness Patel asserted that the Company did not properly support its claim that it would experience an increase in its FPFTY OPEB expense due to the expiration of the prior service credit. He recommended allowing the Company to recover its projected FTY OPEB claim of $270,000 for the FPFTY, thereby reducing the Company's OPEB expense claim by $780,000. I&E St. 1, pp. 42-44; I&E St. 1-SR, pp. 37-39.

76. The Company presented extensive testimony explaining how the prior service credit was created following the Company's modification to its retiree benefits plan in 2014, how its amortization over the remaining life of the active plan participants resulted in unusually low OPEB expense in recent years, and that the prior service credit will expire in June 2021, resulting in the increased OPEB expense that the Company is claiming. PECO St. 2-R, pp. 25-28; Hearing Tr. 231-33.

77. Mr. Patel did not support why the Company's FTY OPEB expense claim is reasonable but its FPFTY OPEB expense claim is not.

78. OCA witness Morgan also asserted that the Company failed to support its claim for FPFTY OPEB expense. In his direct testimony, Mr. Morgan recommended an allowance equivalent to the Company's most recent actual three-year average, resulting in a downward adjustment of $1,085,000. OCA St. 2, pp. 26-27; OCA Sch. LKM-13. In his surrebuttal testimony, Mr. Morgan revised his calculation resulting in a recommendation to adjust the Company's claim by $486,000. OCA St. 2-SR, p. 19; OCA Sch. LKM-13.

79. I&E's and OCA's recommendations should be rejected, and the Company's claim should be approved.

E. Cost To Achieve Exelon/PHI Merger

80. The 2016 merger of PECO's parent, Exelon Corporation, with Pepco Holdings, Inc. resulted in significant cost savings to PECO. The merger has already resulted in savings to

PECO and its customers of approximately $4.3 million in the last five years. However, Exelon also incurred certain costs to integrate the merged companies in order to produce the merger savings that the Company and its customers continue to realize (the "costs to achieve" the merger, or "CTA" costs). The Company sought recovery of its allocable portion of the CTA expenses, totaling $1,111,000, over a three-year amortization period. PECO St. 3, pp. 40-41; PECO Ex. MJT-1 Revised, Sch. D-15; PECO St. 2-R, p. 12.

81. Mr. Patel and Mr. Morgan recommended that the Commission disallow the Company's entire CTA claim. Mr. Patel and Mr. Morgan contended that the Company's CTA claim consists of costs incurred prior to the HTY for which the Company did not obtain deferral approval from the Commission, and that approval of recovery in this rate case would constitute improper retroactive ratemaking. Mr. Patel and Mr. Morgan also stated that it would be inappropriate for the Company to recover its CTA when the merger-related savings were realized in prior years and not shared with customers. I&E St. 1, pp. 22-25; I&E St. 1-SR; pp. 18-20; OCA St. 2, pp. 33-36; OCA St. 2-SR, pp. 19-20; OCA Sch. LKM-19.

82. The Commission may permit recovery of prior period unanticipated, extraordinary, and non-recurring expenses without violating the prohibition against retroactive ratemaking.[2] The Company's CTA is a discrete and limited amount. Moreover, it is appropriate to recognize costs in a given accounting period that produce substantial benefits that extend into future accounting periods.

83. The Company's allocated CTA expense was not fully known until after the 2018 CTA was determined. This expense is tied to merger benefits from which PECO's customers are continuing to benefit and which will continue in the future. The merger-related savings are

[2] *See Popowsky v. Pennsylvania Pub. Util. Comm'n*, 695 A.2d 448, 452 (Pa.Cmwlth. 1997).

passed on to customers through reduced costs to Exelon's distribution utilities, including PECO. PECO St. 2-R, p. 14.

84. Mr. Patel also contended that the Company's proposed three-year amortization period is inappropriate. I&E St. 2, p. 24; I&E St. 2-SR, p. 19. A three-year amortization period is reasonable because it corresponds to the period that rates established in this rate case are anticipated to be in effect. *See* PECO St. 3, pp. 36, 40-41; PECO St. 3-R, pp. 22-23.

F. Regulatory Commission Expenses (General Assessments)

85. PECO's FPFTY claim for regulatory commission expense is $2,197,000. This represents an increase of $462,000 over HTY general assessments for the Commission, the OCA and OSBA. PECO St. 2-R, p. 20; *see also* OCA Sch. LKM-22.

86. PECO's actual 2020-2021 (FTY) general assessments were $2,022,423, which is an increase of $288,000 (16.6%) over the HTY level of expense. PECO St. 2-R, p. 20; PECO Ex. RJS-2-R.

87. The OCA's proposed adjustment to reduce regulatory commission expense to the HTY level based on an alleged failure to explain the nature of the FPFTY increase (OCA St. 2, p. 28) is refuted by evidence of actual general assessments for the FTY. Using the actual percentage increase in general assessments for the FTY to set FPFTY rates would result in a 16.6% increase in FPFTY general assessments and a $161,000 increase to the Company's original claim. PECO St. 2-R, p. 20.

G. Research and Development Expenses

88. The Company's FPFTY claim of $280,000 for research and development ("R&D") expense was based upon sound budgeting techniques that reviewed NYSearch R&D programs to enhance safety and productivity in the natural gas distribution industry. PECO's historic R&D expense level for the years ended June 30, 2018 and 2019 was abnormally low

because a significant amount of the Company's R&D budget was redeployed in each of those years to offset higher priority needs to manage gas operating expenses, such as emergent gas leak events. PECO St. 2-R, p. 20.

89. The OCA's proposed adjustment to calculate R&D expense based on a three-year historic average (OCA St. 2, p. 37; OCA Sch. LKM-21) does not reflect PECO's current or likely future R&D expenses and would reduce PECO's claim even lower than PECO's actual HTY expense.

H. Employee Activity Costs

90. PECO's O&M expense claim for the FPFTY includes the costs of certain employee activities totaling $139,402 that provide important benefits in terms of employee morale and productivity. The Company's annual picnic and other special events in which PECO celebrates its workforce, their accomplishments and strategic goals and initiatives for the upcoming year help make PECO an attractive workplace and incentivize high levels of customer service. PECO St. 2-R, p. 21.

91. I&E witness Patel's proposal to disallow PECO's employee picnic and celebrations claim of $80,933 (I&E St. 1, p. 26 and I&E St. 1-SR, pp. 20-22) is contrary to the Commission's prior decision rejecting similar adjustments. The costs challenged by Mr. Patel relate to employee recognition events, which the Commission has found may properly be included in a utility's operating expenses for ratemaking purposes. *See*, *e.g.*, *Pa. P.U.C. v. Citizens' Elec. Co.*, Docket No. R-2019-3008212 (Opinion and Order entered Apr. 27, 2020), p. 75; *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Opinion and Order entered Oct. 25, 2018) ("*UGI Electric 2018*"), pp. 70-71.

92. The OCA's proposed adjustment to reduce PECO's claimed employee activity costs to the HTY expense level (OCA St. 2, p. 40; OCA Sch. LKM-24) is refuted by Mr.

Stefani's testimony that PECO experienced abnormally low spending on employee activities during the HTY because of the Commonwealth's response to the COVID-19 emergency, including stay-at-home orders in effect during the second quarter of 2020, which are unlikely to recur in 2021 and 2022. PECO St. 2-R, p. 22.

I. Travel, Meals and Entertainment

93. The FPFTY budgeted data used by PECO to calculate its travel, meals and entertainment expense claim of $1,032,000 is reasonable.

94. I&E witness Patel proposed to apply inflation factors to PECO's HTY experience to arrive at his allowance of $862,153 for these expenses based solely on his observation that PECO's forecasted level of expenses for the FPFTY reflects a 22.13% increase over its FTY claim. I&E St. 1, pp. 41-42; I&E St. 1-SR, pp. 35-37.

95. Mr. Morgan, in turn, proposed to disallow all but PECO's HTY level of expenses. OCA St. 2, p. 41; OCA Sch. LKM-25.

96. Both witnesses ignore the fact that the HTY data and FTY budgeted data reflect COVID-19 travel restrictions that will be alleviated by the availability of a COVID-19 vaccine and other measures to mitigate the impact of COVID-19 during the FPFTY. *See* PECO St. 2-R, pp. 22-23.

J. Membership Dues

97. The Company claimed membership dues expense of $646,899 in the FTY and $655,897 in the FPFTY. Mr. Patel recommended a reduction of $67,762 in the FPFTY, contending that the Company failed to properly support its claim and recommended that the Commission reduce the Company's claim by applying inflation factors of 2.75% and 2.03% to the Company's HTY membership dues to determine the FTY and FPFTY expenses. I&E St. 1, pp. 27-29; I&E St. 1-R, pp. 22-25.

98. The Company's actual membership dues expense has fluctuated in the prior three years. PECO's actual expense in July 2017 through June 2018 was $586,041, increasing to $689,986 in July 2018 through June 2019 (an approximately 17.5% increase), and decreasing to $561,005 in the HTY (an approximately 18.5% decrease). *See* I&E Ex. No. 1-SR.

99. The Company's historical three-year average for membership dues expense is approximately $612,000. *Id. See also* PECO St. 2-R, p. 23. T

K. Injuries and Damages

100. The Company's FPFTY claim for injuries and damages expense of $638,000 is derived from a third-party actuarial report obtained by the Company. Mr. Morgan proposed to normalize the Company's claim for injuries and damages expense based on the Company's historical three-year average. This would result in a $464,000 downward adjustment. OCA St. 2, p. 30; OCA St. 2-SR, pp. 23-24; OCA Sch. LKM-16.

101. Utilization of a three-year average would be unreasonable since the negative $9,000 injuries and damages expense for the twelve months ended June 30, 2019 was due to an actuarial update to the Company's workers' compensation, bodily injury and property damage reserve for that period. The prior year's actual expense for the twelve months ended June 30, 2018 was $301,000 and the following year's actual expense for the twelve months ended June 30, 2020 was $231,000. The negative 2019 amount is an aberration that unreasonably skews the Company's three-year average downwards. PECO St. 2-R, p. 24.

102. The Company's budgeted amounts for FTY and FPFTY injuries and damages expense, on the other hand, are derived from the independent third-party actuarial reports obtained by the Company, and which were shared with the parties. It would be unreasonable to normalize this expense based on a three-year average when one of those three years was

abnormally low, and the Company expects a marked increase in this expense based upon its third-party actuarial reports.

L. Property Taxes

103. The Company's claim for property tax expense was based on the Company's most recent actual property tax bills from 136 municipalities with an adjustment to apply a 2.5% inflation factor. PECO St. 2-R, pp. 24-25. Mr. Morgan adjusted the Company's claim downwards by eliminating the application of the 2.5% inflation factor. OCA St. 2, pp. 41-42; OCA Sch. LKM-28.

104. It is reasonable to assume that the Company's property tax expense will increase consistent with the inflation adjustment utilized by the Company.

105. In addition, Mr. Morgan's adjustment is incorrect because he applied his adjustment to PECO's entire budgeted amounts for property taxes in the FTY ($3.594 million) and FPFTY ($3.618 million). However, these amounts are comprised of two components: Public Utility Realty Tax ("PURTA") and real estate tax. PECO's budgeted amounts for PURTA do not reflect an inflation rate since they were derived directly from the 2019 Pennsylvania PURTA Notice of Determination. PECO St. 2-R, pp. 24-25; PECO Ex. RJS-3-R. Eliminating the 2.5% inflation factor solely from the real estate tax portion of the Company's claim for property taxes (to which it was applied by the Company) would only reduce the Company's claim by $61,395 instead of the $112,000 reduction proposed by Mr. Morgan.

106. The Company's application of a 2.5% inflation factor was reasonable and consistent with Commission practice, and therefore, Mr. Morgan's adjustment should be rejected.

M. Energy Efficiency and Conservation Program Costs

107. PECO requested $4.5 million in annual funding for its gas energy efficiency and conservation ("EE&C") programs. This funding request would increase the annual budget of the EE&C program and allow PECO to expand program offerings to residential customers and income-eligible customers, pursue innovative pilot projects, and support new marketing and outreach to increase customer participation in the program. *See* PECO St. 9, pp. 6-10; *see also* PECO St. 9-R, pp. 4-6.

108. I&E witness Patel recommended a disallowance of $1,772,500. This disallowance, if granted, would fund the Company's EE&C program at $2,727,500 per year (a 39% decrease from the Company's request). *See* I&E St. 1, p. 34; *see also* I&E St. 1-SR, pp. 27, 32. Mr. Patel stated that while he did not oppose the introduction of new rebate programs, he believed that the Company could accommodate the cost of these programs within his recommended program budget. *See* I&E St. 1, p. 34.

109. OCA witness Geoffrey C. Crandall also recommended the continuation of the EE&C budget from the prior three years with no increase. *See* OCA St. 6, p. 3.

110. PECO acknowledged that past program participation levels did not meet projections, but explained that more targeted marketing efforts and trade ally engagement are planned to increase customer participation and justified the full program funding proposed by PECO. *See* PECO St. 9-R, pp. 3-6.

111. OCA witness Crandall criticized the cost-effectiveness of the Company's proposed EE&C program. *See* OCA St. 6, pp. 4-6, 11-19. In particular, Mr. Crandall identified an error in PECO's analysis of its smart thermostat program. Mr. Crandall stated that correcting this error would cause the smart thermostat program not to be cost effective and would reduce the cost-effectiveness of the overall EE&C program. *See* OCA St. 6, pp. 17-19.

112. PECO performed a revised cost-effectiveness analysis (the "Revised Analysis") to address the error and several additional recommendations made by Mr. Crandall. *See* PECO St. 9-R, pp. 2-3. Under the Revised Analysis, PECO's proposed program was still cost effective, with a total resource cost ("TRC") test value of 1.02. *See* PECO St. 9-R, p. 3.

113. Mr. Crandall agreed with all but one of the changes PECO made in its Revised Analysis. His one disagreement was that PECO included the electricity savings from a high-efficiency gas furnace with an electronically commutated motor ("ECM") fan but did not include the incremental measure cost for the ECM fan in its analysis. *See* OCA St. 6-SR, pp. 4-6.

114. Ms. Masalta explained that the cost of the ECM fan was included in the cost for high-efficiency furnaces in the Revised Analysis, and, therefore, the program remained cost-effective. *See* Hearing Tr. 206-08.

N. Rate Case Expense Normalization

115. PECO has claimed an allowance for rate case expense in the aggregate amount of $1.6 million and is proposing to amortize this amount over a three-year period, resulting in a normalized claim of $520,000 per year. PECO projects that it will need to file another rate case in three years, which formed the basis for the three-year normalization period the Company used in this case. *See* PECO St. 3, p. 36; PECO St. 3-R, p. 22; PECO Ex. MJT-1 Revised, Sch. D-7.

116. I&E and the OCA proposed a five-year normalization period for rate case expense based on an approximate average of the historical interval between the filing of PECO's 2008 and 2010 rate cases (two years) and between its 2010 and current base rate cases (ten years). *See* I&E St. 1, pp. 5-11; I&E St. 1-SR, pp. 6-7; OCA St. 2, pp. 30-31; OCA Sch. LKM-17.

117. With the Company's planned $1.2 billion investment in gas utility plant improvements by June 30, 2024 and even marginal year-over-year increases in O&M expenses,

it is not reasonable to assume, as I&E and the OCA have, that PECO could delay a subsequent base rate filing for five years. PECO St. 3-R, p. 22.

118. I&E's and the OCA's exclusive reliance on historical rate case filing intervals to dictate the normalization period to be used in this case is contrary to the Commission's most recent statement of its policy and practice on this issue. *See PPL 2012*[3], pp. 47-48 (holding that rate case normalization periods should reflect "future expectations"); *UGI Electric 2018*[4], pp. 59-60 (same).

O. Regulatory Initiatives

119. PECO has claimed $47,000 to amortize over a period of three years the O&M and depreciation expenses that the Company incurred to establish a Gas Procurement Charge ("GPC") and Merchant Function Charge ("MFC") pursuant to the Commission-approved settlement of PECO's natural gas unbundling rate proceeding at Docket No. P-2012-2328614 ("Gas Unbundling Settlement"). In its rebuttal case, the Company accepted the OCA's proposed adjustment to regulatory initiative expenses that would eliminate the costs that PECO incurred prior to the HTY in this case to implement its Neighborhood Gas Pilot Program. *See* PECO St. 3, p. 40; PECO St. 3-R, pp. 4, 24; PECO Ex. MJT-1 Revised, Sch. D-14.

120. Paragraph 39 of the Gas Unbundling Settlement expressly authorized PECO to defer costs associated with system changes necessary to establish and implement the GPC and MFC, including information technology ("IT") programming costs, and to seek recovery in the Company's next rate case. In addition to capitalized software costs, PECO incurred $20,570 in

[3] *Pa. P.U.C. v. PPL Elec. Utils. Corp.*, Docket No. R-2012-2290597 (Opinion and Order entered Dec. 28, 2012) ("*PPL 2012*").
[4] *Pa. P.U.C. v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058 (Opinion and Order entered Oct. 25, 2018) ("*UGI Electric 2018*")

operating expenses related to system changes necessary to implement the GPC and MFC, including design, project management and training costs. PECO St. 3-R, pp. 24-25.

121. Mr. Morgan's proposed adjustment that would not recognize those IT-related operating expenses (OCA St. 2, p. 32) is inconsistent with the Gas Unbundling Settlement.

122. I&E's alternative proposed normalization period of five years for regulatory initiative expense should be rejected for the reasons discussed in Section VI.J of PECO's Main Brief.

P. Manufactured Gas Plant Remediation Expense

123. PECO has undertaken positive efforts to remediate former manufactured gas plant ("MGP") sites in its service territory consistent with the standards established by the Pennsylvania Department of Environmental Protection and intends to achieve regulatory closure for 24 of the 26 presently identified MGP sites by the end of 2023. PECO St. 1, pp. 13-14.

124. PECO has claimed $804,000 to amortize the $7.237 million that the Company will not have recovered through current rates for its MGP remediation liability at June 30, 2021 over a period of nine years. PECO St. 3, pp. 39-40; PECO Ex. MJT-1 Revised, Sch. D-13.

125. The OCA proposed an adjustment to increase the period over which MGP remediation expenses are to be amortized for ratemaking purposes from nine years, as the Company proposed, to fourteen years, and recommended that PECO be required to impute carrying costs on $14.3 million of MGP remediation expenses. OCA St. 2, pp. 28-30; OCA Sch. LKM-15.

126. The settlements achieved in PECO's 2008 and 2010 gas base rate proceedings included a cost recovery mechanism for MGP remediation. The 2010 settlement provided that the Company's reset of its MGP remediation expense allowance would be based on a normalized annual level of MGP remediation costs that PECO will incur over the remainder of its

remediation program. In light of the estimated dates of completion for all of the MGP projects, PECO's proposed nine years (i.e., three subsequent base rate cases) is a reasonable amortization period. PECO St. 3-R, pp. 25-26.

127. OCA witness Morgan's contention that PECO has "over-collected" funds for MGP remediation is refuted by evidence that any MGP funds PECO has received from customers have been and will be spent on remediation projects. PECO St. 3-R, p. 26.

128. PECO has agreed to pay interest on the monthly balance of MGP funds that are not yet spent on remediation activities at the residential mortgage lending rate specified by the Secretary of the Pennsylvania Department of Banking and Securities after July 1, 2021, when new rates will take effect. This interest will accrue and be applied to reduce revenue requirements in PECO's next gas base rate proceeding. *See id*.

Q. Depreciation Expense

129. PECO's claim for annual depreciation expense allowance is $86,146,000 (PECO Ex. MJT-1 Revised, Sch. D-1) based on depreciation calculations performance by Ms. Fulginiti.

130. No party has disputed the reasonableness of the Company's proposed depreciation rates.

131. The OCA and I&E have recommended adjustments to depreciation expense. *See* OCA St. 2, p. 41 and OCA Sch. LKM-27; I&E St. 3, pp. 12-14. These adjustments, however, are concomitant to their proposed adjustments to accrued depreciation related to plant additions and, therefore, should be rejected for the reasons discussed in Section IV.B of PECO's Main Brief.

VI. INCOME TAXES

132. The Company's claims for Federal and State income taxes are set forth in PECO Exhibit MJT-1 Revised, Schedule D-18.

133. No party disputes the manner in which the Company calculated its Federal and State income taxes.

134. PECO's Federal and State income taxes change based on changes in revenue and expenses (including deductible interest expense) and return. In addition, income taxes will also change based on changes in tax depreciable property due to changes in the depreciation that is deducted in the tax calculation. For this reason, the OCA's proposal to eliminate PECO's rate base claim for FPFTY plant additions would have the concomitant effect of increasing income taxes. *See* PECO St. 3-R, pp. 7-9; OCA Sch. LKM-31.

VII. RATE OF RETURN

A. Capital Structure

135. The Company's capital structure is 53.38% common equity and 46.62% long-term debt, which represents its projected capital structure as of June 30, 2022, the end of the FPFTY. PECO St. 5, pp. 18-19; PECO Ex. PRM-1 (updated), Schs. 1 and 5.

136. The only party that opposed use of the Company's actual capital structure for computing the rate of return was OCA, which proposed the use of a hypothetical capital structure of 50.00% common equity and 50.00% long-term debt.

137. OCA's proposed capital structure has no relationship to the actual financial risk of the Company. PECO St. 5-R, pp. 5-8.

138. The Company's actual equity ratio of 53.38% falls below the equity ratios of companies with similar financial risk in PECO witness Moul's comparison group, falls below the equity ratios of other companies with similar financial risks in OCA witness O'Donnell's comparison group, and falls below the equity ratios of other companies with similar financial risks in I&E witness' Keller's comparison group. PECO St. 5-R, pp. 6-7; OCA St. 3, p. 40; I&E St. 2, p. 12.

139. Since the Company's actual equity ratio of 53.38% falls below the equity ratios of other companies with similar financial risk, the Company's actual equity ratio is well within the range of reasonableness, and there is no justification for using a capital structure other than the Company's actual capital structure. *Columbia Gas Order* at 116-118.[5]

B. Cost of Long-Term Debt

140. The Company's cost of long-term debt is 3.84% for the FPFTY. PECO Ex. PRM-1 (updated), Sch. 6, pp. 1-3.

141. No party opposes using the Company's 3.84% cost of long-term debt for calculating the rate of return. *See* Main Brief at VIII.C.

C. Common Equity Cost Rate

142. Commission policy recognizes that multiple cost of equity models should be consulted because "[s]ole reliance on one methodology without checking the validity of the results of that methodology with other cost of equity analyses does not always lend itself to responsible ratemaking."[6] The use of more than one cost of equity method provides a superior foundation to arrive at the cost of equity because at any point in time, any single method can provide an incomplete measure of the cost of equity depending upon extraneous factors that may influence market sentiment. PECO St. 5, pp. 6-7.

143. The Company's evidence shows a fair cost of equity under the Discounted Cash Flow ("DCF") Methodology of 13.46%, a cost of equity under the Risk Premium method of 10.00%, a cost of equity under the Capital Asset Pricing Methodology ("CAPM") of 12.67%,

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[5] *Pa. P.U.C. v. Columbia Gas of Pa., Inc.,* Docket No. R-2020-3018835A (Opinion and Order entered Feb. 19, 2021*)* (the "*Columbia Gas Order*")
[6] *2012 PPL Order* at 80.

and a cost of equity under the Comparable Earnings approach of 12.00%. PECO St. 5; PECO St. 5-R; PECO Ex. PRM-1 (updated), Sch. 1, p. 2.

144. The evidence of the cost of equity models demonstrate the fairness of a base cost of equity of 10.70%, which rests between the lower end of the range of the results of the models and the midpoint. PECO St. 5, pp. 7-8. The base cost of equity is conservatively set near the lower end of the results due to the uncertainty associated with the COVID-19 pandemic. PECO St. 5, p. 7.

145. The cost of equity for the Company should consist of the base cost of equity of 10.70%, plus a 25-basis point adder in recognition of the Company's superior management performance, resulting in an overall cost of equity of 10.95%. PECO St. 5, p. 7-8; PECO Ex. PRM-1 (updated), Sch. 1, p. 2.

1. Discounted Cash Flow Methodology

146. To compute the cost of equity with the DCF methodology, the following formula should be applied to a "barometer group" comparable in financial risk to the Company:

Dividend (D_1/P_0) + Growth Rate (g) + Leverage Adjustment = DCF Result (k).

147. The barometer group used in the application of the DCF methodology should be comprised of the following utilities from Value Line: Atmos Energy Corp.; Chesapeake Utilities Corp.; New Jersey Resources Corp.; NiSource Inc.; Northwest Natural Holding Company; ONE Gas, Inc.; South Jersey Industries, Inc.; Southwest Gas Holdings, Inc.; and Spire, Inc. PECO Ex. PRM-1, Sch. 3, p. 2.

148. Although disputed by I&E witness Keller, New Jersey Resources and Southwest Gas Holdings are appropriately included in the barometer group. Mr. Keller excludes these two companies on the grounds that the relative percentage of their revenues from utility operations

are lower than other companies in the barometer group, but this disregards the important fact that both companies' assets are more than 60% devoted to utility operations. PECO St. 5-R, p. 19.

149. The Commission itself uses the same barometer group (including New Jersey Resources and Southwest Gas Holdings) as Mr. Moul when applying the cost of equity models in its most recent Quarterly Earnings Report (Docket No. M-2020-3023406 at Public Meeting held January 14, 2021).

150. UGI Corporation should not be included in the barometer group because it is more diversified outside of the gas distribution business than other comparable companies. UGI Corporation reports financial results for six separate segments consisting of propane sales, two international liquefied petroleum gas businesses, energy services and electric generation, in addition to its natural gas utility business. PECO St. 5, p. 6.

151. The dividend yield to be used in the DCF analysis is 3.79%. PECO Ex. PRM-1 (updated), Sch. 7.

152. The growth rate to be used in the DCF analysis is 7.50%. PECO Ex. PRM-1, Schedule 1, p. 2.

153. I&E witness Keller utilizes a growth rate for the DCF analysis that is unreasonably low because he excludes a Value Line estimate for Northwest Natural Gas, and then retains growth rates from other sources that are much too low (e.g., 1.65% by Yahoo for NiSource; 3.10% by Yahoo, 3.10% by Zacks and 2.80% by Morningstar for Northwest Natural). PECO St. 5-R, pp. 22-23. If corrected, Mr. Keller's growth rate would have been 7.63%. PECO St. 5-R, p. 24.

154. The DCF methodology uses forecasted growth rates, and utilizing historic growth rates, as OCA advocates, is inconsistent with the DCF methodology. PECO St. 5-R, p. 25.

155. The leverage adjustment is 1.96%. PECO St. 5, pp. 35-36; Ex. PRM-1 (updated), Schedule 10.

156. The opposition of OCA and I&E to the leverage adjustment is based upon mischaracterizations of it. Contrary to the assertions by OCA witness O'Donnell, the leverage adjustment is not a "market-to-book" adjustment. PECO St. 5-R, p. 31. I&E witness Keller incorrectly disregards the leverage adjustment because rating agencies use book value, but this is irrelevant because the rating agencies are not tasked with identifying a cost of equity for a regulated company. PECO St. 5-R, pp. 28-29. Although Mr. Keller is correct that the Commission has not accepted the leverage adjustment in a couple of cases, these cases are distinguishable. PECO St. 5-R, p. 30.

2. Capital Asset Pricing Methodology

157. To compute the cost of equity with the CAPM, three components are necessary: (1) a risk-free rate of return ("Rf"); (2) the beta measure of systematic risk ("β"); and (3) the market risk premium ("Rm-Rf") derived from the total return on the market of equities reduced by the risk-free rate of return.

158. The risk-free rate of return (*RF*) for the CAPM is 2.00%. PECO St. 5, pp. 45-46.

159. The beta measure (β) for the CAPM is 1.10. Exhibit PRM-1, Sch. 10; PECO St. 5, pp. 43-44.

160. The market premium for the CAPM is 8.77%. PECO Ex. PRM-1 (updated), Sch. 1, p. 2; *id.*, Sch. 13, p. 2.

161. The CAPM should incorporate a size adjustment of 1.02%, in light of the market capitalization of the barometer group and for purposes of reflecting the inverse relationship between firm size and risk. PECO St. 5, pp. 47-48.

162. The CAPM result is 12.67%.

163. The CAPM analyses of OCA and I&E significantly understate the cost of equity due to several errors: (i) I&E witness Keller's use of the yield on 10-year Treasury notes rather than longer-duration Treasury offerings; PECO St. 5-R, p. 32-33; (ii) OCA witness O'Donnell's consideration of historical geometric means to calculate total market return; PECO St. 5-R, pp. 36-38; (iii) the failure of Messrs. Keller and O'Donnell to use leverage adjusted betas; PECO St. 5, p. 43; and (iv) the failure of Messrs. Keller and O'Donnell to make a size adjustment. PECO St. 5-R, p. 35; PECO St. 5-SR, p. 2. In addition, OCA witness O'Donnell's application of the CAPM is flawed due to its lack of a prospective yield on Treasury bonds and the derivation of a market risk premium that is unreflective of investor-expected returns. PECO St. 5-R, p. 39.

3. Risk Premium Approach

164. Under the Risk Premium approach, the cost of equity capital is determined by corporate bond yields plus a premium to account for the fact that common equity is exposed to greater investment risk than debt capital. PECO St. 5, p. 38. The cost of equity (i.e., "k") is represented by the sum of the prospective yield for long-term public utility debt (i.e., "i"), and the equity risk premium (i.e., "RP"). *Id*.

165. The prospective yield for A-rated public utility bonds to be used in the Risk Premium approach is 3.25%. PECO St. 5, p. 41; Ex. PRM-1 (updated), Schedule 1, p. 2.

166. The equity risk premium to be used in the Risk Premium approach is 6.75%. PECO St. 5, p. 42; Ex. PRM-1 (updated), Sch. 1, p. 2.

167. The Risk Premium approach results in a cost of equity of 10.00%. PECO St. 5, p. 42; PECO St. 5-R, p. 40.

4. Comparable Earnings Method

168. The Comparable Earnings ("CE") method estimates a fair return on equity by comparing returns realized by non-regulated companies to returns that a public utility with similar risk characteristics would need to realize in order to compete for capital. PECO St. 5 at 48.

169. The correct application of the CE Method is to non-regulated companies in order to avoid the circular reasoning implicit in the use of the achieved earnings/book ratios of other regulated firms. PECO St. 5, pp. 49-51.

170. The CE Method results in a cost of equity of 12.00%. PECO St. 5, pp. 49-51; Exhibit PRM-1 (updated), Sch. 1, p. 2.

D. Business Risks and Management Performance

171. The Company has implemented a number of important initiatives and technological improvements focused on safety and reliability, including: (i) actively enhancing its mapping system using modern technology to integrate with our Geographic Information System ("GIS"); (ii) utilization of marker balls, which are buried alongside underground facilities, to provide an accurate, convenient and long-lasting means to identify specific locations on the Company's gas distribution system, including valves, dead ends, leaks, or places where pipe changes directions; (iii) implementation of improved measures to avoid occurrences of incidental cross-boring with another existing utility; and (iv) recent initiation of a natural gas reliability project in Delaware and Montgomery counties to meet the growing needs and demands of the Company's customers. PECO St. 1, pp. 16-18.

172. The Company has undertaken several initiatives to improve its customer service. The Company expanded its communications capabilities so customers can interact with the

Company using mobile devices. The Company deployed a mobile application with features such as slide-to-pay (by credit card and e-check), outage reporting, and the ability to enroll in electronic billing, automatic payments, and budget billing. The Company also added a two-way outage text feature that enables customers to text "OUT" to report an outage and "STAT" to receive an outage status update. *Id*., p. 20. The Company also has plans to further enhance customer service, including plans for: (i) additional customer service representative coaching and training to improve the customer experience and resolve the customer's questions during the first call ("First Call Resolution"); (ii) an operational metric to track First Call Resolution; and (iii) improved web and mobile capabilities to provide customers additional options for self-service. *Id*. at 22.

173. The Company has undertaken positive efforts to eliminate potential environmental concerns at its former MGP sites, with an intention of achieving regulatory closure with the Pennsylvania Department of Environmental Protection for 24 of the 26 presently identified MGP sites by the end of 2023. PECO St. 1, pp. 13-14. Once remediated, the sites may be used for various beneficial land-use purposes that otherwise would not be permitted. *Id*.

174. The PECO customer experience, as measured by J.D. Power, has improved from a score of 726 to 748, resulting in PECO's customer service ranking among comparative utility companies increasing from 7th out of 12 in 2017 to 4th out of 12 in 2019. PECO St. 1, p. 22.

175. PECO has kept annual growth in operation and maintenance expenses since 2010 below 1.9%, or 1.3% if increases in gas mapping and locating expenses are removed, without filing a rate case. PECO St. 2, pp. 5-6; Hearing Tr. 219.

176. In light of this evidence of strong management performance and the Company's commitment to continuous improvement, the Company should receive a 0.25% adder to the base 10.70% cost of equity. PECO St. 5, p. 52; Hearing Tr. 219.

E. Fair Rate of Return

The Company's overall rate of return should be set at 7.64%. *See* PECO St. 5; PECO St. 5-R; PECO Exhibit PRM-1 (updated), Schedule 1. This is calculated by using the Company's capital structure of 53.38% common equity and 46.62% long-term debt, the Company's long-term cost of debt of 3.84% and its return on equity of 10.95%. *Id*.

VIII. CUSTOMER PROGRAMS AND MISCELLANEOUS ISSUES

A. Recommendations Related to the COVID-19 Emergency

177. Since March 2020, PECO has offered all residential customers the opportunity to enter into a twenty-four–month payment agreement. The Company has utilized multiple strategies to inform customers about this special payment agreement and facilitated enrollment through automated processes. *See* PECO St. 10-R, p. 3.

178. With respect to its universal service programs, on December 17, 2020, the Commission approved PECO's proposal to temporarily modify the eligibility requirements for the Company's hardship fund (the "Matching Energy Assistance Fund" or "MEAF") to expand the number of customers who may qualify for assistance. *Petition of PECO Energy Company (PECO) to temporarily amend its current 2016-2018 Universal Service and Energy Conservation Plan (2016 USECP)*, Docket Nos. P-2020-3022124 and M-2015-2507139 (Secretarial Letter issued Dec. 17, 2020); *see also* PECO St. 10-R, p. 3.

179. The Company also filed a COVID-19 relief proposal on June 26, 2020, that included a bill credit for CAP customers, temporary waivers of certain requirements for CAP

enrollment and recertification, and a transfer of unspent Low-Income Usage Reduction Program ("LIURP") funds to a summer cooling initiative. The relief proposal remains pending before the Commission. *Petition of PECO Energy Company for Public Meeting August 6, 2020 Expedited Approval of Temporary Universal Service Measures To Address COVID-19 Related Economic Hardship And Provide Additional Opportunities For Electric Usage Reduction*, Docket No. P-2020-3020555; *see also* PECO St. 10-R, pp. 3-4.

180. In accordance with Commission orders at Docket No. M-2020-3019244, the Company implemented a variety of COVID-19 relief measures, including a moratorium on termination of service and waiver of connection fees and deposits for reconnection of service. *See* PECO St. 10-R, p. 4.

181. OCA witness Roger D. Colton recommended an Emergency COVID-19 Relief Program for residential customers who are in arrears, are not eligible for or participating in CAP, and provide proof of unemployment benefits or receipt of the first federal COVID-19 relief check. The Relief Program would have four primary benefits: (1) access to a long-term payment arrangement; (2) screening for CAP and MEAF eligibility; (3) suspension of collection efforts; and (4) a one-time bill credit of up to $400. *See* Schedule RDC-1; OCA St. 5, p. 27.

182. Mr. Colton's recommendation is not necessary or appropriate in light of the Company's existing COVID-19 response and the Commission's continuing direction on collections matters during the pandemic. The Company is already providing all residential customers with access to a payment agreement with a term up to twenty-four months and any residential customer that identifies a financial difficulty is provided with information about PECO's universal service programs. As to collections activity, it is appropriate to continue to act consistently with the Commission's directives at Docket No. M-2020-3019244, which the

Commission issued after extensive consideration of the views of many stakeholders. *See* PECO St. 10-R, p. 5.

B. Universal Service Programs

183. PECO's proposed 2019-2024 Universal Service and Energy Conservation Plan ("2019-2024 USECP") is pending before the Commission at Docket No. M-2018-3005795. The 2019-2024 USECP contains the Company's proposed universal service program terms, budgets and customer outreach and educations plans.

184. The 2019-2024 USECP changes the format of PECO's Customer Assistance Program ("CAP") from a Fixed Credit Option ("FCO") to a Percentage of Income Payment Plan ("PIPP"). Under the PIPP, a CAP customer would receive a bill credit based upon his or her annual income and the applicable energy burden ("EB") percentage. PECO has proposed to adopt recommended EBs from the Revised CAP Policy Statement (Docket No. M-2019-3012599) for customers at 0-50% and 51%-100% of the federal poverty level ("FPL") and maintain PECO's existing EBs for customers at 101%-150% of the FPL. The PIPP also incorporates reduced minimum bill amounts and new customer notifications if a customer approaches maximum credit amounts. *See* PECO St. 10-R, p. 8; *see also* Docket No. P-2020-3020727.

185. PECO expects the PIPP to improve bill affordability for all CAP income groups as compared to the current FCO. Subject to minimum bill and maximum credit amounts, a CAP customer's credit would increase under the PIPP to ensure the customer continued to pay no more than the applicable EB. Given the time that will be required to transition to a PIPP, PECO has also sought Commission approval to utilize the recommended EBs from the Revised CAP Policy Statement as part of the FCO until the Company transitions from the FCO to its PIPP. *See* PECO St. 10-R, pp. 8-9; *see also* Docket No. P-2020-3022154.

186. OCA witness Colton and CAUSE-PA witness Miller expressed concern that the percentage of low-income customers enrolled in CAP is too low. *See* OCA St. 5, pp. 33-36; CAUSE-PA St. 1, pp. 22-23.

187. Ms. Colarelli explained that PECO's CAP participation rate, as defined by the Commission, is 77.5% and the highest of any Pennsylvania natural gas distribution company ("NGDC"). *See* PECO St. 10-R, pp. 5-6; PECO Ex. KC-1-R. In addition, the Company has proposed an expanded outreach and education program for gas and electric customers as part of its 2019-2024 USECP. *See* PECO St. 10-R, p. 10.

188. Proposed changes to PECO's universal service programs should be considered in the 2019-2024 USECP proceeding and not in a base rate proceeding. All parties would benefit from having a complete view of the Company's universal service proposals, including all program-specific details and budgets. *See* PECO St. 10-R, pp. 9-11.

189. Mr. Miller recommended the following changes to PECO's CAP: (1) adopt the EBs in the Revised CAP Policy Statement; (2) adjust the credit under the FCO to immediately account for any base rate increase; (3) develop a plan to increase CAP enrollment by 50% by 2025; (4) move arrears from CAP customers into pre-program arrearage forgiveness; (5) waive all late fees and reconnection fees; and (6) waive income certification requirements until the pandemic is over. *See* CAUSE-PA St. 1, pp. 30-34, 39-41.

190. PECO has already made specific EB proposals for both the remaining period of the FCO and the PIPP in the 2019-2024 USECP proceeding. *See* PECO St. 10-R, pp. 9-10. Consistent with the Commission's recent findings in the *Columbia Gas Order*, EB and CAP credit calculation issues should not be considered separately from other parts of the Company's universal service programs. *Columbia Gas Order*, p. 160 (finding that a utility's EB levels

"should not be considered separately from other parts of [the utility's] CAP and universal service programs but should be considered as part of [the utility's] entire universal service plan, including the need for changes and associated costs").

191. PECO's 2019-2024 USECP proceeding already includes the Company's proposal for an expanded outreach and education program. Enrollment plans, along with other CAP issues such as arrearage forgiveness, are better suited for the 2019-2024 USECP proceeding than a gas base rate proceeding. Notably, PECO's gas-only CAP population (300 customers) is a very small part of its total gas and electric CAP population (114,000). *See* PECO St. 10-R, p. 10.

192. PECO is already waiving late fees and reconnection fees in accordance with Commission Orders at Docket No. M-2020-3019244, the Company no longer assesses late fees to CAP customers in accordance with the Revised CAP Policy Statement, and PECO's proposal to temporarily waive written income documentation requirements remains pending before the Commission. *See* PECO St. 10-R, pp. 9-10.

193. As Mr. Miller acknowledges, the Company explained in detail how the FCO credit would be adjusted on a quarterly basis in response to a base rate increase. *See* CAUSE-PA St. 1, pp. 23-24.

194. Mr. Miller also states, however, that he was "advised by counsel" that a more immediate reflection of a base rate increase into the FCO credit is "consistent with the terms of a March 2015 Settlement agreement establishing PECO's CAP FCO." *Id.* at 34. The issue of how and when to reflect a base rate increase into the FCO credit is the subject of detailed testimony in Docket No. C-2020-3021557 and is pending before Administrative Law Judge Mary D. Long.

195. Mr. Miller recommended the following changes to LIURP: (1) increase the budget by $2 million for an annual budget of $4,250,000; (2) establish a per-job $2,000 health

and safety budget to remediate health and safety issues that prevent LIURP services; (3) make the Company's heating pilot program a permanent part of the LIURP at the current annual funding level of $700,000; (4) adopt a lower high-usage threshold for multifamily units; and (5) adopt a policy of rolling over any unspent LIURP funds to the next year. *See* CAUSE-PA St. 1, pp. 34-37.

196. Ms. Colarelli explained that PECO's LIURP proposals, including overall program funding, spending limitations and high-usage thresholds are all pending before the Commission at Docket No. M-2018-3005795. In addition, almost doubling the budget, as Mr. Miller proposes, is unrealistic and would not change the size of PECO's eligible customer pool. Finally, any decision about making the *electric* heating pilot permanent is premature without final data, and, in any event, should not be made in a *gas* base rate proceeding. *See* PECO St. 10-R, p. 11. The Company's position is consistent with the *Columbia Gas Order*, where the Commission adopted the presiding ALJ's finding that funding for Columbia's health and safety pilot should not be changed until the effectiveness of the program can be evaluated. *Columbia Gas Order*, p. 174.

197. Mr. Miller recommended that PECO waive the MEAF requirement that grant recipients achieve a zero balance, provide grant recipients with a payment arrangement for any remaining balance, and utilize pipeline refunds to increase MEAF funding by $2 million. *See* CAUSE-PA St. 1, pp. 38-39.

198. PECO has already implemented several temporary modifications to MEAF requirements to expand the number of customers who may qualify for assistance. PECO St. 10-R, p. 3.

199. The MEAF zero-balance requirement should not be waived because MEAF is not intended to be a supplemental grant program but rather a means to address collections risk by achieving a zero balance. *See* PECO St. 10-R, pp. 11-12.

200. PECO's current MEAF budget is appropriate and should not be supplemented with diverted pipeline refunds. Those refunds are currently applied to reduce the Purchased Gas Cost ("PGC") and, therefore, the diversion proposed by Mr. Miller would increase the PGC paid by non-shopping PECO customers, including residential customers. *See* PECO St. 10-R, p. 12.

C. Neighborhood Gas Pilot Rider

201. PECO is proposing to extend the Neighborhood Gas Pilot Rider ("NGPR") for five years beginning July 1, 2021, and to increase the annual NGPR cost to $7.5 million. The Company is also proposing to modify the NGPR in two ways. First, the Company will provide the first forty feet of gas main extension to each prospective residential natural gas customer at no cost, subject to unanticipated ground conditions or unusual permit requirements. Second, the Company will modify the calculation of the contribution in aid of construction ("CIAC") by assuming that 66% of prospective customers would take service during the first year of the extension. This differs from the current program where the Company assumes that 66% of prospective customers will join over twenty years. *See* PECO St. 9, pp. 10-14; *see also* PECO St. 8, p. 13.

202. I&E witness Keller agreed with the Company's proposal to provide forty feet of main extension per contracted customer at no cost with certain limitations for abnormal underground conditions or unusual permit requirements. *See* I&E St. 2, pp. 49-50. Mr. Keller also recommended that the CIAC calculation remain the same, i.e., assume 66% of customers join over twenty years instead of in year one. Mr. Keller based his objection to changing the CIAC calculation on the fact that the Company had spent just $15 million of its $25 million

spending limit during the first five years of the NGPR, and because COVID-19 may impact customer willingness to pay for natural gas service. *See* I&E St. 2, pp. 50-51. For these reasons, Mr. Keller also recommended that the cost of the NGPR remain at $5 million per year. *See* I&E St. 2, p. 50.

203. In the first five years of the NGPR, 44% of potential customers have signed contracts to take service. The rapid uptake of natural gas service by potential customers shows that the current CIAC assumption should be revised. *See* PECO St. 9-R, p. 11.

204. The Company continued to see strong interest in the NGPR in 2020 despite the impacts of the COVID-19 pandemic. Based on customer interest in the NGPR, the Company expects installed projects to increase by twenty-five neighborhoods per year under the revised program. This projected growth would require the full $7.5 million budget requested by the Company in this case. *See* PECO St. 9-R, pp. 11-12.

D. Energy Efficiency And Conservation Programs

205. PECO requested $4.5 million in annual funding for its EE&C program. Ms. Masalta explained that the funding was necessary to expand program offerings for both residential and low-income customers, fund pilot projects for emerging technologies, and use targeted marketing and customer outreach to increase customer participation in the program. *See* PECO St. 9, pp. 6-8; *see also* PECO St. 9-R, pp. 4-6.

206. For the residential customers, the Company proposed three new offerings: an ENERGY STAR®+ furnace rebate, rebates for faucet aerators and showerheads, and a smart thermostat rebate. The Company also proposed doubling the existing rebate for ENERGY STAR® storage hot water heaters. *See* PECO St. 9, pp. 6-7.

207. I&E witness Patel did not oppose "[the] introduction of new rebate programs," *See* I&E St. 1, p. 34. OCA witness Mr. Crandall fully supported the proposed low-flow aerator

and showerhead programs at PECO's requested budget level. *See* OCA St. 6, p. 33. Mr. Crandall also supported PECO's ENERGY STAR® furnace and smart thermostat rebate programs, but with a reduced budget. *See* OCA St. 6, pp. 31-33. Mr. Crandall opposed the residential boiler and storage hot water heater programs and claimed that these individual measures fail the TRC test for cost-effectiveness. *See* OCA St. 6, pp. 31-32.

208. For low-income customers, the Company proposed a new Safe and Efficient Heating Program. This program would serve low-income customers who are not currently eligible for a LIURP heating audit. The program would include a site visit and unit inspection, provide information on unit maintenance along with extra filters, and install a carbon monoxide detector. PECO would also replace a limited number of furnaces and boilers as part of this program. *See* PECO St. 9, pp. 7-8. Mr. Crandall fully supported this program at PECO's requested budget of $1,000,000 per year. *See* OCA St. 6, pp. 33-34. Mr. Patel stated that he did not oppose new programs but did not address this program specifically. *See* I&E St. 1, p. 34.

209. The Company's requested allowance also included funds for pilot projects to pursue emerging technologies that would reduce gas consumption, improve safety, or both. *See* PECO St. 9, p. 8. Although Mr. Crandall recognized that pilot programs are "potentially useful," he recommended not funding this program. *See* OCA St. 6, p. 34. Mr. Patel did not oppose this or any new program. *See* I&E St. 1, p. 34.

210. Messrs. Patel and Crandall both argued that the Company's requested increase was not needed because past program participation did not meet expectations and the Company only spent 74% of its annual collection. *See* I&E St. 1, pp. 34-36; I&E St. 1-SR, 29-30; OCA St. 6, pp. 27-29; OCA St. 6-SR, pp. 12-14.

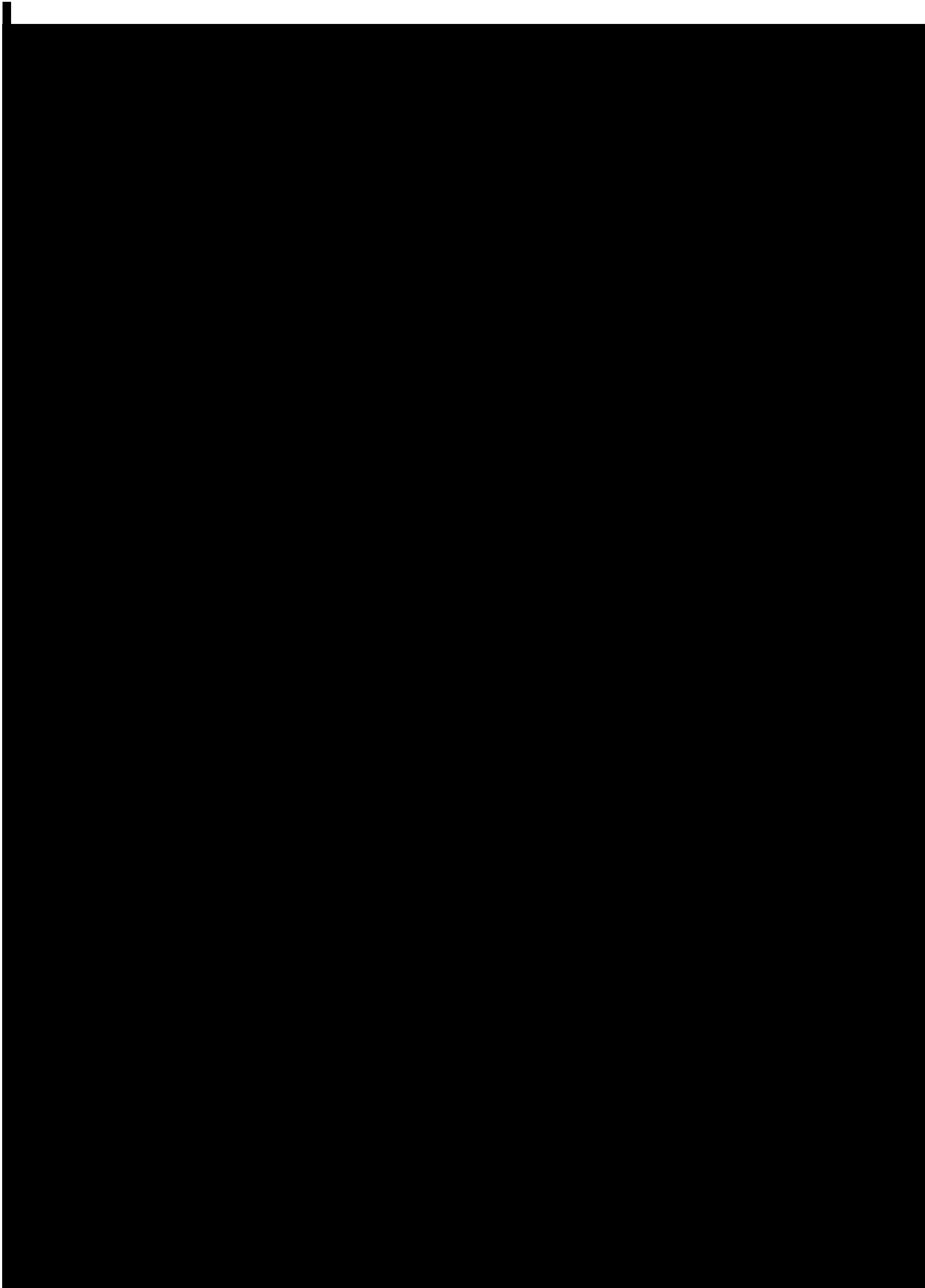
211. Ms. Masalta explained that the Company's proposed budget will support expanded program offerings to encourage customer participation by giving them more ways to participate and includes funding for targeted marketing campaigns that, while more expensive, the Company believes will increase customer participation. *See* PECO St. 9, pp. 6-9; PECO St. 9-R, pp. 4-7. The Company's EE&C program is also cost-effective at the portfolio level, with a TRC of 1.02. *See* PECO St. 9-R, p. 4. Finally, if less than $4.5 million is spent, the unspent funds will be returned to customers. *See* PECO St. 9, p. 10.

E. Distribution Integrity Management Program

212. PECO ensures the safe and reliable operation of its distribution system by meeting or exceeding federal and state operational requirements. PECO's Distribution Integrity Management Program ("DIMP") is used to identify and resolve risks to the distribution system, in accordance with the Pipeline and Hazardous Materials Safety Administration's ("PHMSA's") integrity management requirements under 49 C.F.R. Part 192. PECO's DIMP focuses on the following seven areas: (1) System Knowledge; (2) Threat Identification; (3) Risk Evaluation and Ranking; (4) Identification and Implementation of Measures to Address Risks; (5) Performance Measurements, Results Monitoring and Evaluation of Effectiveness; (6) Periodic Evaluation and Improvement; and (7) Reporting Results. The Company monitors its compliance with each prescribed element of the DIMP plan in order to evaluate PECO's performance in meeting the applicable standards and to reassess threat levels and mitigation measures in light of new information and evolving conditions on the Company's system. Additionally, the Company regularly reviews and assesses the many factors affecting its distribution system to identify risk and determine the best mitigation strategy. PECO St. 1, pp. 14-15.

213. PECO evaluates and mitigates risk across multiple categories under the DIMP. PECO calculates scores for those categories and creates a ranking to measure the performance of

one group of assets compared to another. The ranking produced under the DIMP provides a relative indication of severity of risk among the other risk categories. PECO St. 1-R, p. 5. The DIMP identified the following top ten risks to its gas distribution system: ***** BEGIN CONFIDENTIAL*****



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IX. RATE STRUCTURE

A. Cost of Service

1. Class Cost-of-Service Study

222. PECO witness Ms. Jiang Ding prepared a class cost of service study ("COSS") for the Company to use as a guide in allocating its proposed revenue increase among its customer classes. PECO's COSS relies on allocation methods that reflect the distribution system, which is designed to meet the following three primary objectives: (1) To extend distribution service to all customers; (2) To meet the aggregate design peak-day capacity requirements of all customers entitled to receive service on the design peak day; and (3) To deliver the total volume of natural gas needed to meet customers usage requirements. PECO St. 6, p. 6.

223. After the Company submitted its supporting data in this case, it uncovered a formula error in the model used to develop its COSS. PECO prepared a revised and corrected COSS that it provided to all parties in its responses to the OSBA's Interrogatories (Set I) Nos. 1 and 2, which was also submitted by Ms. Ding as PECO Exhibit JD-7R accompanying her Rebuttal Testimony.

224. Cost-of-service analysis consists of three principal steps: functionalization, classification and allocation. Ms. Ding summarized the manner in which each major category of plant investment and each major category of operating costs were functionalized, classified and allocated. PECO St. 6, pp. 12-23. The largest component of PECO's plant investment and associated fixed costs consists of mains. PECO Exhibit JD-6R. The costs of the Company's mains are part of its distribution function and were classified as capacity-related. PECO St. 6, p. 13.

225. Approximately 1% of the cost of the Company's mains was directly assigned, while the balance of the cost of mains was allocated using the Average and Excess Demand ("A&E") method as described in the treatise *Gas Rate Fundamentals* published by the American Gas Association (1987 edition). PECO St. 6, p. 13. This is the same method PECO used in its last gas base rate case at Docket No. R-2010-2161592. Under the A&E method, the portion of the cost of mains equal to the system average load factor is allocated among the rate classes based on their average daily deliveries (annual deliveries divided by 365 days). PECO St. 6-R, p. 6. The balance of mains costs is allocated based on excess demand, which is the amount by which the design peak demand exceeds average demand for each class. The excess demand is allocated among rate classes in proportion to each class' peak demand over its average demand. PECO St. 6, pp. 12-14. PECO accounted for the average and excess demand components in its

COSS based on PECO's system load factor, which assigns average demand a weight of 25.23% and excess demand a weight of 74.77%. PECO St. 6-R, p. 6.

226. OSBA witness Robert D. Knecht generally agrees with PECO's COSS methodology. However, Mr. Knecht objects to recognizing any average demand in the allocation of mains. Even so, Mr. Knecht proposed weighting the average and excess demand equally. Mr. Knecht maintains that such weighting is required by Commission precedent. OSBA St. 1, p. 24.

227. Mr. Knecht is incorrect. Commission precedent does not proscribe PECO's use of system load-factor weighting. Moreover, PECO's COSS approach (which reduces the weighting of average demand below 50%, but not all the way to zero as Mr. Knecht would prefer) is actually closer to the allocation methodology for which Mr. Knecht advocates.

228. OCA witness Glenn A. Watkins opposed PECO's use of the A&E method to allocate the cost of mains, advocating instead the Peak and Average Demand method ("P&A"), which allocates mains costs based in part on average demand and in part on each class' total peak demand. OCA St. 4, 9-10, 21-23. Mr. Watkins claimed PECO's application of the A&E method departed from the rules established by *Gas Rate Fundamentals* because no "excess" demand was allocated to interruptible rate classes. OCA St. 4, p. 18.

229. Mr. Watkins is incorrect. First, the P&A method creates a bias in favor of low-load customers that contribute greatly to peak demand. The P&A method double-counts average demand – once in the "average" demand component and a second time as part of the composition of total peak demand (which includes average demand). PECO St. 6-R, p. 7; PAIEUG St. 1-R, p. 8. Second, Mr. Watkins' conclusions also contradict the Commission's acceptance of the

A&E method in *Pa. P.U.C. v. PPL Gas Util. Corp.* and *Pa. P.U.C. v. Phila. Gas Works*.[7] Third, *Gas Rate Fundamentals* provides for discretion in determining how much excess demand costs should be allocated to interruptible customers. As Ms. Ding explained, PECO designs and sizes its capacity to reflect design peak day conditions that assume – correctly – that interruptible customers will not be contributing to peak demand at the time of the design day peak. PECO St. 6-R, pp. 8, 24-25.

2. Forfeited Discounts/Non-Base Rate Revenues and Storage Plant

230. Mr. Watkins alleged that Ms. Ding did not "appropriately reflect non-base rate revenues nor the additional forfeited discount revenues that will be generated as a result of the Company's proposed overall increase." OCA St. 4, p. 20.

231. Mr. Watkins is incorrect and has misinterpreted the data presented in PECO's exhibits developing its base rate revenue requirement. Mr. Watkins erroneously concluded that PECO had not properly reflected forfeited discount revenue and non-base rate revenue in calculating its proposed increases. PECO properly credited all of those amounts in developing its proposed increase. PECO St. 6-R, pp. 12-14. Mr. Watkins also failed to respond in his surrebuttal testimony to Ms. Ding's explanation that $1,528,000 of what Mr. Watkins refers to as "non-base rate revenue" and the Company identified as "Other Operating Revenue" has been properly reflected in the development of the Company's proposed increase.

232. Mr. Watkins also claimed that PECO's allocation of the cost of gas storage plant should be allocated based on the storage allocator Ms. Ding used to assign natural gas storage expenses in PECO Ex. JD-6. OCA St. 4, p. 22.

[7] *Pa. P.U.C. v. Columbia Gas of Pa., Inc.*, R-2020-3018835A (Recommended Decision issued Dec. 4, 2020), p. 12.

233. Mr. Watkin's alternative allocation is incorrect because storage plant is used to meet design peak day and short-term needs of firm sales customers. PECO St. 6-R, p. 12. Using the allocator Mr. Watkins proposes would improperly assign storage costs to interruptible customers under rate classes such as Rate TS-I. Notably, all transportation customers already incur additional costs if they do not balance deliveries within 10% of their daily usage as provided in PECO's Retail Gas Tariff. *Id*. at 12.[8]

3. Rate Design

234. OSBA witness Mr. Knecht expressed concerns over (i) Rate GR and GC Design Day Peak Demand; (ii) Rate L and Rate TS-F; (iii) Rate TS-F Design Day Demand; (iv) Rates TS-F and TS-I Annual Volumes Rate Differential; and (v) Interruptible Rate Classes – MV-I, IS and TCS.

235. Mr. Knecht perceived a deficiency in PECO's analysis of class-specific demands. Mr. Knecht believes that the design day load factors for Rate GR and Rage GC customers are identical and therefore proposed "design day demand load factors using a statistical analysis of monthly class loads and heating degree days" which he then "applied design day conditions to the statistical analysis." OSBA St. 1, p. 28.

236. Mr. Knecht's alternative analysis is incorrect because PECO performed a reasonable analysis of the various rate classes as the basis for segregating "small firm" design-day demand among its firm service classes. PECO St. 6-R, p. 19. Mr. Knecht's argument should therefore be disregarded.

237. Mr. Knecht expressed two concerns relating to Rates L and TS-F and their relationship to each other. First, Mr. Knecht alleged that PECO had not include design day

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[8] *See also* PECO Energy Company Gas Service Tariff, Sixth Revised Page No. 67, section 2.4.

demands for "pure" Rate L customers (i.e., those that do not use Rate L for Standby Sales Service). Second, Mr. Knecht takes issue with the long-standing Commission-approved relationship between Rate L and Rate TS-F for transportation customers served on Rate TS-F that voluntarily elect to obtain Standby Sales Service from PECO. OSBA St. 1, pp. 26-27.

238. Mr. Knecht's proposal blurs the distinction between sales service and transportation service. Moreover, customers have expressed their preference to continue the existing relationship between Rate L as Standby Sales Service and Rate TS-F transportation service by electing to receive Standby Sales Service. PECO St. 6-R, pp. 21-22. Mr. Knecht's recommendation should, therefore, be rejected.

239. Mr. Knecht claims that the Company obtained the design day demand of 68,000 mcf/day for Rate TS-F from its Purchased Gas Cost filing and noted that it does not appear the Company adjusted that figure to remove demands related to customers served by directly-assigned meters, as it did for the Rate TS-F total through-out volumes. The Company agreed that the design day demand should have been reduced by demand relating to one customer served with directly-assigned meters and made that change in the revised COSS submitted with Ms. Ding's Rebuttal Testimony.

240. Mr. Knecht argued that the Rates TS-F and TS-I have an unacceptably large differential in the volumetric charges for customers above and below annual volumes of 18 mmcf. Mr. Knecht recommended creating separate "large" (over 18 mmcf per month) and "small" (18 mmcf and under per month) rate schedules for customer currently on Rates TS-F and TS-I. This would produce separate rate classes that would have to be separately analyzed as such in PECO's COSS. Alternatively, Mr. Knecht recommended narrowing the differential in

the volumetric charges for usage above and below the 18,000 mmcf per month breakpoint reflected in the existing Rate Schedule TS-F and TS-I.

241. PECO accepted Mr. Knecht's recommendation to narrow the differential in the volumetric charges for usage above 18,000 mmcf and 18,000 mmcf and below and reflected those changes in the rate design for Rates TS-F and TS-I proposed in the Rebuttal Testimony of PECO witness Bisti. PECO St. 7-R, pp. 15-16; PECO Ex. JAB-4 Revised (Corrected).

242. Mr. Knecht's proposal to create separate rate classification for customers with usage above and below 18,000 mmcf per month is misguided because other factors, beyond usage alone, should be considered in establishing separate rate classifications. PECO St. 6-R, pp. 23-24. Therefore, Mr. Knecht's separate, usage-based classification should be rejected.

243. Mr. Knecht argues that customers served under interruptible Rates MV-I, IS and TCS do not offer any material distribution service benefits. Mr. Knecht therefore assigned design day demands, and associated demand costs, to the MV-I, IS, and TCS rate classes, in his alternative cost-of-service study.

244. Mr. Knecht's proposal for the MV-I, IS, and TCS rates classes should be rejected. Assigning peak day demands to these classes imposes costs on these customers for a level of service they will not receive and do not expect to receive and is inconsistent with cost causation principles.

B. Revenue Allocation

245. PECO's proposed rates are designed to fairly allocate the Company's requested increase among its customer classes and make reasonable progress in moving all classes closer to their cost of service consistent with well-accepted ratemaking principles.

C. Allocation of Universal Service Program Costs

246. Universal service costs are currently allocated to the residential customer class, and PECO did not propose any change to the allocation of such costs in this proceeding. *See* PECO Exhibit JAB-2.

247. Both OCA witness Colton and CAUSE-PA witness Miller recommended that the Company allocate universal service costs to all customer classes (*see, e.g.,* OCA St. 5, pp. 56-90; CAUSE-PA St. 1, pp. 48-54), while OSBA witness Knecht and PAIEUG witness LaConte opposed that recommendation, *see* OSBA St. 1-R, pp. 21-30; PAIEUG St. 1-R, pp. 10-13.

248. PECO believes this gas distribution base rate case is not the appropriate place to consider broad universal service cost allocation proposals, particularly when PECO's gas-only CAP population is an exceedingly small part of its total CAP population. *See* PECO St. 10-R, p. 12.

249. In *Columbia Gas*, the Commission recently rejected proposals to reallocate universal service costs to non-residential gas customers. *See Columbia Gas Order*, pp. 258-261.

250. The Company does not support a change in universal service cost allocation as part of this proceeding but, as Ms. Colarelli explained, intends to address the allocation of universal service costs in its next electric base rate proceeding. *See* PECO St. 10-R, p. 12.

D. Tariff Structure and Rate Design

1. Residential Customer Charge

251. The Company's current residential customer charge is $11.75 per month and has been in place since rates went into effect following the Company's 2010 gas base rate case. This is the lowest residential customer charge among all of Pennsylvania's major gas distribution companies and is far below the residential customer-related costs identified in the Company's COSS prepared in connection with this rate case (i.e., $30.26 per month). The Company

proposed to increase the residential customer charge to $16.00 per month. PECO St. 7, pp. 12-14; PECO St. 7-R, p. 6; *see also* PECO Ex. JD-4R, p. 4.

252. The Company's customer charges are intended to recover costs that can be identified and allocated by customer class, subject to consideration of the principle of gradualism. Customer-classified costs are costs that vary based on the number of customers and not usage. Recovering customer costs through variable distribution charges can have adverse consequences, such as creating inappropriate intra-class subsidies or resulting in the Company under- or over-recovering due to variations in customer usage. PECO St. 7, pp. 13-14.

253. The Company's proposed $16.00 residential customer charge would still fall within the range of the residential customer charges of the other major gas distribution companies in Pennsylvania and remains below the residential customer-classified costs identified in the Company's COSS. *Id.*

254. The OCA opposes any increase in the Company's fixed customer charge for residential gas customers. In the alternative, if the Commission does grant a rate increase, the OCA recommended that, the residential charge increase should be limited to $13.00. In support of these recommendations, OCA witnesses Watkins and Colton claimed that PECO's proposed increase to the customer charge violates the principle of gradualism, is contrary to the goal of promoting energy conservation, and would disproportionately impact low-income customers, particularly because the Company's CAP and federal assistance ("LIHEAP") will not sufficiently mitigate the impacts of the increase. OCA St. 4, pp. 30-31; OCA St. 5, pp. 29-32, 55; OCA St. 5-SR, pp. 4-6.

255. As the Commission recently noted in its decision in *Columbia Gas*, "the continued use of traditional ratemaking methodologies during this pandemic is consistent with

the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards . . ."[9]

256. Traditional ratemaking methodology dictates that a utility should be permitted to recover fixed customer class-related charges through fixed customer charges. While Mr. Watkins maintains that the Company's residential customer charge should be capped at $13.00, an approximately 10% increase, OCA has not provided any evidentiary support as to why a $13.00/10% cap is appropriate.

257. The Company's proposed residential customer charge should not constitute "rate shock," as it still falls below the residential class' customer-related costs, and would be within a reasonable range of the residential customer charges of other major Pennsylvania gas utilities.

258. Mr. Watkins also failed to properly support his contention that increasing the Company's customer charge is contrary to energy conservation.

259. Denying PECO the ability to move its residential customer charge closer to the residential class-related customer costs identified in the COSS would be unreasonable.

260. The Company's proposal to increase the residential customer charge will provide a relative benefit to high-use, low-income customers by lessening the impact of the overall rate increase.

261. CAUSE-PA witness Miller also recommended that the Commission deny the Company's proposed increase to its residential customer charge. Mr. Miller disagreed that the Company's proposed customer charge would be within the range of charges of other natural gas distribution companies since the Company would be imposing the increase in one rate case. In

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[9] *Pa. P.U.C. v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-202003018835 (Opinion and Order entered Feb. 19, 2021), p. 42.

support, he incorrectly claimed that Columbia Gas increased its residential customer charge over a series of rate cases over a series of rate cases between 2010 and 2018. CAUSE-PA St. 1-SR, p. 2. Mr. Miller also stated that the increase would undermine the Company's LIURP since a higher fixed fee would reduce the amount of bill reduction attainable through LIURP measures and undermine energy efficiency efforts. CAUSE-PA St. 1, pp. 41-44; CAUSE-PA St. 1-SR, pp. 2-3.

262. Colombia Gas Company's current residential customer charge was established as a settlement in Docket No. R-2012-2321748, which *decreased* the residential customer charge of $18.73 that had been in effect. Columbia's residential customer charge did not increase in subsequent rate cases.

263. Mr. Miller did not support his assertions that the Company's proposed increase to its residential customer charge will impair energy efficiency efforts or undermine the Company's LIURP. The increased customer charge will not prevent customers from making improvements in energy efficiency.

264. The Commission should grant the Company's proposed increase to its residential customer charge and deny the recommendations made by the OCA and CAUSE-PA.

2. Non-Residential Rate Design

265. The Company's current Rate GC customer charge is $28.55. The Company is proposing to maintain the Rate GC customer charge at its current rate. PECO St. 7-R, pp. 14-15; JAB-4 Revised (Corrected). No parties oppose the Company's proposed Rate GC customer charge.

266. PECO has accepted the following non-residential rate design proposals recommended by the OSBA: (1) reduce the Rate GC volumetric charge differential by applying a larger percentage rate increase to the tail block charge; (2) reduce the Rate TS-F and Rate TS-I

volumetric charge differentials; and (3) elimination of the Rate IS margin sharing mechanism on or before December 1, 2021 as part of its next annual PGC reconciliation filing. PECO St. 7-R, p. 15; PECO Ex. JAB-4 Revised (Corrected).

267. PAIEUG witness LaConte objected to Mr. Knecht's proposal to reduce the Rate TS-F volumetric charge differentials. She alleged that the data provided by Mr. Bisti to determine if the Company's load factor analysis is correct, in response to a PAIEUG discovery request, was not provided in a workable format. Ms. LaConte also contended that the Company's recommended volumetric rate would disproportionately impact large Rate TS-F customers, resulting in large Rate TS-F customers receiving a 56.2% increase in volumetric rates, contrary to the principle of gradualism. Ms. LaConte recommended that the Commission reject the Company's proposed Rate TS-F differential and maintain the current Rate TS-F differential. PAIEUG St. 1-S, pp. 6-8.

268. In response to Ms. LaConte's request for the Company's workpapers utilized to derive its revised Rate TS-F and TS-I rates, the Company provided (1) corrected versions of the Company's proof of revenues for Rate TS-I and TS-F in Excel format (consistent with PECO Ex. JAB-4 Revised (Corrected)); and (2) the version history of volumetric distribution charges under proposed rates for both classes. No other party challenged the "workability" of these materials.

269. The Company's proposal will not result in "rate shock" to the large Rate TS-F customers. As acknowledged by Ms. LaConte, the large Rate TS-F customers are large commercial and industrial users that have enjoyed the benefit of no rate increase since new rates went into effect after the Company's 2010 base rate case. Mr. Knecht's recommended approach to minimizing the differential between small and large Rate TS-F customers reflects a reasonable balance in rate design that takes into account the needs of all customers.

270. Mr. Knecht also recommended that the Company eliminate Rate IS, Rate MV-I, and Rate TCS. He primarily asserted that none of these interruptible rates provide any "obvious benefit" to firm base rate customers. OSBA St. 1, pp. 43-46. Mr. Knecht also noted there are only two customers that take service under Rate MV-I, natural gas vehicles do not appear to be a "winning technology" that continues to justify its own rate, and that Rates MV-I and TCS are anti-competitive in that they are designed to provide lower-cost delivery service to customers taking service from the Company than customers served by competitive natural gas suppliers. Mr. Knecht also observed that Philadelphia Gas Works ("PGW") abandoned similar mechanisms.

271. The Company opposed the elimination of these rate classes. Maintaining interruptible customers is essential to protecting firm customers, including residential customers, from system interruptions during extreme weather conditions. Interruptible customers also enable the Company to avoid investments that might otherwise be necessary to bolster reliability if all customers were firm. The Company and its customers still benefit from interruptible customers, even if those customers are interrupted sparingly. The minimal number of times the Company has needed to interrupt its interruptible customers is a testament to PECO's superior planning and operational management of its system. PECO St. 7-R, pp. 16-19.

272. Mr. Knecht did not provide any evidence that eliminating any of these rates will provide a greater benefit to the Company's distribution system and customers than keeping these interruptible rates in place.

273. Mr. Knecht acknowledged that any potential negative aspects of retaining these rates are likely to be minimal, and that they can be addressed by the Company over a longer term.

274. The Commission should therefore reject OSBA's recommendation to eliminate Rate IS, Rate MV-I and Rate TCS.

3. Distribution Service Improvement Charge ("DSIC") Cost Allocation

275. OSBA witness Knecht expressed concerns regarding the allocation of costs to Rate GC customers under PECO's existing DSIC mechanism based on volumetric charge revenue. *See* OSBA St. 1, pp. 46-48.

276. PECO's DSIC charges to customers are capped at 5% of the amount billed to customers for distribution service, consistent with 66 Pa.C.S. § 1358(a)(1), the Commission's DSIC Implementation Order at Docket No. M-2012-2293611 and the Company's tariff. PECO St. 7-R, pp. 13-14.

277. After carefully considering Mr. Knecht's testimony on this issue, the Company concluded that it would adopt the OSBA's recommendation to modify PECO's budgetary cost allocation procedures to distribute DSIC-eligible costs among the rate classes based on total rate base revenues, including both customer charge and volumetric revenues. PECO Ex. JAB-4 Revised (Corrected).

4. Negotiated Gas Service

278. The Company's current Commission-approved tariff permits the Company to offer negotiated (i.e., discounted) gas service to customers under specified circumstances pursuant to the Company's Rate NGS. To be eligible for service under Rate NGS, a customer must: (1) either have a history of at least 18,000 Mcf of annual natural gas usage billed by the Company, or, if a new customer, establish that the facilities to be served are likely to consume at least 18,000 Mcf of annual natural gas usage; (2) document a viable, currently available competitive alternative to service under Rates GC, L, TS-F, or TS-I; and (3) execute a natural

gas service ("NGS") agreement that comports will all provisions set forth in Rate NGS. *See* PECO Ex. JAB-2, pp. 76-77.

279. Six of the Company's customers currently take service under Rate NGS. I&E, OCA, and OCA contended that PECO did not establish that all of these customers are still eligible to receive service under Rate NGS.

280. OCA witness Watkins recommended that the Company reevaluate the terms and rates for ***** BEGIN CONFIDENTIAL***** *****END CONFIDENTIAL***** including performing an analysis of the customers' ability to use alternative fuels and a supporting financial analysis for proposed negotiated rates on a going-forward basis. Mr. Watkins stated that these findings should be provided to the Commission and OCA on, or before, the Company's next base rate case filing. OCA St. 4, pp. 32-34. In support of his recommendation, Mr. Watkins noted that PECO has been providing service to three of its Rate NGS customers for a significant period of time and that the Company could not provide the original financial analysis supporting the discounted rate to these customers.

281. I&E witness Cline recommended that the Company, at all future base rate case filings, be required to provide an updated analysis for any Rate NGS customer that has not had its alternative fuel source, or opportunity for pipeline bypass or relocation, as applicable, verified for a period of five years or more, and that the Company cease providing service to any customer under Rate NGS that does not have a verified alternative to Company service. I&E witness Cline also recommended that, in future base rate cases, PECO separate the costs and revenues of customers that take service under discounted or reduced rates in their own class in the Company's COSS. I&E St. 3, pp. 33-36; I&E St. 3-SR, pp. 22-25.

282. OSBA witness Knecht stated that the Company failed to demonstrate the eligibility and reasonableness of rates, under Rate NGS, for *** **BEGIN CONFIDENTIAL*****

*****END CONFIDENTIAL***** OSBA St. 1, pp. 39-42; OSBA St. 1-R, pp. 13-15; OSBA St. 1-S, pp. 16-17.

283. The Company agreed with Mr. Watkins' request and stated it would provide the requested information with its next base rate case filing. PECO St. 7-R, p. 23.

284. With respect to Mr. Cline's recommendation that the Company be required to evaluate Rate NGS customers' alternative fuel sources every five years, the Company's Commission-approved tariff for Rate NGS does not require the Company to re-evaluate customer eligibility for Rate NGS at any specified time, except when a customer initially applies for service. At that time, PECO and its customers generally evaluate the potential benefits of a Rate NGS service agreement over a lengthy period, even decades in the case of a bypass alternative or relocation opportunity. Requiring the Company to review the eligibility of its Rate NGS customers every five years would potentially create instability for the Company's Rate NGS customers and make it less likely that customers would enter into competitive agreements with the Company. Such customers might be more likely to pursue alternatives to PECO service, ultimately resulting in a risk of lost revenues that would negatively impact all PECO gas customers. PECO St. 7-R, pp. 22-23.

285. Requiring PECO to regularly re-evaluate Rate NGS customers' eligibility, regardless of the Company's contractual terms, will hinder its ability to enter into NGS agreements and potentially increase costs to other customers.

286. *****BEGIN CONFIDENTIAL***** [REDACTED] *****END CONFIDENTIAL***** For the reasons discussed in Section VIII.A of PECO's Main Brief, that recommendation would violate shareholders' constitutional right to a fair return on and of their investment.

E. Theft/Fraud Investigation Charge

287. As initially proposed, proposed Rule 17.7 included a $460 fee for investigation and remediation of theft or fraud. *See* PECO St. 8, pp. 8-9.

288. PECO later clarified that (1) proposed Rule 17.7 would only be applied in cases of confirmed active gas theft; (2) the $460 fee was consistent with the average cost to investigate and remediate theft only; and (3) the term "fraud" should be stricken from the proposed rule. *See* PECO St. 8-R, pp. 2-3; Hearing Tr. 202.

289. OCA witness Colton opposed proposed Rule 17.7, expressing concern about (1) the breadth and vagueness of rule language; (2) the application of the rule to "applicants"; and

(3) the inclusion of “allocated overheads and administrative costs” in the proposed fee and the potential for double recovery of costs by the Company. *See* OCA St. 5, pp. 109-113; OCA St. 5-SR, pp. 7-9.

290. Addressing Mr. Colton’s concern about breadth and vagueness, Mr. Schlesinger clarified that proposed Rule 17.7 will apply in the case of confirmed active gas theft only, and therefore, all references to fraud will be stricken from the rule. *See* PECO St. 8-R, pp. 2-3; Hearing Tr. 202. He also explained that PECO does not believe it is prudent to provide a specific definition of theft in the Company’s tariff because the means by which tampering occurs evolves over time. *See* PECO St. 8-R, p. 3.

291. Addressing Mr. Colton’s concerns about application of the proposed rule to “applicants,” Mr. Schlesinger explained the legitimate circumstances under which an “applicant” could be properly assessed a fee under the proposed rule. Hearing Tr. 203.

292. Finally, in response to Mr. Colton’s concerns about double recovery of “allocated overheads and administrative costs,” Mr. Schlesinger explained that the Company had made a $10,000 revenue adjustment for “budgeted theft fee revenue” that was based on the actual 2019 gas revenues collected under existing Rule 17.6 related to the investigation and remediation of theft. *See* PECO St. 8-R, p. 3; Hearing Tr. 202.

PROPOSED CONCLUSIONS OF LAW

1. Based on the record evidence, PECO has satisfied the burden of proof imposed by Section 315(a) of the Public Utility Code to establish by a preponderance of substantial evidence that it is entitled to implement rates designed to produce additional annual operating revenues of $66,194,000.

2. Rates established by the Commission, or any other utility regulatory authority, are not "just and reasonable" unless they are within the zone of reasonableness determined by reference to the costs a utility incurs to furnish public utility service and a return that satisfies applicable legal and Constitutional standards. *Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968) ("any rate selected . . . *from* the broad zone of reasonableness . . . cannot be attacked as confiscatory.") (emphasis added).

3. The requirement of just and reasonable rates "confer[s] upon the regulatory body [the Commission] the power to make and apply policy concerning the appropriate *balance* between prices charged to utility customers and returns on capital to utility investors *consonant with constitutional protections* applicable to both." *Pennsylvania Electric Co. v. Pa. Pub. Util. Comm'n*, 502 A.2d 130, 133 (Pa. 1985) (quoting *Pa. Pub. Util. Comm'n v. Pennsylvania Gas and Water Co.*, 424 A.2d 1213, 1219 (1980) (emphasis original), *cert denied*, 454 U.S. 824 (1981)).

4. The Commission has the duty and the discretion to determine the proper balance between the interests of ratepayers and a utility's investors. Rates cannot be just and reasonable if they do not balance consumer and investor interests. The public interest is determined by a balancing of those interests without favoring either of them. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

5. The position advocated by the OCA and CAUSE-PA that a utility can be denied an increase in revenues and rates based on general economic conditions is contrary to law, would constitute unlawful confiscation of utility property, would seriously imperil the Company's ability to satisfy its statutorily imposed obligation to provide safe, reliable and reasonable service and, therefore, is rejected.

6. PECO's proposed Rule 17.7 is reasonable and should be approved.

7. The other changes in rules set forth in the Company's proposed Tariff No. 4, not having been contested by any party, are hereby approved.

PROPOSED ORDERING PARAGRAPHS

IT IS ORDERED:

1. That PECO is authorized to file a tariffs or tariff supplements containing rates, provisions, rules, and regulations, consistent with the findings herein, to produce revenues not in excess of $[656,293,000].

2. That tariffs or tariff supplements may be filed on less than statutory notice and, pursuant to the provisions of 52 Pa. Code §§ 53.31 and 53.101, may be filed to be effective for service rendered on and after the date of entry of the Commission's Opinion and Order.

3. That PECO shall file detailed calculations with its tariff filing, which shall demonstrate that the filed rates comply with the proof of revenue, in the form and manner customarily filed in support of compliance tariffs.

4. That PECO shall allocate the authorized increase in operating revenues to each customer class and rate schedule within each customer class in the manner prescribed in the Commission's Opinion and Order.

5. That the Complaints filed by the various parties to this proceeding are granted, denied or deemed satisfied, consistent with the Commission's Opinion and Order in this case.