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March 15, 2021

VIA eFILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
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Harrisburg, PA 17120

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

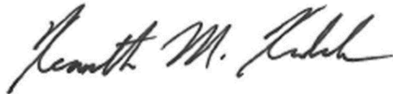
Dear Secretary Chiavetta:

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

A confidential version of the Reply 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,



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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 **Reply 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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Dated: March 15, 2021

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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	:	

REPLY BRIEF OF PECO ENERGY COMPANY

PUBLIC VERSION

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I. INTRODUCTION

PECO Energy Company ("PECO" or the "Company") files this Reply Brief in response to the Main Briefs of the Bureau of Investigation and Enforcement ("I&E"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA"), the Philadelphia Area Industrial Energy Users Group ("PAIEUG"), and the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania ("CAUSE-PA"). In this proceeding, PECO is requesting Pennsylvania Public Utility Commission ("Commission" or "PUC") approval for an increase of $66.2 million in total annual operating revenues, which will be PECO's first increase in gas distribution rates in over ten years.[1]

To a very large extent, the issues raised in the other parties' Main Briefs have been fully addressed in the Company's Main Brief filed on March 3, 2021, and an extensive reanalysis of each subject is, therefore, unnecessary. However, as an aid to the Deputy Chief Administrative Law Judge (the "ALJ"), this Reply Brief will revisit certain of the key areas of disagreement.

II. SUMMARY OF ARGUMENT

The Commission has made clear that the COVID-19 pandemic does not change the traditional ratemaking standards historically applied by this Commission. Substantial evidence presented by PECO in this proceeding fully justifies the revenue increase that PECO has proposed in its first rate case in more than a decade, and the Commission should reject each of the adjustments to PECO's rate base, revenue, expenses, and rate of return proposed by the other parties. PECO's rate design is based on the proper application of well-established principles of cost allocation and revenue allocation, and will result in just and reasonable rates for all of

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[1] PECO originally filed for an increase of $68.7 million, but reduced the amount as a result of certain adjustments (including an update to PECO's cost of debt based on PECO's latest debt issuance). These adjustments are described in the rebuttal testimony of PECO witness Michael J. Trzaska. *See* PECO St. 3-R, pp. 2-5.

PECO's customers that should be approved by the Commission. The Commission should also approve PECO's expanded energy efficiency and conservation ("EE&C") programs and neighborhood gas pilot rider ("NGPR") for customers, which are reasonable and in the public interest, and reject proposals for unwarranted expansions to low-income customer programs and changes in cost allocation in light of the comprehensive programs that PECO is already offering or that are now pending before the Commission.

III. OVERALL POSITION ON RATE INCREASE REQUEST

In Section III of its Main Brief (pp. 8-14), PECO addressed the testimony of OCA witness Scott J. Rubin and CAUSE-PA witness Mitchell Miller recommending that the Commission deny PECO any rate increase due to the COVID-19 emergency. Consistent with that approach, PECO will address these parties' "no increase" proposals in this section while addressing the traditional revenue, expense and rate of return recommendations of I&E, the OCA, and OSBA in Sections VI-VIII and X *infra*.[2] In addition, in Section IX, PECO will address the scope of its customer assistance programs (including temporary programs to assist customers during the COVID-19 emergency) and additional new programs now pending before the Commission.

PECO explained in its Main Brief that the Commission, in recent decisions approving base rate increases for Columbia Gas of Pennsylvania, Inc. ("Columbia") and Pennsylvania American Water Company ("PAWC"), made crystal clear that "the continued use of traditional ratemaking methodologies during the pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*,

[2] The Philadelphia Area Industrial Energy Users Group ("PAIEUG") did not take a specific position on the overall rate increase, but did state that the Commission "should review PECO's proposed requested rate increase in combination with the arguments set forth by the OCA, OSBA, and I&E and in light of the unique circumstances [of the COVID-19 pandemic] present today." PAIEUG M.B., p. 6.

and the pandemic does not change the application of those standards."[3] The Commission also underscored that evidentiary issues with a utility's fully projected future test year ("FPFTY") projections must be addressed on a "claim-by-claim" basis, and any "broad brush" rejection due to the pandemic was inappropriate. PECO M.B., pp. 12-13.

PECO also highlighted the testimony of PECO witness Paul Hibbard, the former chairman of the Massachusetts Department of Public Utilities, who explained in detail how Mr. Rubin's theory of ratemaking in a "null" zone outside of the traditional ratemaking zone of reasonableness and Mr. Mitchell's test of "reasonable affordability" were inconsistent with ratemaking principles. PECO M.B., pp. 8-9. In addition, Mr. Hibbard testified about his analysis of all 67 electric and natural gas utility cases either settled or litigated in the United States between March 2020 and December 2020, in which the vast majority have resulted in rate increases (with an average increase for gas utilities larger than before the onset of the COVID-19 pandemic). *Id.*, pp. 10-11.

Neither the OCA nor CAUSE-PA addressed the testimony of Mr. Hibbard in their Main Briefs, nor did they acknowledge that PECO had already delayed the filing of this rate case due to the COVID-19 pandemic, at the cost of tens of millions of dollars. PECO M.B., pp. 11-12; Hearing Tr. 253-55. The Commission should reject their continued arguments for "no increase" for two principal reasons, in addition to those set forth in PECO's Main Brief.

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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*"), p. 40 (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*")); *see also 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*"), p. 46.

First, the Commission has concluded that the economic effects of the COVID-19 pandemic are, by themselves, not a basis for the denial of a rate increase. As the Commission explained in *Columbia Gas* (p. 51):

> While we acknowledge the gravity of these unemployment statistics, it has not been demonstrated in this case with substantial evidence or explanation that the impact of any rate increase on unemployed customers will lead to harm that outweighs all other valid ratemaking concerns "especially the polestar – cost of providing service." *Lloyd*, 904 A.2d at 1020. Furthermore, taking the approach of denying any rate relief due to rising unemployment numbers among residential customers is inconsistent with our prior rate orders issued during this pandemic: specifically, the *PGW Rate Order*, the *UGI Gas Rate Order*, and the *PWSA Rate Order*, where we granted rate increases despite rising unemployment numbers across the Commonwealth due to the pandemic. No party in this proceeding has offered a rational basis to justify a different treatment under the circumstances here.[4]

Although both the OCA and CAUSE-PA cite a variety of statistics regarding the economic effects of the pandemic in Pennsylvania, neither party provides any explanation as to why the Commission should now reach a different conclusion here than in *Columbia Gas* and *PAWC*, where the OCA and CAUSE-PA presented the same witnesses and made similar arguments. Notably, the OCA goes so far as to cite *Columbia Gas* and suggest that it supports the same OCA "no increase" position that the Commission rejected in that proceeding. *See* OCA M.B., pp. 23-24. For its part, CAUSE-PA does not even acknowledge the *Columbia Gas* and *PAWC* decisions – despite the fact that its witness, Mr. Miller, testified in both proceedings and the Commission twice rejected CAUSE-PA's "no increase" position.[5]

Second, the evidence demonstrated that PECO's existing rates are not sufficient to generate a sufficient return on investment, as the OCA contends. PECO witness Robert Stefani,

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[4] *Columbia Gas*, pp. 51-52.
[5] *Columbia Gas*, pp. 29-32 & 50-52; *PAWC*, pp. 42-46.

PECO's Senior Vice President, Chief Financial Officer and Treasurer, explained that without a rate increase, PECO's gas operations are projected to produce an overall return on investment capital of 5.73%, and a return on common equity of 7.26%, during the FPFTY ending June 30, 2022 ("FPFTY"). PECO St. 2., p. 4. PECO's expert witness, Paul R. Moul, established that PECO's rates should produce an overall rate of return of 7.70%, with a return on common equity of 10.95%, after applying well-established methods and financial data. PECO St. 5, pp. 5-7. And while the rate of return recommendations of both the OCA's and I&E's expert witnesses were flawed for reasons discussed in Section VIII of PECO's Main Brief and in Section VIII *infra*, neither of their market-based recommendations were as low as the return that would result from the denial of any rate increase. The OCA's contention that PECO's current revenues would be sufficient to provide a constitutionally acceptable return was based on the testimony of its witness, Mr. Rubin, who did not offer an expert rate-of-return analysis. Again, the Commission had previously rejected the exact same approach by the OCA, and the OCA provides no explanation as to why it is acceptable now.[6]

In short, the OCA and CAUSE-PA failed – again – to demonstrate how a "no increase" position is consistent with basic ratemaking principles, as recently set forth in both the *Columbia Gas* and *PAWC* decisions. The Commission should – again – reject their proposals to deny PECO's rate increase in its entirety.

[6] *See* OCA M.B., p. 26 (discussing Mr. Rubin's recommendation of a 5.74% rate of return during the FPFTY). OCA witness O'Donnell's general statement that he "concurs" with Mr. Rubin's recommendation while also supporting his own higher recommendation of 6.30% (OCA St. 3, p. 3) cannot transform Mr. Rubin's conclusory recommendation into substantial evidence that meets Commission requirements and constitutional standards. *See Columbia Gas*, p. 53-54 (rejecting a "no increase" claim that was not supported by expert witness testimony).

IV. RATE BASE

A. Fair Value

In its Main Brief (p. 14), PECO provided an overview of its rate base claims for the FPFTY and pointed out that only two rate base items remain in dispute. First, witnesses for I&E and the OCA proposed adjustments to reduce PECO's claimed plant in service balances at June 30, 2022. In addition, both I&E and the OCA object to PECO's claim for rate base recognition of a pension asset that arises because of a difference in the calculation of pension costs for ratemaking purposes in Pennsylvania and under Generally Accepted Accounting Principles ("GAAP"). The Company responds to I&E's and the OCA's discussion of those contested issues in Section IV.D. below.

B. Utility Plant In Service

In Section IV.B. of PECO's Main Brief, the Company addressed in detail the evidence presented throughout the course of this proceeding regarding the original cost of all plant additions and retirements forecasted to occur during the FPFTY. As noted therein, the OCA has taken issue with PECO's budgeted data for the FPFTY plant additions, and I&E has challenged PECO's claimed plant in service balances for the "Natural Gas Reliability" project. The OCA and I&E address their proposed allowances for PECO's investment in plant in service during the FPFTY in Section IV.D.1. of their Main Briefs. Accordingly, the Company will respond in the corresponding section of this Reply Brief.

C. Depreciation Reserve – Annual/Accumulated

No party has contested the Company's depreciation calculations. As previously noted, however, I&E and the OCA have proposed adjustments to PECO's claimed level of plant additions. Those adjustments carry with them related adjustments to the Company's depreciation accrual. For the reasons explained in PECO's Main Brief (pp. 15-21) and Section

IV.D.1. below, neither I&E's nor the OCA's underlying adjustments to FPFTY plant additions should be adopted.

D. Additions To Rate Base

1. Projected Plant Additions

The OCA and I&E challenged the Company's FPFTY plant additions. The OCA proposed an allowance only at the Company's forecasted level of plant additions for the future test year ("FTY") ending June 30, 2021, without an allowance for any incremental plant additions during the FPFTY, and I&E proposed reducing PECO's claimed plant in service balances for the Natural Gas Reliability project described in PECO witness Ronald A. Bradley's direct testimony (PECO St. 1, p. 17). The OCA's and I&E's objections are without merit and should be rejected.

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

The OCA recommended that the Commission eliminate the Company's 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 OCA witness Lafayette K. 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.

The OCA's recommendation is entirely based on Mr. Morgan's contention that the Company's budget process was "abbreviated" and did not appropriately factor in the impacts of COVID-19, and is therefore unreliable. *See* OCA M.B., pp. 32-37.

The OCA's position is without merit. The Company provided substantial evidence in support of its rigorous budget process. Mr. Stefani, PECO's Senior Vice President, Chief

Financial Officer and Treasurer, went to great lengths to explain how the Company derived its FTY and FPFTY capital and operating budgets, and confirmed that the process utilized by the Company was consistent with the process reviewed by the Commission during its Focused Management and Operations Audit of PECO in 2014. *See* PECO M.B., p. 16. *See also* PECO St. 2, pp. 10-12; PECO St. 2-R, p. 2; Hearing Tr. 249-51.

The OCA is aware that the Company originally intended to file this base rate case with the Commission in March 2020. OCA St. 1, p. 9. Notwithstanding the fact that the Company delayed its filing of this rate case in the context of the initial days of the COVID-19 pandemic for the benefit of customers, the OCA is now trying to exploit that fact to "muddle the water" regarding the Company's budget process. The facts are clear. As Mr. Stefani explained:

> [T]he [C]ompany originally intended to file this base rate case in March 2020 with a [historic test year ("HTY")] ending December 31, 2019. However, the [C]ompany made the decision to delay its fi[l]ing by six months due to the COVID-19 pandemic, which OCA's own witness, Mr. Rubin, acknowledges. As a result of this delay, in July 2020, the [C]ompany took the budget that was already approved by senior management in January 2020 and updated it with the most up to date information to accommodate the use of a fiscal year ending in June, in other words a [HTY] ending June 30, 2020, in order to align with the [C]ompany's delayed fi[l]ing. The process was completed in August of 2020.
>
> ***
>
> Mr. Morgan is simply setting up a straw man by alleging that this process was somehow abbreviated. It would have been irresponsible for the [C]ompany to not update its budget with the most up to date information, and as PECO's chief financial officer and a member of PECO senior management, I can tell you without qualification that the capital and operating budgets proposed by the [C]ompany for the [FTY] and [FPFTY] as part of this rate case were fully reviewed and authorized by the [C]ompany senior management team.

Hearing Tr. 250-51.

The Company also demonstrated that Mr. Morgan's conclusion that the Company provided inconsistent data regarding its plant in service projections is the result of Mr. Morgan's misunderstanding of the data and how it was presented. PECO M.B., pp. 18-19. *See also* PECO St. 2-R, pp. 5-7; Hearing Tr. 244-47. The OCA's choice to simply ignore, rather than respond to, the Company's explanation is indicative of the insufficiency of support for the OCA's conclusions.

The same is true for the OCA's allegation that PECO failed to properly account for the impacts of COVID-19 on the Company's projected plant in service additions. Mr. Morgan expressed "concern" that PECO acknowledged that the pandemic impacted planned FTY plant additions, but not FPFTY plant additions, and therefore he "did not have a high degree of confidence in the Company's forward looking estimates." OCA M.B., p. 35. Mr. Morgan's concerns, however, are wholly a result of his refusal to accept the sworn statements of Mr. Bradley and Mr. Stefani as true.[7] The Company explained that there were some construction delays in the initial months of the COVID-19 pandemic, but the Company was able to almost entirely recover, and ended up spending 99% of its 2020 construction budget, and that no delays were projected that would impact the Company's FPFTY plant in service. Mr. Bradley explained:

> PECO experienced some delays on some projects [i]n the early months of the pandemic. But delays don't stop us from working on our system, and we've developed procedures to ensure that our construction teams can work safely and efficiently despite the pandemic. As a result, we were able to use 99 percent of our planned construction budget in 2020. Those procedures will remain in place as necessary to ensure the safety of our employees

[7] As another example, the OCA in its Main Brief alleges that there may be additional COVID-19 impacts that the Company has not acknowledged by referencing a statement in Mr. Bradley's testimony at the evidentiary hearing that bare steel replacements have been rescheduled and postponed due to the pandemic. OCA M.B., p. 37. However, the OCA selectively omits any reference to the next sentence of Mr. Bradley's testimony, which states that "none of those will have any impact on the [FTY] or [FPFTY] capital program." Hearing Tr. 213.

> and our contractors during this pandemic, but they are not delaying our construction program and I do not know of any basis for believing that our scheduled work for the [FTY] and the [FPFTY] will be delayed.

Hearing Tr. 218. This statement aligns with Mr. Stefani's testimony that:

> It's true as Mr. Bradley acknowledged that some projects during the [HTY] were delayed due to the impacts of the COVID-19 pandemic. However, the [C]ompany does not expect that the in-service dates of any of the projects listed in OCA-XIII-3 all [with] dates in the [FTY] or [FPFTY], will be delayed. As I stated in my rebuttal testimony the [C]ompany spent approximately $274 million of its $277 million 2020 construction budget, which is approximately 99 percent of the construction budget. And it anticipates that it will be fully caught up by June 2021 without any resultant impact on work scheduled for and anticipated to be completed in the [FTY] or [FPFTY].

Hearing Tr. 246.

Conversely, there is no evidence in the record to support Mr. Morgan's contention that, by the end of the FPFTY, the Company will place only its projected FTY plant additions into service and not place any of its projected FPFTY plant additions into service. These facts are distinguishable from *Columbia Gas*, which the OCA cites to in support of its proposed adjustment. In *Columbia Gas*, the Commission affirmed the ALJ's downward adjustment of the FPFTY, finding that Columbia did not provide adequate support for a FPFTY claim that significantly exceeded its prior historical average. For that reason, the Commission awarded Columbia a three-year average of two historical years and its FTY plant-in-service claim.[8] In PECO's current case, the OCA did not assert that the Company's FPFTY claim significantly exceeds the Company's FTY and prior historical plant additions. The OCA instead challenged the Company's budget process and whether the Company properly accounted for potential delays in construction due to the COVID-19 pandemic.

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[8] *Columbia Gas*, pp. 56-62.

The OCA's recommendation is contrary to the substantial evidence presented by the Company to support its projections. The Commission should therefore reject the OCA's proposed adjustment to the Company's plant in service claim.

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

Included in the Company's proposed plant additions is $82,481,428 related to the Company's Natural Gas Reliability project. As explained in the Company's Main Brief, this project consists of three components: (1) the installation of 11.5 miles of gas main; (2) capital upgrades to the Company's West Conshohocken liquefied natural gas ("LNG") facility; and (3) the construction of a new gate, or reliability, station. PECO M.B., pp. 19-20. *See also* PECO St. 1-R, pp. 18-20; Hearing Tr. 213-17.

I&E recommended a disallowance of $47,624,803. I&E argued that the Company's full claim should be denied because (i) the Company provided a response to discovery stating that the entire project will be completed in June 2023 and the Company later stated the project would be completed at the end of 2022 and (ii) a strictly linear application of (a) the percentage of the funds spent to date and (b) the percentage of the project completed to date, assuming project completion in June 2023, demonstrates that the Company will only spend $34,856,625 by the end of the FPFTY. I&E M.B., pp. 15-17.

The Commission should deny I&E's recommended disallowance. The Company's plant addition claim only includes two of the three components of the Natural Gas Reliability project - the installation of 11.5 miles of gas main and the construction of a new gate, or reliability, station. These two components of the project will be placed into, and provide service to customers by the second quarter of 2022 (i.e., during the FPFTY). The Company's claim does not include, and has never included, its capital upgrades to the Company's West Conshohocken

LNG facility since that component of the project will be completed after the FPFTY. As Mr. Bradley explained at the evidentiary hearing:

> I stated in my rebuttal testimony that the entirety of the project [i.e., all three components] will be placed into service by the end of 2022. This is correct, as the project is now expected to be completed six months earlier than as described in the [C]ompany's response to I&E-RB-4-D. However, that is irrelevant to the [C]ompany's plant in service claim since the claim does not include that portion of the reliability project that will not be in service during the [FPFTY].

Hearing Tr. 217.

The fact that the Company initially anticipated that the LNG upgrades would be completed in June 2023 and later updated that estimate to the end of 2022 to reflect an updated construction timeline is a red herring, since, in either case, that portion of the Natural Gas Reliability project would not be included in the Company's claim in this rate case.

The Commission should also find that I&E's strictly linear application of (a) the percentage of the funds spent to date and (b) the percentage of the project completed to date, assuming project completion in June 2023, is untenable. First, as already demonstrated, the Company has provided substantial evidence that all three phases of the project should be completed by the end of 2022 and not June 2023. Therefore, I&E's calculation stretches approximately six months beyond when the project will actually be complete and begin providing service to customers. Second, I&E has not provided any evidence to assume that a strictly linear application of funds is reasonable and aligns with the Company's actual expenditures. Third, and most important, the Company's claim only includes portions of the Natural Gas Reliability project that will independently be placed into service prior to the FPFTY, so any disallowance of the expenditures related to the 11.5 miles of gas main and the

construction of a new gate station would deny the Company the benefit of assets in rate base that will be serving customers in the FPFTY.

2. Pension Asset

As PECO explained in its Main Brief, 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. 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. PECO M.B., p. 22; PECO St. 3-R, p. 10.

The pension asset consists of $35.1 million in 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, in accordance with GAAP, was not recorded in PECO's plant accounts. PECO M.B., p. 22; PECO St. 3-R, p. 11. 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 M.B., p. 23; PECO St. 3-R, p. 11.

PECO, the OCA, and I&E agree on the definition of the pension asset and the resulting amount of the pension asset. *See* OCA M.B., p. 38 (stating that "the Company makes an annual cash contribution to its pension plan in accordance with federal requirements"); I&E M.B., p. 18 (discussing pension asset). Where I&E and the OCA disagree with PECO is whether the pension

asset should be included in rate base, but each of the reasons to exclude the pension asset that I&E and the OCA offer are flawed.

The pension asset is properly included in rate base. For the most part, I&E simply contends that PECO's actual cash contribution should not be included in rate base because it is a "mismatch" created by GAAP accounting. I&E M.B., pp. 18-19. This argument ignores the economic reality that PECO has committed actual investor funds to its pension costs, as it does with other salary and wage expenses that are capitalized; those funds are not currently recognized in PECO's rate base; and, as a result, PECO is denied an opportunity to earn any return on a substantial portion of its capitalized pension contributions. Contrary to I&E's contention, earnings on PECO's pension contributions do not accrue to the benefit of PECO because all of the earnings on those contributions accrue to, and remain in, the pension funds. *See* PECO St. 3-R, p. 19.

The OCA offers more varied arguments as to why the pension asset should not be included in rate base, but they are similarly without merit. Contrary to the OCA and Mr. Morgan's contentions, OCA M.B., p. 40, the pension asset is not an expense on which PECO is trying to earn a return; it represents the portion of PECO's total pension that is neither capitalized nor charged as an expense, and which PECO does not amortize. *See* PECO St. 3-R, pp. 16-17.[9]

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[9] Mr. Morgan's suggestion that the pension asset is an expense and PECO is attempting to earn a return on "expenses" is wrong. The portion of PECO's pension contribution that is not charged to expense is specifically deemed, for accounting and ratemaking purposes, to be a capital expenditure, not an expense. The pension asset is a portion of that capital expenditure that PECO actually incurs but, because of differences between ratemaking and GAAP accounting, is not currently recognized to any extent in the ratemaking process. As PECO witness Michael J. Trzaska noted, capitalized pension costs are no different from the portion of salaries and wages that is also capitalized, and utilities clearly are permitted to earn a return on capitalized salaries and wages. *See* PECO St. 3-R, p. 16. The case law upon which OCA relies is completely inapplicable because it denied a utility's claim to include in rate base the unamortized balance of an item that all parties, including the utility, agreed was a prepaid expense. *See* OCA M.B., pp. 40 (citing *Pa. Pub. Util. Comm'n v. Pa. Power Co.*, Docket No. R-8115110, *et al.*, 1982 Pa. PUC Lexis 154 at *117-18). The pension asset is not a prepaid expense. Rather, it is an expenditure that is not included in PECO's expenses and is properly categorized for accounting and ratemaking purposes as a capital item.

The OCA's contention that the pension asset will be properly included in rate base "in future years when it is appropriate to do so for financial accounting purposes" assumes away the issue, since PECO is not permitted to include most of the pension asset in its plant accounts. Similarly, PECO does not "overearn" by including the pension asset in rate base, as PECO consistently reduces the pension asset by the amount that is actually capitalized. *See* PECO St. 3-R, p. 17.

PECO is not seeking to recover previously unrecovered carrying costs. Both the OCA and I&E assert that PECO is attempting to recover past pension costs that it was not able to recover in prior proceedings. *See* I&E M.B., p. 18; OCA M.B., p. 37. This is not correct. As Mr. Trzaska testified, "PECO is only proposing to include the pension asset in rate base to recover the associated carrying costs on a prospective basis. PECO recognizes that it must bear those previously-unrecovered carrying costs and is not seeking their recovery in this case." PECO St. 3-R, pp. 11-12.

PECO's pension costs will eventually be included in plant accounts. I&E argues that the difference between actual cash contributions and the amounts recorded in plant accounts should "match" over time, or change to a liability account. I&E M.B., p. 20. A future "match" or liability account does not obviate the need for a return on PECO's actual cash contribution; moreover, to the extent that the relationship between PECO's contribution and the amount of that contribution it is permitted to capitalize goes "negative" at any point, there will be no over-recovery since PECO will reflect the change through a reduction in rate base for ratemaking purposes. PECO St. 3-R, pp. 19-20.

PECO is properly referencing the "black box" settlements in three Duquesne Light Company cases that permitted inclusion of pension contributions in rate base. Both I&E and the OCA object to PECO's reference to the Commission's approval of three prior settlement

agreements in Duquesne Light electric base rate proceedings in which express provisions of the settlement agreements described rate base adjustments for pension expense consistent with PECO's claim in this proceeding. *See* I&E M.B., p. 19 (asserting that "black box" settlements do not necessarily represent positions that parties would have taken in litigation); OCA M.B., pp. 41-42 (quoting language from Duquesne Light's Joint Petition for Settlement that the settlement does not constitute "precedent"). PECO recognizes the limited precedential nature of settlements. *See* PECO M.B., p. 24. However, just as non-precedential opinions of Pennsylvania courts may properly be cited and relied upon for their logic and persuasive value (*see* Pa.R.A.P. 126(b)), the same applies to Commission decisions approving settlements that carved out specific, explicit terms as exceptions to the "black box" nature of the rest of the settlement. No party denies that the Duquesne Light orders that PECO cited reflect prior Commission approval of the inclusion of a pension asset in rate base, as PECO has proposed in this case. *See* PECO St. 3-R, pp. 12-15. Neither I&E nor the OCA can deny that the Commission, in approving a settlement, must find that its terms produce rates that are just and reasonable. The Commission clearly did that in approving each of the three settlements that included explicit terms allowing rate recognition of a pension asset for Duquesne Light that is indistinguishable from the pension asset proposed by PECO.

Given the flaws in the arguments of both I&E and the OCA identified above and in PECO's Main Brief, the Commission should reject their proposed adjustments to remove the pension asset from rate base.

3. Uncontested Items

No party has contested PECO's revised rate base claims for its investment in materials and supplies and gas storage inventory. I&E's and the OCA's Main Briefs confirm that they do not dispute the methodology PECO used to establish its cash working capital requirements. *See*

I&E M.B., p. 50; OCA M.B., p. 42. The adjustments proposed by I&E and the OCA are concomitant to their proposed adjustments to the Company's operating and maintenance ("O&M") expenses. As explained in PECO's Main Brief (pp. 28-51), those proposed O&M expense adjustments are unsupported, contravene Commission precedent, and should be rejected.

E. Conclusion

For the reasons set forth above, the Commission should reject each of the proposed adjustments to PECO's rate base claims.

V. REVENUES

A. Forfeited Discounts

The only contested revenue issue is I&E witness Ethan H. Cline's proposed adjustment to increase PECO's forfeited discount (late payment) revenue by $358,000 based on the use of a three-year average of the historic ratio of forfeited discounts with total revenues instead of the Company's approach that employs the relationship of forfeited discounts with past-due accounts receivable. I&E's discussion of this issue (I&E M.B., pp. 22-23) consists entirely of a recitation of Mr. Cline's testimony.

PECO's Main Brief, at pages 26-27, explains the errors in Mr. Cline's analysis. Although Mr. Cline claims his proposed adjustment is a means of "smoothing" year-to-year variations, the evidence in the case establishes that forfeited discounts have a much stronger relationship with past-due accounts receivable than with overall revenues. I&E's critique of PECO's linear trend analysis of forfeited discounts over an eight-year period (2012-2019) presented in Exhibit RJS-1-R is based on its erroneous conclusion that PECO did not account for the impact of the proposed rate increase on its pro forma level of forfeited discounts. To the contrary, PECO included a forfeited discount rate in the gross revenue conversion factor used to determine the Company's revenue requirement. *See* PECO M.B., pp. 26-27. PECO's

methodology to calculate pro forma forfeited discount revenue for the FPFTY is clearly reasonable and appropriately reflects the payment patterns of the Company's current customers.

VI. EXPENSES

A. Payroll And Payroll-Related Expense

1. Fully Projected Future Test Year Employee Complement

Both the OCA and I&E have recommended adjustments to PECO's payroll expense, employee benefits and payroll taxes related to the forecasted employee complement of 639 full-time equivalent ("FTE") employees in the Company's FPFTY budget. OCA witness Morgan proposed an adjustment to reduce the FPFTY employee complement to 604 employees, which was PECO's actual complement on September 30, 2020, and I&E witness D.C. Patel proposed a vacancy rate of 2.10% based on an average of the Company's actual vacancy rates experienced for the three-year period ended June 30, 2020. *See* OCA M.B., pp. 44-45; I&E M.B., p. 24. The fundamental errors of those proposed adjustments were fully addressed in the Company's Main Brief (pp. 28-31).

In their respective Main Briefs, the OCA (pp. 44-46) and I&E (pp. 25-26) both suggest that PECO will not have the authorized and budgeted 639 employees on its payroll during the FPFTY given the Company's actual hiring experience. The record tells a different story.

Mr. Stefani explained that the 639-employee complement consists of 602 actual FTE employees at the end of the HTY and 37 FTE employees that PECO will add over the FTY and FPFTY. Mr. Stefani further testified that all of the 37 positions at issue in this case are in the process of hiring and are expected to be filled by the end of the FPFTY despite impacts from the COVID-19 emergency that temporarily prevented PECO from hiring all anticipated gas operations personnel (635 FTE employees) by the end of 2020. Significantly, the lower number of positions in 2020 was largely driven by the cancellation of PECO's Gas Mechanics School in

March 2020 due to the pandemic, but it has already been rescheduled for September 2021. *See* PECO M.B., pp. 28-30.

The record in this proceeding establishes that PECO's actual employee headcount at December 31, 2020 was 612 FTE employees. The OCA's claim that the 2020 year-end headcount understates the "gap" between PECO's actual and projected employees is based on the flawed assumption that allocated employees were excluded from the 639 employees budgeted for the FPFTY. The 612 and 639 figures both represent total FTE employees for PECO's gas operations, including allocated employees. As Mr. Stefani explained (PECO St. 2-R, p. 11), the total net increase of 37 positions forecasted for the FPFTY reflects several energy technicians whose allocated FTE to PECO's gas operations will total seven employees.

As explained in PECO's Main Brief (p. 29), the Commission has previously rejected adjustments similar to those proposed by the OCA and I&E. In those prior decisions, the Commission's determinations were based largely on the strength of the utility's representation that it was actively seeking to hire individuals to fill then-vacant positions authorized for the applicable future test year.[10] PECO presented the same evidence relied on by the Commission in those cases, namely that the Company fully expects to achieve its forecasted staffing level of 639 FTE employees by June 30, 2022. Accordingly, the "vacancy rate" adjusted figures proposed by the OCA (604 FTE employees) and I&E (626 FTE employees) should be rejected in this case as well.

The OCA cites the *Columbia Gas* decision in support of its assertion that PECO's payroll claim (and related employee benefits expenses and payroll taxes) should not be based on a full

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[10] *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 Electric 2012*"), p. 40; *Pa. P.U.C. v. Pennsylvania-American Water Co.*, Docket No. R-00038304, 231 P.U.R.4th 277 (2004).

complement of employees. A review of that order reveals evidentiary deficiencies that are not present here. The Commission reduced Columbia's payroll expense to reflect the highest number of employees recorded on its books during 2020, resulting in a net increase of only 19 employees compared to Columbia's forecasted 59 employees because Columbia did not present evidence that the vacant budgeted positions would be filled by the end of 2021 (the FPFTY in that case).[11] In contrast, as previously explained, PECO presented substantial evidence that the Company intends and expects to staff its gas operations with 639 FTE employees by June 30, 2022.

2. Union Contract Ratification Bonus

The OCA opposes PECO's proposal to normalize a one-time cash payment to union employees made in connection with the ratification of its current collective bargaining agreement that will expire in 2021. In its Main Brief (pp. 46-48), the OCA contends that PECO's claim should be disallowed because the union contract ratification bonus was paid prior to the HTY in this case. As explained in PECO's Main Brief (p. 30), the Company incurs a ratification bonus each time it negotiates new union contracts and PECO's proposal to spread those costs over the term of its current agreement (six years) is reasonable and appropriate.

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 3.9% decrease from the Company's projected FTY contracting and materials expense of $44,651,000. *See* PECO M.B., p. 33. I&E proposed that the Commission reject the Company's projected FPFTY amount and, instead, limit the Company's recovery to the three-year average of the Company's historical contracting and

[11] *See Columbia Gas*, pp. 67-72.

materials expense. I&E contended that (i) the Company failed to adequately support its projected FTY and FPFTY spending claims; (ii) the Company did not support and explain the significant increase in spending from the HTY to the FTY; (iii) the Company did not provide substantial evidence that all projected expense increases in the FTY will continue to be incurred in the FPFTY; (iv) the Company underspent its budgeted contracting and materials expense in recent fiscal years; and (v) it is speculative to assume that the impact of COVID-19 related restrictions will diminish completely in the FTY and FPFTY and that the Company will be able to spend its entire budgeted amount. *See* I&E M.B., pp. 27-29.

I&E's proposed adjustment should be rejected. The Company provided substantial evidence that it will incur its projected FTY and FPFTY contracting and materials expense. The increases over the HTY amount projected for the FTY and FPFTY are being driven principally by (1) PECO's activities to enhance its mapping system to improve the Company's ability to locate and track gas distribution facilities and associated increased investment in its gas mapping project; (2) additional contracting and materials expense related to PECO's planned activities to reduce its non-emergent leak backlog; and (3) 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 both the FTY and the FPFTY. *See* PECO M.B., pp. 31-32. *See also* PECO Ex. MJT-1 Revised, Sch. D-4; PECO St. 2-R, pp. 17-19; Hearing Tr. 252-53.

In addition, the Company's HTY contracting and materials expense was abnormally low due to temporary impacts from the COVID-19 pandemic, but HTY spending levels are not indicative of future levels of the Company's contracting and materials expense. As Mr. Stefani noted 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, 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 the Company will meet its FTY and FPFTY budgets for contracting and materials expenses. *See* Hearing Tr. 251-53.

The anomalous nature of the Company's HTY contracting and materials expense makes it unreasonable for the Commission to adopt I&E's proposed three-year average, since the average would be skewed significantly lower than actual anticipated spending due to the temporary COVID-19 related impacts that occurred in the HTY. Further, I&E has not provided any support as to why the Company's projected FTY and FPFTY contracting and materials expense projections are "speculative" when the Company provided evidence that it is on-track to meet its FTY spending target and does not anticipate any further COVID-19 related impacts that would impair the Company's ability to meet its FPFTY budget. Therefore, the Commission should deny I&E's proposed adjustment.

C. Outside Services (Including Service Company Charges)

The Company is seeking recovery of approximately $22 million in outside services expenses in the FPFTY, which is inclusive of PECO's claim for Exelon Business Services Company ("EBSC") expenses. As PECO explained in its Main Brief, the Company utilizes the EBSC for certain services, such as information technology ("IT"), finance, human resources, government and external affairs and public policy, and legal services, which enables the Company to realize economies of scale and scope that it would not be able to realize on a standalone basis. *See* PECO M.B., p. 33. *See also* PECO St. 2, pp. 16-21; PECO St. 2-R, p. 15.

I&E and the OCA both recommended that the Commission adjust the Company's claim. I&E recommended that the Commission adjust the Company's HTY actual outside services expense for inflation based on the Consumer Price Index ("CPI") factors of 2.75% to determine

the FTY allowance, and an additional 2.03% to determine the FPFTY allowance. I&E contended that the Company failed to support its proposed increase in outside services expense from the HTY to the FTY, and that, in reality PECO has been experiencing a declining trend in EBSC and contracting service costs in the three years prior to the FTY. I&E M.B., pp. 29-31.

The OCA recommended that the Commission adjust the Company's allowance to reflect the most recent three-year average EBSC expense. The OCA asserted that the Company failed to substantiate its proposed incremental increase in the FPFTY expense over the FTY, and that the Company should not be permitted to use inflation-based adjustments to determine its outside services expense. OCA M.B., pp. 50-52.

The Company's HTY actual outside services expense was $21,648,000. The Company's FTY claim is $21,093,000 and its FPFTY claim is $22,135,000. The Company's FPFTY claim represents an approximately 4.9% increase over the FTY, but only an approximately 2.25% increase over the HTY. The Company's FPFTY claim is also lower than the Company's historical three-year average for outside services expense. *See* PECO M.B., p. 34. *See also* PECO Ex. RJS-2-R, pp. 16-17.

I&E's proposal is unreasonable because its "starting point" is different than the Company's actual HTY expense. As explained in the Company's Main Brief, Mr. Patel's conclusions were drawn solely from an analysis of allocations to Federal Energy Regulatory Commission ("FERC") accounts contained in PECO Exhibit MJT-1, Schedule D-4, when Mr. Patel should have utilized the GAAP-based projections set forth in PECO Exhibit RJS-1 and Attachment III-A-22(a), which were included in the Company's initial filing. *See* PECO M.B., p. 34. *See also* PECO Ex. RJS-2-R, pp. 16-17. Applying Mr. Patel's CPI factors to the HTY data set forth in Attachment III-A-22(a) (i.e., a starting point of $21,640,000 instead of the

$12,818,000 starting point utilized by Mr. Patel) yields a greater FPFTY amount than is being sought by the Company. The Commission should therefore reject I&E's proposed adjustment and approve the Company's outside services expense claim.

The Commission should also reject the OCA's proposed adjustment. Inflation adjustments may be permitted for specific expense items whose prices are expected to increase in the future. This was acknowledged by I&E in its response to the Company's outside services expense. *See* I&E M.B., p. 31 ("I&E also notes that it is not disputing the use of inflation factors, in general, to determine a proforma expense allowance."). The Company's FPFTY claim is only 2.25% higher than the Company's HTY actual expense. This is a reasonable projected increase for an expense that the Company believes will increase in the FPFTY.

D. Other Post-Employment Benefits Expense

The Company is claiming other-post-employment benefits ("OPEB") expense of $1,050,000 in the FPFTY. As explained in the Company's Main Brief, 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 prompted 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 M.B., p. 36; 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; PECO Ex. RJS-3RJ (Confidential), p. 3.

I&E recommended that the Commission deny the Company any incremental FPFTY expense and only permit the Company to recover its projected FTY OPEB claim of $270,000. *See* I&E M.B., pp. 31-33. The OCA recommended that the Commission only permit the Company its historical three-year average of OPEB expense. OCA M.B., pp. 53-54. Both I&E and the OCA contended that their proposed adjustments were warranted, alleging that the Company did not substantiate its claim that the amortization of its prior service credit was expiring resulting in a significant increase in its FPFTY claim over the FTY.

Both I&E and the OCA, however, are ignoring the substantial evidence provided by the Company to substantiate its claim. Mr. Stefani explained the circumstances under which the prior service credit was created, how it was amortized, when the amortization would expire, and how that would result in increased OPEB expense in the FPFTY. PECO St. 2, pp. 7-8; PECO St. 2-R, pp. 25-28; Hearing Tr. 231-33. The Company also provided independent third-party actuarial reports documenting the 2019 and 2020 amounts of the prior service credit at issue, which also confirmed that the prior service credit amortization will expire in June 2021, causing the projected increase in the FPFTY OPEB expense. *See* PECO M.B., p. 37. *See also* Hearing Tr., pp. 231-33; PECO Ex. RJS-1RJ (Confidential), p. 15; PECO Ex. RJS-2RJ (Confidential), p. 15; PECO Ex. RJS-3RJ (Confidential), p. 3.

The expiration of the prior service credit amortization is a known and measurable event, confirmed by the Company's independent third-party actuary, that will increase the Company's

OPEB expense in the FPFTY. The Company has substantiated its claim and, therefore, the Commission should reject the adjustments proposed by I&E and the OCA.

E. Costs To Achieve Exelon/PHI Merger

The Company's claim includes the proposed recovery of $1,111,000 in costs that were incurred to produce merger savings that the Company and its customers realized as a result of the 2016 merger of PECO's parent Exelon Corporation with Pepco Holdings, Inc. (the "costs to achieve" the merger, or "CTA" costs). The Company proposed amortizing the CTA expenses over a three-year period. *See* PECO M.B., pp. 37-38. *See also* PECO St. 3, pp. 40-41; PECO Ex. MJT-1 Revised, Sch. D-15; PECO St. 2-R, p. 12.

The OCA and I&E recommended the Commission disallow the Company's claimed CTA expense in its entirety, asserting that the Company's recovery of these merger costs would result in retroactive ratemaking, and that since customers have not shared in the benefits of the merger, the Company should not be able to recover its expenses to achieve merger benefits. OCA M.B., pp. 54-55; I&E M.B., pp. 33-35. I&E also asserted that since the Company already accrued merger savings greater than its CTA, it should not be permitted to recover its CTA expenses.

However, as explained in the Company's Main Brief, the Commission may permit the recovery of prior period unanticipated, extraordinary, and non-recurring expenses without violating the prohibition against retroactive ratemaking.[12]

These expenses were discrete and limited, and they produced substantial benefits that extend into future accounting periods. The expenses were unanticipated, as the Company's allocated CTA expense was not fully known until after the 2018 CTA was determined. Moreover, these were extraordinary, as they were related to a one-time merger and are non-

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[12] *See Popowsky v. Pa. P.U.C.*, 695 A.2d 448, 452 (Pa. Commw. Ct. 1997). *See also Popowsky v. Pa. P.U.C.*, 643 A.2d 1146, 1149 (Pa. Commw. Ct. 1994).

recurring. Moreover, and more importantly, this expense is tied to merger benefits that PECO's customers are continuing to benefit from and which will continue in the future. The OCA's and I&E's assertions that customers have not shared in merger benefits is without merit. The merger-related savings are passed on to customers through reduced costs to Exelon's distribution utilities, including PECO. As the Company explained in its Main Brief, 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, and the CTA expenses were unanticipated, extraordinary, and non-recurring, the Commission should deny I&E's and the OCA's proposed disallowance and permit the Company to recover its proposed CTA expense, amortized over a three-year period.

F. Regulatory Commission Expenses (General Assessments)

The OCA proposed an adjustment to reduce the Company's regulatory commission expense claim to the amount of general assessments booked in the HTY ($1,735,000). OCA M.B., pp. 55-56. PECO's budgeted increase for these expenses ($462,000 or approximately 26.6% of the book amount) was fully justified by the actual costs ($2,033,423) that PECO incurred for 2021-2022 (FTY) general assessments, which is a 16.6% increase over the HTY level. And, as Mr. Stefani further explained, using the actual percentage increase in general assessments for the FTY to forecast PECO's regulatory commission expenses for the FPFTY would actually exceed the Company's claim. *See* PECO M.B., pp. 39-40. The OCA completely

ignores the evidence presented by Mr. Stefani in its Main Brief. Accordingly, the OCA's proposed adjustment should be rejected.

G. Research And Development Expenses

In its Main Brief (pp. 56-57), the OCA continues to seek an expense adjustment based on the use of a three-year average to calculate the Company's research and development ("R&D") expense. The OCA contends that PECO did not substantiate its budgeted increase for R&D expense in the FPFTY and a historic average is necessary to reflect a "normal" level of this expense. However, as the Company explained in its Main Brief (p. 40), the use of a three-year average would introduce an anomaly because a significant amount of the Company's R&D budget over that three-year period was redeployed to address higher priority needs, including emergent gas leak events. In short, the OCA's assumption that FPFTY levels would be in line with PECO's average R&D expense over the three years ended June 30, 2020 is not reasonable.

H. Employee Activity Costs

As explained in PECO's Main Brief (pp. 41-42), the Company's claim for employee activity costs should be approved because those events provide significant benefits in terms of employee morale and productivity that lead to enhanced customer service. In its Main Brief (pp. 37-38), I&E recites Mr. Patel's objections to PECO's claimed costs for its annual picnic and other employee celebrations. However, those costs relate to employee recognition events, which the Commission has determined are reasonable and necessary in the provision of utility service to customers.[13] I&E has not offered any valid reason to depart from the Commission's prior holding on this issue.

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[13] *See*, *e.g.*, *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*"), p. 71 ("We find the ALJs appropriately applied Commission precedent in the present case, concluding that UGI's picnic was an employee recognition event and recommending allowance of UGI's claim for employee activity expenses.").

The OCA calls into question PECO's forecasted employee activity costs for the FPFTY citing purported uncertainty caused by the COVID-19 emergency. OCA M.B., pp. 57-58. The record confirms that PECO's HTY experience was an aberration related to the stay-at-home orders and other restrictions to mitigate the spread of COVID-19 that were in effect during the second quarter of 2020 but are unlikely to recur in 2021 and 2022. PECO M.B., pp. 41-42. Therefore, the OCA's recommendation to disallow all but PECO's HTY level of employee activity expense should be rejected.

I. Travel, Meals And Entertainment

As explained in PECO's Main Brief (p. 42), its claim for travel, meals and entertainment expenses is fully supported by the record in this case. The HTY and FTY data used to calculate their proposed adjustments (*see* I&E M.B., pp. 38-39; OCA M.B., pp. 58-59) reflects the impact of the COVID-19 pandemic on corporate travel in 2020 prior to the availability of a vaccine.

J. Membership Dues

The Company claimed membership dues expense of $646,899 in the FTY and $655,897 in the FPFTY. *See* PECO M.B., pp. 42-43. I&E contended that the Company's projections are "speculative and unreliable because they are not consistent with general inflation in costs". I&E St. 1-SR, p. 24. Mr. Patel proposed an adjustment by taking the Company's HTY membership dues expense of $561,005 and making a 2.75% CPI adjustment increase for the FTY to arrive at a $576,433 allowance for the FTY, and a further 2.03% adjustment increase for the FPFTY to arrive at a FPFTY allowance of $588,135. *Id.* *See also* I&E M.B., p. 41.

I&E's recommendation should be rejected. As acknowledged by Mr. Patel, the Company's membership dues expense has fluctuated in recent years. The Company's membership dues expense from 2017-18 through its projected FPFTY expense is as follows:

2017-18	2018-19	2019-20	FTY	FPFTY
$586,041	$689,986	$561,005	$646,899	$655,897
Increase YTY	$103,945	-$128,981	$85,894	$8,998
% Change YTY	17.74%	-18.69%	15.31%	1.39%

I&E St. 1-SR, p. 24.

As shown above, the Company's HTY membership dues expense dropped almost 19% from the prior year. The HTY level of expense was an aberration and is not indicative of future levels of expense. These inflationary increases are less than the inflationary increases proposed by I&E; the difference is the starting point. As an example, if I&E had applied its proposed inflationary factors to the Company's three-year historical average (even inclusive) of the abnormally low HTY, it would have arrived at proposed allowances of $629,183 for the FTY and $641,955 for the FPFTY.

The Company does not believe it is reasonable to start from the HTY, given the abnormally low level of expense that year, and I&E has not supported its rationale for doing so. Therefore, the Commission should reject I&E's proposed adjustment.

K. Injuries And Damages

The Company's FPFTY claim for injuries and damages expense is $638,000. *See* PECO M.B., p. 43. The OCA proposed to normalize the Company's claim based on the Company's historical three-year average, which would result in a $464,000 downward adjustment. *See* OCA M.B., pp. 59-61. The OCA asserted that normalization is necessary to avoid an over-recovery, noting that the Company's historical expense in this category has fluctuated from $301,000 in 2018, to -$9,000 in 2019, to $231,000 in 2020. OCA M.B., p. 60.

The Commission should reject the OCA's proposed adjustment. The OCA cites to *A Guide to Utility Ratemaking* for the proposition that regularly occurring expenses, that may occur

at regular intervals, but in irregular amounts, should be normalized so that expenses are fairly recovered on an annual basis. *Id.*[14] However, the OCA fails to note that the real purpose of normalization is to identify and remove non-annual events that would unfairly skew recovery.[15]

The OCA's proposed three-year average is unreasonable since it would reflect a clear aberration in 2019 – a negative $9,000 expense – which was the result of an actuarial update. This negative amount is precisely the type of aberration that normalization attempts to avoid being reflected in rates, as it would unreasonably skew the Company's three-year average downwards. *See* PECO M.B., pp. 43-44. *See also* PECO St. 2-R, p. 24.

The Company's FTY and FPFTY budgeted amounts, on the other hand, were derived from independent third-party actuarial reports that were shared with the parties. These independent third-party reports indicate that the Company's injuries and damages expense will increase significantly in the FPFTY. It would be unreasonable to impose a three-year historical average in place of independent third-party recommendations, especially when one of the years to be factored into the average contains an abnormally low *negative* expense amount. This is exactly the type of result that normalization intends to avoid. Therefore, the Commission should reject the OCA's recommendation.

L. Property Taxes

The Company's FTY and FPFTY property tax expense projections, $3,594,000 and $3,618,000, were determined by applying a 2.5% inflation adjustment to the Company's most recent actual property tax bills from 136 municipalities. The OCA recommended disallowance of the Company's proposed inflation adjustment, which would result in a $112,000 reduction in the Company's recovery of Taxes Other than Income. OCA M.B., pp. 61-62.

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[14] *See also* James H. Cawley and Norman J. Kennard, *A Guide to Utility Ratemaking* (2018), p. 86.
[15] *Id.*, p. 85.

The OCA's proposed adjustment should be rejected. The OCA cited to *Pa. P.U.C. v. Wellsboro Elec. Co.*[16] in support of its contention that the Company's proposed inflation adjustment should be denied. However, in *Wellsboro*, the utility had proposed a blanket three percent inflation adjustment to all of its O&M accounts in its FTY to reach its FPFTY projections.[17] Here, the Company proposed an inflation adjustment to a specific tax expense. Inflation adjustments may be permitted for specific expense items whose prices are expected to increase in the future.[18] The exact amount of future property tax assessments cannot be known at this time. However, it is reasonable to assume that the Company's property taxes will increase on par with a reasonable rate of inflation. Therefore, the Commission should find that the Company's proposed inflation adjustment is reasonable and deny the OCA's proposed adjustment.

M. Energy Efficiency And Conservation Program Costs

Three parties, CAUSE-PA, I&E, and the OCA, addressed the Company's proposed EE&C program in their Main Briefs.[19] CAUSE-PA stated that it is "generally supportive" of the Company's proposed EE&C program. *See* CAUSE-PA M.B., p. 37. CAUSE-PA also supported the direct installation service offered through the proposed Safe and Efficient Heating Program ("SEHP"). *See* CAUSE-PA M.B., p. 38. Along with its support of the EE&C and SEHP programs, CAUSE-PA requested several changes: (1) that PECO include more opportunities for low-income customers to access energy efficient equipment and programing without an upfront cost; (2) a relaxation of the income requirements for the SEHP to include renters and those with

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[16] *Pa. P.U.C. v. Wellsboro Elec. Co.*, Docket No. R-2019-3008208, 2020 WL 2487415 (Pa. P.U.C. Apr. 29, 2020).
[17] *Id.*, pp. *22-23.
[18] *See Pa. P.U.C. v. Pennsylvania Gas and Water Co.*, Docket No. R-00922482, 1993 WL 856537, p. *31 (Pa. P.U.C., June 23, 1993).
[19] PAIEUG took no position on the Company's proposed EE&C program, and OSBA did not address it. *See* PAIEUG M.B., pp. 8-9; OSBA M.B.

incomes between 101%-150% of the Federal Poverty Level ("FPL"); and (3) greater coordination with other low-income programs including the Low Income Usage Reduction Program ("LIURP"), the Low Income Home Energy Assistance Program ("LIHEAP"), and the weatherization assistance program ("WAP"). *See* CAUSE-PA M.B., pp. 38-39.

I&E recommended an EE&C program allowance of $2,727,500, a reduction of $1,772,500 from the Company's request. *See* I&E M.B., p. 43. I&E also recommended that the Company accommodate all EE&C programing within its proposed budget. *See* I&E M.B. p. 44. In other words, I&E did not oppose any of the Company's proposed new EE&C programming, including the SEHP. According to I&E, it based its recommendation on past spending and customer participation in the EE&C program. *See* I&E M.B. pp. 43-45. I&E also pointed to the current low price of natural gas and the resulting long payback of efficiency measures to claim that the Company will be unable to increase participation in the EE&C program. *See* I&E M.B., p. 45.

OCA recommended that the Commission deny the Company's request and instead adopt OCA witness Geoffrey C. Crandall's proposal to maintain the existing EE&C budget and his proposed portfolio. *See* OCA M.B., pp. 62-63. Mr. Crandall's proposed portfolio, if approved, would eliminate funding for rebates for customers who purchase efficient storage hot water heaters or residential boilers. *See* OCA M.B., p. 155. It would also eliminate funding for residential emerging technologies pilot projects. *See* OCA M.B., p. 155. According to the OCA, it eliminated these programs because the individual measures were not cost effective, even though the Company's overall EE&C portfolio was cost effective. *See* OCA M.B., pp. 155-56.

Mr. Crandall's proposal would also sharply reduce funding for rebates for customers who purchase efficient furnaces by 66%, super-efficient furnaces by 70%, and smart thermostats by

85% compared to the Company's proposal. *See* OCA M.B., p. 155. According to the OCA, the reason for these steep reductions is that these individual measures were not cost effective. *See* OCA M.B. pp. 155-56. But the OCA admitted that these measures could be cost effective if the Company used a seasonal avoided cost analysis. *See* OCA M.B., pp. 155-56. Along with eliminating or reducing customer rebates, Mr. Crandall also recommended reducing the administrative costs for the EE&C program and including a reconciliation adjustment mechanism for the commercial EE&C budget.[20] *See* OCA M.B., pp. 155-56, 158.

The Company disagrees with the recommendations from CAUSE-PA, I&E, and OCA for the reasons provided in Section IX.D., below. And for those reasons, the Company requests that its request be approved.

N. Rate Case Expense Normalization

I&E and the OCA have recommended a five-year normalization period for rate case expense, instead of the three-year normalization period employed by PECO. In support of their alternative normalization periods, I&E and the OCA rely exclusively on the intervals between PECO's last three gas base rate case filings. I&E M.B., pp. 46-47; OCA M.B., pp. 63-64. However, the Commission has made clear that it will consider "future expectations" regarding the need for rate relief, such as ongoing capital improvement costs, in determining the appropriate normalization period for rate case expense.[21]

[20] Mr. Crandall also recommended including an evaluation, measurement, and verification ("EMV") study of the Company's EE&C programs, and the Company agreed to do so. *See* OCA M.B., p. 148; *see also* OCA St. 6, p. 37-38; PECO St. 9-R, pp. 9-10.

[21] *See*, *e.g.*, *UGI Electric 2018*, p. 60 ("We agree with UGI that the ALJs did not properly consider the Company's planned acceleration of its capital expenditures in determining the appropriate normalization period…The record evidence supports a finding that a long period between base rate proceedings is highly unlikely and that the Company's proposed use of a three-year normalization period for rate case expense is appropriate.").

This guidance is in no way diminished by the decisions cited by I&E (p. 47) and the OCA (p. 64) in their Main Briefs. In *Pa. P.U.C. v. City of Dubois*,[22] the utility offered no support for a more aggressive rate case normalization period than its filing history other than pure conjecture that rate cases could become more frequent in the future.[23] Similarly, in *Pa. P.U.C. v. Emporium Water Co.*,[24] the Commission found that a general reference to indeterminate increased costs of compliance with regulations was too speculative to justify an accelerated normalization period for rate case expense.[25]

I&E's reliance on *Columbia Gas* is also misplaced. In that case, the Commission found that it was reasonable to rely on an historic pattern of rate cases (i.e., on average, every 20 months) to determine the appropriate period for normalization of rate case expense because the magnitude of *Columbia's* 2020 infrastructure improvement plan would not necessitate annual rate relief.[26] That is not the case here. As explained in PECO's Main Brief (p. 47), the Company's three-year normalization period is reasonable because PECO will invest approximately $1.2 billion to replace, maintain and upgrade gas plant between July 1, 2020 and June 30, 2024. Thus, there is no basis for concluding that PECO could delay a subsequent base rate filing for five years.[27]

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[22] Docket No. R-2016-2554150 (Opinion and Order entered May 18, 2017).
[23] *See id.*, pp. 61-66.
[24] Docket No. R-2014-2402324 (Opinion and Order entered Jan. 28, 2015).
[25] *See id.*, pp. 45-49.
[26] *Columbia Gas*, pp. 78-79.
[27] Quoting from Mr. Morgan's testimony, the OCA contends that "[r]ather than estimate [savings from decreased travel and document production during the pandemic], the annual cost reduction brought about by the 5-year normalization will also to serve to reflect the potential savings." OCA M.B., p. 64. This is a classic red herring because the OCA offers no quantification of the alleged cost savings. Moreover, it would be unreasonable to impose a five-year period in which to normalize PECO's rate case expense based upon evidence of PECO's infrastructure needs from July 2020 through June 2024.

O. Regulatory Initiatives

At pages 65 to 66 of its Main Brief, the OCA reproduces, then ignores, that portion of the Commission-approved settlement of PECO's natural gas unbundling proceeding establishing the Gas Procurement Charge ("GPC") and Merchant Function Charge ("MFC"). As the quoted language makes clear, the Commission authorized PECO to defer all GPC/MFC implementation costs, including IT programming costs. Accordingly, PECO's claim appropriately recognizes O&M expenses associated with IT changes necessary to implement the GPC and MFC. *See* PECO M.B, pp. 48-49.[28]

P. Manufactured Gas Plant Remediation Expense

This issue was addressed at pages 49 to 51 of PECO's Main Brief. The Company simply reiterates that its proposed nine-year amortization period for the Company's unrecovered manufactured gas plant ("MGP") remediation liability is reasonable based on the estimated completion dates for the remaining MGP projects.

Q. Depreciation Expense

The adjustments and arguments presented by I&E and the OCA regarding PECO's claim for depreciation expense, which are concomitant to the opposing parties' adjustments to FPFTY plant additions, have been fully addressed in PECO's Main Brief (pp. 15-21) and in Section IV.B. above.

VII. TAXES

There are no contested issues concerning income taxes. In its Main Brief (p. 51), PECO explained that the OCA's proposed adjustment to eliminate the Company's rate base claim for

[28] In its Main Brief (p. 47), I&E contends that the Commission should adopt a five-year normalization period for regulatory initiatives expense. In doing so, however, I&E offers the same argument that it presents in connection with its proposed rate case expense normalization. As discussed in Section VI.N. above, PECO's proposed three-year normalization is appropriate and the cases on which I&E relies are easily distinguishable.

incremental FPFTY plant additions would have the concomitant effect of increasing income taxes and decreasing the rate base deduction for deferred income taxes. The OCA agrees with the Company and reflected the concomitant adjustments. OCA M.B., pp. 51-52. Issues raised by I&E and the OCA pertaining to taxes other than income taxes are addressed in Sections VI.A. and VI.M. above.

VIII. RATE OF RETURN

A. Introduction

As discussed in its Main Brief, the appropriate rate of return for the Company is 7.64%. The Company's capital structure should be set at its actual capital structure of 53.38% common equity and 46.62% long-term debt. The Company's long-term cost of debt should be set at 3.84% and its cost of equity at 10.95%. *See, e.g.,* PECO M.B., pp. 53-54. The flaws in the rate of return analyses put forth by the OCA, I&E, and OSBA, which would result in a lower rate of return and fail to satisfy Commission standards, are discussed below.

B. Capital Structure

As an operating public utility that issues its own debt directly in the capital markets, PECO's own capital structure ratios should be used to determine its overall rate of return. PECO M.B., p. 55. 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 M.B., p 55; PECO St. 5, pp. 18-19; PECO Ex. PRM-1 (updated), Schs. 1 and 5.

As noted in the Company's Main Brief, only the OCA opposes use of the Company's actual capital structure. OCA argues that a hypothetical capital structure of 50.0% equity and 50.0% debt should be used in the rate of return calculation. OCA M.B., p. 81.

The Commission's policy regarding the use of a hypothetical capital structure in place of the company's actual capital structure is explained in *PPL Electric 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.[29]

The OCA did not meet this standard. The OCA offered evidence that PECO's capital structure is not equivalent to the precise average of the equity and debt ratios of the companies within the barometer group, but that is not the standard. OCA M.B., pp. 80-81; OCA St. 3, pp. 39-40. To depart from the Commission's standard approach, the OCA must show that PECO's capital structure is atypical or "too heavily weighted to debt or equity". In that regard, the OCA's own evidence shows that PECO's capital structure is entirely typical, as the Company's equity ratio is less than four of the companies (i.e., 40%) of the equity ratios of the natural gas companies in OCA witness Kevin W. O'Donnell's barometer group. OCA St. 3 at p. 40 (Table 6). Accordingly, the Company's own capital structure should be used in the rate of return.[30]

The OCA also offered evidence of the capital structure of Exelon Corporation, PECO's parent, but this does not show that PECO's capital structure is atypical or too heavily weighted toward debt or equity. Moreover, as PECO witness Mr. Moul explained, this is an inappropriate comparison: "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. Accordingly, OCA's position should be rejected, and PECO's actual capitalization should be used in the rate of return calculation.

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[29] *PPL Electric 2012*, p. 68 (citations omitted).
[30] *Id*; *Columbia Gas*, p. 116.

C. Cost Of Long-Term Debt

No party disagrees with PECO's proposal to use its actual cost of long-term debt of 3.84%. *See* OCA M.B., pp. 81-82; I&E M.B., p. 9. Accordingly, the long-term cost of debt should be 3.84%.

D. Common Equity Cost Rate

The indicated cost of equity for PECO should be measured with reference to four separate, well-established cost of equity methods: the Discounted Cash Flow ("DCF") methodology, the Risk Premium approach, the Capital Asset Pricing Model ("CAPM"), and the Comparable Earnings method. PECO M.B., p. 59. The results of these methods indicate the following costs of equity for the Company:

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

PECO proposes 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. In particular, PECO proposes a base cost of equity of 10.70%, with a 25-basis point adder in recognition of superior management performance, resulting in a cost of equity of 10.95%.

The proposals by the OCA, I&E, and OSBA are not appropriate. While PECO has found notable flaws in I&E's cost of equity analysis, the proposals by the OCA and OSBA are more troubling as they are more than 200 basis points below the Company's calculation. OSBA did

not provide a typical cost of equity analysis and adopted the OCA's analysis in its Main Brief.[31] Due to numerous errors and incorrect adjustments, the OCA's calculation of the cost of equity is more than 100 basis points below even the lowest of PECO's cost of equity models. The positions of the parties in this case would not provide the Company with a cost of equity that comports with the Commission's standards and United States Supreme Court precedent.

1. Barometer Group

The correct proxy or barometer group to be used consists of the following nine companies: 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. The Company's barometer group is the exact group used by the Commission's Bureau of Technical Utility Services in its most recent report.[32]

I&E disagrees with the inclusion of Southwest Gas Holdings, Inc. ("Southwest Gas") and New Jersey Resources Corp. ("New Jersey Resources") in the barometer group. I&E witness Keller applies a screening criterion for the barometer group that requires at least 50% of revenues from utility operations. As discussed in the Company's Main Brief, however, this is the wrong measure because the percentages of utility assets owned by Southwest Gas and New Jersey Resources are above 60%, demonstrating that they are primarily utility businesses. PECO M.B., pp. 73-74; PECO. St. 5-R, p. 19.

Moreover, I&E's application of a strict 50% "bright line" for revenues under the circumstances of this case is arbitrary. For example, Southwest Gas fails Mr. Keller's test by a

[31] *See* OSBA M.B., p. 5.
[32] 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).

mere three percentage points,[33] yet 83% of its assets are devoted to utility service and 76% of its income is from utility service. PECO St. 5-R, p. 19. Any argument that Southwest Gas's business is incomparable to regulated utility businesses would appear to fly in the face of these facts, but Mr. Keller's test tersely strikes Southwest Gas from any further consideration.

The OCA's barometer group is also incorrect. While OCA includes Southwest Gas and New Jersey Resources in its barometer group, OCA also inappropriately includes UGI Corporation, which is more diversified outside of the gas distribution business than the other companies properly includible in the barometer group. PECO St. 5, p. 6. Thus, UGI Corporation should be excluded from the barometer group. The OCA also used Exelon Corporation as a proxy for PECO's financial risk, which is wrong for the reasons explained in the Company's Main Brief. PECO M.B., p. 73; PECO St. 5-R, p. 18.

2. Use of Multiple Cost of Equity Methods

As noted, PECO's cost of equity is appropriately determined in light of the results of four methodologies: the DCF, CAPM, Risk Premium approach, and Comparable Earnings analysis. The OCA disagrees with the Company's reference to methods other than the DCF methodology. OCA M.B., p. 118. Similarly, I&E emphasizes reliance upon the DCF methodology as the "most reliable," with the CAPM results as a comparison. I&E M.B., p. 55.

These criticisms are without merit, as Mr. Moul's analysis is consistent with Commission policy. Specifically, 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

[33] *See* PECO St. 5-R, p. 19 (showing Southwest Gas Corporation's percentage of total revenues from utility operations is 47%).

ratemaking."[34] Moreover, review of other models is logical as 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. Investors consider the results of the models used by Mr. Moul, so they are appropriately considered here. PECO St. 5-R, p. 40.

3. Discounted Cash Flow Model

a. Dividend Yield

As discussed in the Company's Main Brief, the appropriate dividend yield to be used in the DCF model is 3.79%. PECO M.B., pp. 61-62.

The OCA argues that the Company's calculation of the dividend yield in the DCF calculation is the result of "several" unsupported and unexplained adjustments. OCA M.B., p. 115. Without addressing the merits of Mr. Moul's adjustment, Mr. O'Donnell simply characterized it as "not necessary." *Id.*; OCA St. 3, p. 98. Contrary to OCA's assertion, the adjustments are fully supported in the lower panel of data present on page 15 of 29 of PECO Exhibit PRM-1.

The OCA's position reflects a lack of understanding of the record, as Mr. Moul made only a single adjustment – not several – to his dividend yield calculation, and that adjustment was more than adequately supported and explained. Mr. Moul explained the necessity for the adjustment in his direct testimony, stating: "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. Recall that the DCF is an expectational model that

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[34] 2012 PPL Order, p. 80.

must reflect investors' anticipated cash flows." PECO St. 5, p. 25. Mr. Moul's adjustment is clearly shown on PECO Exhibit PRM-1, Schedule 7, which displays three separate calculations for expected increases in dividends: one at one-half the growth component, a second for discrete growth in the quarterly dividend, and a third for the compounding of the annual quarterly dividends. As further shown on Exhibit PRM-1, the results of these three calculations were averaged in order to provide a single reasonable adjustment (14 basis points) to "reflect the higher expected dividends for the future". PECO St. 5, p. 25; PECO Ex. PRM-1, Sch. 7.

b. Growth Rate

The appropriate growth rate to be used in the DCF model is 7.50%, as discussed in the testimony of Mr. Moul. The Company addressed the differing views of the OCA and I&E on the growth rate in its Main Brief at pages 62-63 and 74-75. In short, a significant flaw in the OCA's interpretation of the DCF model is in the OCA's position that a combination of historic and projected growth rates must be used. Historical data is already factored into analysts' forecast of earnings growth, and the OCA's interpretation is inconsistent with the DCF model. PECO St. 5, p. 28. The fact that projected growth rates must be used is supported in the financial literature and is a point upon which both the Company and I&E experts agreed. PECO M.B., pp. 62-63; I&E St. 2-SR, p. 18.

Where the positions of the Company and I&E primarily diverge on the growth rate calculation is with regard to Mr. Keller's exclusion of one high growth rate estimate for Northwest Natural Gas. Mr. Keller's adjustment is biased toward achieving a lower overall result because, after judging the Value Line growth rate estimate for Northwest Natural Gas as too high, he does not exclude growth rate estimates that are too low. PECO St. 5-R, pp. 22-23. If Mr. Keller had used the Value Line estimate for Northwest 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.

c. Leverage Adjustment

The cost of equity result yielded by the DCF model should incorporate a leverage adjustment of 2.17%. PECO M.B., p. 61. PECO Ex. PRM-1, Sch. 1, p. 2. Summing the dividend yield (3.79%) and the growth rate (7.50%), the leverage adjustment results in a DCF cost of equity of 13.46%. *Id.*

I&E and the OCA both argue that Commission case law supports their positions opposing the Company's recommended leverage adjustment. I&E rejects a leverage adjustment out of hand on the basis that the Commission recently did not specifically adopt a utility's proposed leverage adjustment in *Columbia Gas*. I&E M.B., p. 59. The OCA makes a similar argument, but instead references the Commission's decision in *UGI Electric 2018*. OCA M.B., p. 117. The OCA also points to Mr. Moul's acknowledgement that he could not recall the Commission accepting one of his proposed leverage adjustments in a prior case. *Id.* None of this adds up to a Commission policy against a leverage adjustment. To the contrary, the Commission has granted a leverage adjustment on numerous occasions.[35] The Commission did not accept the utility's proposed return on equity, including a leverage adjustment, in *Columbia Gas*, but also did not provide any discussion of the leverage adjustment one way or another. And, although the Commission did not accept a leverage adjustment in *UGI Electric 2018* "based on the record," the Commission's policy, expressed in that order, is that "the award of [a leverage] adjustment is

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[35] *Pa. P.U.C. v. Pennsylvania-American Water Co*., Docket No. R-00016339 (2002) (approving 60 basis point adjustment); *Pa. P.U.C. v. Phila. Suburban Water Co*., Docket No. R-00016750 (2002) (approving 80 basis point adjustment); *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No. R-00038805 (2004) (approving 60 basis point adjustment); *Pa. P.U.C. v. PPL Elec. Utilities Corp*., Docket No. R-00049255 (2004); *Pa. P.U.C. v. PPL Gas Utils. Corp*., Docket No. R-00061398 (Order dated Feb. 8, 2007) ("*PPL Gas 2007*") (approving 70 basis point adjustment); *Pa. P.U.C. v. Pa. American Water Co*., Docket No. R-0001639 (Order dated Jan. 10, 2012) (approving 60 basis point adjustment).

not precedential but discretionary with the Commission."[36] Thus, Commission precedent does not support the OCA's and I&E's position.

What the Commission cases, including *UGI Electric 2018*, make clear is that a leverage adjustment is entirely appropriate when supported by the record. In *UGI Electric 2018*, the Commission did not find the record persuasive in terms of the leverage adjustment, noting that UGI was seeking a leverage adjustment "based on a perceived risk related to its market to book ratio."[37] In that respect, the Commission found the utility's request to be similar to the leverage adjustment issue in *PPL Electric 2012*, where the Commission denied a leverage adjustment to compensate for "perceived risk related to PPL's market-to-book ratio" as "unnecessary."[38]

Unlike the facts of *UGI Electric 2018*, PECO is not seeking a leverage adjustment based upon protecting or achieving a certain market-to-book ratio for the Company. The leverage adjustment calculated by Mr. Moul is different in that its need arises due to the DCF model's use of the market cost of equity of the barometer group, where the result is then applied to the subject utility's book capitalization for ratemaking purposes. 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. PECO M.B., p. 63. The market costs of equity of the barometer group are reflective of market capitalizations that significantly diverge from the barometer group's book capitalization. The average *market* equity ratio of the barometer group is 66.96%, but the average *book* equity ratio of the barometer group is 51.43%. PECO Ex. PRM-1, Sch. 10. Under these circumstances, Mr. Moul explained that he

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[36] *UGI Electric 2018*, p. 93 (emphasis added).
[37] *Id.*
[38] *PPL Electric 2012*, p. 91.

calculated a leverage adjustment with respect to the barometer group. PECO St. 5, pp. 35-36; PECO Ex. PRM-1, Sch. 10. However, in no way did Mr. Moul attempt to bend the DCF calculation to reflect the market-to-book ratio of the barometer group. Neither the OCA's witness nor I&E's witness refuted Mr. Moul's explanation.

Although I&E claims that no leverage adjustment is necessary because credit rating agencies use book value in their analyses, this assertion was refuted by Mr. Moul. As he explained, I&E's observation is irrelevant because 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 M.B., p. 75.

4. CAPM

The results of the CAPM should be considered in determining the cost of equity for PECO. The results of the CAPM show a cost of equity of 12.67% for the Company.

There are numerous flaws in the CAPM analyses of the OCA and I&E. As discussed in PECO's main brief, the OCA incorrectly used the geometric mean in its historic analysis of the total market returns. PECO M.B., p. 77. Further, neither the OCA's nor I&E's CAPM analyses incorporates 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. *Id.* And neither the OCA nor I&E incorporate a size adjustment in their CAPM analyses, thereby rendering their analyses understated and inappropriate. *Id.*

5. Risk Premium Method

The results of the Risk Premium method should be considered in determining the cost of equity for PECO. The results of the Risk Premium method show a cost of equity of 10.00% for the Company. PECO M.B., pp. 66-67.

Both the OCA and I&E have argued that the Risk Premium method is not entitled to any weight in evaluating the cost of equity because it is too similar to the CAPM. I&E St. 2, pp. 18-19; OCA St. 3, p. 16; OCA M.B., p. 119. These arguments should be rejected. In his rebuttal testimony, Mr. Moul responded to these claims and explained the importance and particular relevance of the Risk Premium method for evaluating a utility's cost of equity:

> The Risk Premium method provides a reasonable measure of the cost of equity because it is based upon the utility's own borrowing rate. Since the yield on public utility debt provides the foundation for the Risk Premium method, its result reflects the fact that common equity carries more risk than utility debt. Moreover, the Risk Premium method is a more comprehensive measure of the cost of equity because it measures more than just systematic risk as provided by the beta in the CAPM.

PECO St. 5-R, pp. 39-40.

The OCA also faults Mr. Moul for using forecasted bond yields in his analysis, asserting that "the best predictor of future yields is the current yield curve". OCA M.B., p. 119. This point was also refuted by Mr. Moul. As Mr. Moul explained, if Mr. O'Donnell's premise were true, then the best predictor of future earnings would be today's earnings, which is obviously not the case. PECO St. 5-R, p. 41. Use of forecasts accommodates the reality that the future will diverge from current circumstances to some degree. *Id.*

6. Comparable Earnings Analysis

The results of the Comparable Earnings analysis should be considered in determining the cost of equity for PECO. The results of the Comparable Earnings method show a cost of equity of 12.00% for the Company. PECO M.B., pp. 67-68.

The OCA opposes consideration of the Comparable Earnings analysis, arguing that the method has been rejected by the Commission before, is entirely subjective, and that Mr. Moul's proxy group of non-regulated firms is dissimilar to PECO as a regulated gas utility. OCA M.B., p. 122. The OCA's objections are without merit. In its most recent case, the Commission has

indicated that it will consider other cost of equity methods in evaluating the cost of equity. In terms of the allegation of "subjectivity," this is not correct: Mr. Moul used a set of specific criteria to screen companies for the proxy group for his analysis and ensure their similarity to PECO. Furthermore, Mr. Moul explained that, under the standard of *Hope* the return to the utility should provide it "with returns on investments in other enterprises having corresponding risks." PECO St. 5-R, p. 42. Obviously, PECO does not compete for capital only with other regulated gas distribution companies, but against an array of companies in multiple industries. The Supreme Court's holding in *Bluefield Water Works vs. Public Service Commission*, 262 U.S. 679, 692-93 (1923) also specifically requires consideration of whether the return on equity for PECO is equal to "investments in other business undertakings," not just the regulated gas distribution industry. The Comparable Earnings approach should be considered because it satisfies the comparability standard established in the *Hope* case.

E. Business Risks And Management Performance

PECO's evidence shows a demonstrated excellence with regard to the quality and reliability of its service, its commitment to energy efficiency, its willingness to embrace cost-effective new technologies, its vigilance in protecting the safety of its workers, and its strong promotion of community and economic development. PECO St. 1, pp. 13-22; PECO St. 1-R, p. 15. PECO has also successfully managed and controlled its operating expenses since its last base rate case in 2010 to deliver savings to customers, with a compound annual growth rate in O&M expense since 2010 of 1.9% (or 1.3% if increases in gas mapping and locate expenses since 2010 are removed). PECO St. 2, pp. 5-6. On these grounds, an adder of 0.25% for strong management performance is appropriate. PECO St. 5, p. 52; PECO M.B., pp. 68-71.

The OCA and I&E oppose the management performance adder. I&E claims that management effectiveness is earning a higher return through the efficient use of resources and

cost cutting measures. I&E M.B., p. 56. I&E argues that PECO should not be awarded additional basis points for doing what it is required to do by the Public Utility Code and the Commission's regulations in order to provide adequate, efficient, safe, and reasonable service. *Id.*, p. 58. The OCA argues that PECO 's J.D. Power scores have not been at the top. OCA M.B., p. 102. The OCA also asserts that the testimony of OCA witness Roger D. Colton, who avers to have conducted his own analysis of PECO's management performance, shows that the Company's performance is not exemplary. Among other things, Mr. Colton reviewed certain information on (1) the ease of being able to reach PECO; (2) the ease of using PECO's automated telephone service; (3) the way in which PECO customer service representatives handled a customer-initiated contact with the Company; (4) the Company's call center representatives' "courtesy"; (5) the extent to which PECO's call center representatives were found to be "knowledgeable" in their contacts with customers; and (6) PECO's "overall quality of service" during a recent contact with the utility. OCA St. 5, pp. 91-108.

The evidence introduced by the OCA and I&E regarding the management performance adder is selective and did not diminish the overall picture presented in the evidence of Mr. Bradley. Both the OCA and I&E witnesses focused on J.D. Power scores without acknowledging the improvement over time. 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. Over a longer period, the data is clear on the improvement in customer service:

> Historical data shows that PECO customer satisfaction scores for the PUC Transaction study of no lower than 88% from 2016 through 2019. Prior to that time period, there was a significant improvement from 2014 (82%) to 2016 (88%). PECO achieved similar results on J.D. Power scores of no

> lower than 89% from 2015 through 2019, with a significant improvement from 2014 (84%) to 2015 (89%).

PECO St. 1-R, p. 16. These improvements resulted from the Company's efforts to improve customer satisfaction. *Id*. While the Company does not claim to have yet received the top-most scores from J.D. Power, the improvements in the scores over time shows the exemplary effect of the Company's management on overall performance.

The OCA also argues that certain of PECO's safety and reliability enhancements are attributable only to requirements of the Penrose Lane Settlement. OCA M.B., p. 101. However, this claim is flawed because the OCA does not recognize that the technology incorporated in the Penrose Lane Settlement was already under development through the Gas Technology Institute (in which PECO is a member) prior to the incident, and PECO had already developed plans to migrate its geographic information system from its electric system to its gas operations. PECO St. 1-R, p. 17.

The OCA also argues that a management performance adder was unwarranted in light of the COVID-19 pandemic, but the OCA did not adequately account for the variety of initiatives that PECO undertook to assist customers during the COVID-19 pandemic, which were described by PECO witness Kelly Colarelli in PECO Statement No. 10-R.

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

I&E recommends a cost of common equity of 10.24%. I&E M.B., p. 9. The OCA recommends a cost of common equity for the Company of 8.75%. OCA M.B., p. 74.[39]

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[39] PECO notes that the OCA's recommended return is lower than the 10.2% Distribution System Improvement Charge ("DSIC") market-based return on equity for gas distribution utilities recently authorized by the Commission. *See Report on the Quarterly Earnings of Jurisdictional Utilities For The Year Ended September 30, 2020*, Docket No. M-2020-3023406 (issued January 14, 2021), p. 23; PECO St. 5-R, p. 13.

PECO explained in its Main Brief the flaws in I&E's and the OCA's cost of equity analyses. *See* PECO M.B., pp. 71-79. For the barometer group, I&E's barometer group inappropriately excludes New Jersey Resources and Southwest Natural Gas, and the OCA's barometer group inappropriately excludes UGI Corporation. *See* Section VIII.D.1., *supra*.

In terms of the DCF methodology, as discussed in Section VIII.D.3., *supra*, I&E used a flawed growth rate estimate due to its disregard of the Value Line estimate for Northwest Natural Gas. The OCA's DCF methodology is flawed due to the errors in the barometer group and the failure to incorporate a leverage adjustment.

With respect to the CAPM, the analyses of the 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 bonds, (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. PECO M.B., pp. 76-78. In addition, Mr. 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. *See id*.

I&E did not put forth an analysis under the Risk Premium or Comparable Earnings methods. The OCA rejected the Risk Premium method. Their criticisms of these methods are addressed above and in PECO's Main Brief. PECO M.B., pp. 78-79.

OSBA did not offer any analysis under the standard models employed by Mr. Moul or the other witnesses. After asserting that the DCF model has significant disadvantages in its use of forecasted growth rates and the inherent perpetual growth rate assumption, OSBA recommended that the Commission adopt the OCA's recommendations. OSBA M.B., pp. 6-9. For the reasons

discussed in PECO's Main Brief and in this Reply Brief, both the arguments put forward by OSBA and the OCA's recommendation it now supports should be rejected. PECO M.B., pp. 71-72.

IX. CUSTOMER PROGRAMS AND MISCELLANEOUS ISSUES

A. Recommendations Related To The COVID-19 Emergency

The OCA recommends that PECO implement an Emergency COVID-19 Relief Plan ("ERP") to provide financial and collections relief to qualifying residential customers. OCA M.B., pp. 127-29. The OCA contends that the Company's existing efforts, such as offering a 24-month payment arrangement to any residential customer and providing information about universal service programs to residential customers identifying a financial difficulty, are insufficient. *Id.* at 130-32. The OCA further claims that "PECO has only enrolled 25.8% of its confirmed low-income customer population" in the Company's Customer Assistance Program ("CAP") and that PECO's 24-month payment arrangements are "not consistent with Section 1405(b) of the Public Utility Code".[40] *Id.*

As PECO explained in its Main Brief (pp. 80-82), the Company has taken several proactive measures to assist residential and low-income customers during the COVID-19 pandemic and, for collections matters, has acted consistently with the Commission's directive at Docket No. M-2020-3019244. In addition, the OCA is mistaken about the enrollment of confirmed low-income customers in CAP. PECO's CAP participation rate, as defined by the Commission, is **77.5%** and the *highest* of any natural gas distribution company. *See* PECO St. 10-R, p. 6. Finally, the Company's standard offer of a 24-month payment arrangement is not inconsistent with Section 1405(b) of the Public Utility Code because it does not preclude a

[40] 66 Pa. C.S. § 1405(b) provides "not to exceed" payment arrangement lengths for customers with different income levels.

longer payment arrangement being granted to customers based on income information. For all these reasons, the ERP should be rejected by the Commission.

CAUSE-PA recommended some temporary changes to PECO's universal service programs in light of the COVID-19 emergency. The Company has addressed these recommendations, along with CAUSE-PA's other universal service proposals, in the following Section IX.B.

B. Universal Service Programs

In its Main Brief, CAUSE-PA continued to recommend that multiple changes to the Company's CAP, Matching Energy Assistance Fund ("MEAF") and LIURP be implemented as part of this base rate proceeding. CAUSE-PA M.B., pp. 15-37.

The Company explained that such proposals would be better considered as part of the ongoing proceeding that is dedicated to the Company's proposed 2019-2024 Universal Service and Energy Conservation Plan ("2019-2024 USECP") 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.[41] Considering universal service proposals in isolation and apart from the 2019-2024 USECP proceeding would deny all parties a complete view of how such proposals may impact other parts of the USECP. PECO M.B., pp. 82-83. The OCA joined the Company in recommending that several of CAUSE-PA's recommendations be considered in the 2019-2024 USECP proceeding instead of this base rate proceeding. OCA M.B., p. 138 (energy burden recommendation); p. 140 (arrearage forgiveness); and p. 142 (plan to increase CAP enrollment).

[41] Significantly, the 2019-2024 USECP changes the format of PECO's CAP from a Fixed Credit Option ("FCO") to a Percentage of Income Payment Plan ("PIPP"). PECO expects the PIPP to improve bill affordability for all CAP income groups as compared to the current FCO. PECO M.B., pp. 82-83.

While the Company's full responses to CAUSE-PA's specific CAP, MEAF and LIURP recommendations are provided in PECO's Main Brief, certain issues are highlighted in the following paragraphs. Notably, CAUSE-PA *never* squarely addresses the recommendation of PECO and the OCA that CAUSE-PA's proposals be considered in the full context of the 2019-2024 USECP proceeding instead of this base rate proceeding.

Regarding CAUSE-PA's CAP proposals,[42] PECO explained that most of the issues raised are either pending before the Commission in other proceedings (e.g., adoption of new energy burdens, adjustment of the CAP credit after a rate increase, enhanced customer outreach), or already being implemented by the Company (e.g., waiving late fees and reconnection fees). PECO M.B., pp. 84-85. The Company emphasized that, consistent with the Commission's recent findings in *Columbia Gas*, energy burden and CAP credit calculation issues should not be considered separately from other parts of the Company's universal service programs.[43] The OCA similarly argued that CAUSE-PA's CAP proposals should be considered as part of the 2019-2024 USECP proceeding, and also noted that such consideration would permit CAUSE-PA to provide programmatic and operational details that are currently lacking from certain proposals. OCA M.B., p. 138 (energy burden recommendation); p. 140 (arrearage forgiveness); and p. 142 (plan to increase CAP enrollment). For all these reasons, the Commission should reject CAUSE-PA's CAP proposals.

Regarding CAUSE-PA's MEAF proposals,[44] PECO explained that it has already implemented several temporary modifications to MEAF requirements to expand customer

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[42] CAUSE-PA's CAP proposals are summarized on page 84 of PECO's Main Brief.
[43] *Columbia Gas*, p. 160 (finding that a utility's energy burden 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] CAUSE-PA's MEAF proposals are summarized on pages 85-86 of PECO's Main Brief.

eligibility and disagreed with the recommendation to waive the zero-balance requirement because MEAF is not intended to be a supplemental grant program. Finally, PECO did not support CAUSE-PA's proposal to divert pipeline refunds to MEAF because such refunds are currently applied to reduce the Purchased Gas Cost for all non-shopping PECO customers. PECO M.B., pp. 85-86. For these reasons, CAUSE-PA's MEAF proposals should be rejected.

Finally, PECO responded to CAUSE-PA's LIURP proposals[45] by explaining that many of the issues raised by CAUSE-PA, including overall program funding, spending limitations and high-usage thresholds are all pending before the Commission at Docket No. M-2018-3005795. Regarding CAUSE-PA's proposal to make an *electric* heating pilot permanent, PECO explained that such a decision is premature without final data, and, in any event, should not be made in a *gas* base rate proceeding. PECO M.B., p. 85. For all of these reasons, the Commission should reject CAUSE-PA's LIURP proposals.

C. Neighborhood Gas Pilot Rider

Only I&E addressed the NGPR.[46] As for I&E, it recommended that the PUC approve the Company's proposed revision to the NGPR to include the first 40 feet of main extension per customer. *See* I&E M.B., p. 60. But I&E also recommended that the Commission continue the annual allowance of $5 million for the NGPR program, which is $2.5 million less than the Company's request. *See* I&E M.B., pp. 60-61. I&E claims that its proposed budget is reasonable and reflects the spending and customer participation levels during the first five years of the NGPR. *See* I&E M.B., pp. 60-62.

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[45] CAUSE-PA's LIURP proposals are summarized on page 85 of PECO's Main Brief.

[46] CAUSE-PA, the OCA, OSBA, and PAIEUG either stated they had no position on the NGPR or simply did not address it. *See* CAUSE-PA M.B., p. 37; OCA M.B., p. 142; PAIEUG M.B., p. 9 (took no position on the NGPR); *see also* OSBA M.B. (did not address on the NGPR).

I&E's proposal should be rejected for three reasons. First, I&E's proposed budget ignores the added cost of providing 40 feet of main extension per customer. Providing these main extensions at no cost to customers will require significant capital expenditures that justify the Company's request. Second, I&E's proposed budget, if approved, would unnecessarily limit customer participation in the program. Its proposal would increase program capital costs without increasing the budget and would thus limit customer participation. In contrast, the Company's proposed changes and increased budget are designed to increase customer participation in the program by lowering costs for customers. *See* PECO St. 9-R, p. 11. Third, as stated in the Company's Main Brief, the data shows that there is strong customer interest in the program. *See* PECO M.B., p. 87; PECO St. 9-R, pp. 11-12. Furthermore, PECO expects the number of installed projects to increase if its proposed changes are approved. *Id.* For these reasons, I&E's proposal should be rejected and the Company's request should be approved.

D. Energy Efficiency & Conservation Programs

As discussed above in Section VI.M., CAUSE-PA, I&E, and the OCA requested changes to the Company's EE&C program. In brief, CAUSE-PA generally supported the Company's request but also requested that the Commission require the Company to increase access to energy efficient equipment for low-income customers with no upfront costs, relax eligibility requirements for the SEHP, and coordinate the EE&C program with other low income programs. *See* CAUSE-PA M.B., pp. 38-39. I&E requested an EE&C program allowance of $2,727,500, a reduction of $1,772,500 from the Company's request. *See* I&E M.B., p. 43. And the OCA asked the Commission to adopt Mr. Crandall's proposal to maintain the existing EE&C budget and to either eliminate or sharply reduce the budget for specific efficiency measures. *See* OCA M.B., pp. 62-63, 155-56.

The Company responded to CAUSE-PA's recommendation to increase access to EE&C programs for low-income customers by noting that all EE&C measures are already available to all low-income customers. CAUSE-PA asked, however, that these measures be expanded to provide access to energy efficient equipment and programing "without an upfront cost". *See* CAUSE-PA M.B., p. 39. But CAUSE-PA identified no source of funding for its proposal. The Company proposed the SEHP to provide specific measures that are only available to low-income customers. These include system inspections, combustion tests, maintenance education, installation of a ten-year carbon monoxide detector, heating system service with extra filters, and a limited number of system replacements. *See* PECO St. 9, p. 7. In other words, the SEHP is not only focused on efficiency but also on safety.

As to CAUSE-PA's recommendation to relax the income eligibility requirements for the SEHP program to include renters and those with incomes between 101-150% of the FPL, the proposed program is available to renters with income between 0-50% of the FPL. The scope of the program, and thus participation, is limited by available funding, which could be restricted further based on the outcome of this proceeding. Finally, as to CAUSE-PA's recommendation to increase coordination with other programs such as LIURP, LIHEAP and WAP, the Company already coordinates with these programs and will continue to do so. The Company has also agreed "to hold a collaborative meeting to discuss coordinating the Company's EE&C program with other services for low-income customers". *See* PECO St. 9-R, p. 9.

The Company responded to I&E's and the OCA's request to approve a reduced budget by noting that their proposed budgets would result in fewer customers benefiting from EE&C programs. This is the wrong approach. The OCA's proposal, in particular, would slash the number of customers who could benefit from these programs. As shown in the following table,

the OCA's proposal would reduce customer participation by 70% from the Company's proposal for program years 2021-2024.

Measure	PECO Proposal (per year)[47]	OCA Proposal (per year)[48]	Underserved from PECO Proposal
ENERGY STAR® Furnace[49]	5,525	1,877	3,648 (66%)
ENERGY STAR® Boiler	500	0	500 (100%)
ENERGY STAR® Water Heater	250	0	250 (100%)
Total (per year)	**6,275**	**1,877**	**4,398 (70%)**
Totals	**25,100**	**7,508**	**17,592(70%)**

The above chart shows that the OCA's proposal would prevent 4,398 customers from receiving rebates every year for the next four program years, or a total of 17,592 customers over the four-year program. The Company designed the program to reflect market data and identified market trends, and growing customer interest. *See* PECO St. 9, p. 9, PECO St. 9-R, p. 7. In contrast, the OCA's proposed reductions would reduce both customer participation and energy savings.

The OCA claims that its proposal has a higher Total Resource Cost ("TRC") and is thus more cost effective.[50] *See* OCA M.B., p. 157. But the TRC was not designed or intended to be the sole barometer of an EE&C program, as the OCA seems to suggest. Rather, the focus of the TRC analysis is simply to ensure that the portfolio *as a whole* is cost effective. If the

[47] *See* Schedule GCC-SR-3; *see also* Schedule GCC-SR-4, p. 1.
[48] *See* Schedule GCC-SR-5, p. 1.
[49] Combining ENERGY STAR® Furnaces >=95% Annual Fuel Utilization Efficiency ("AFUE") and >=97% AFUE.
[50] The OCA also claims that PECO's revised TRC calculation was flawed because it did not include the incremental cost of an electronically commutated motor ("ECM") fan for efficient furnaces. *See* OCA M.B., p. 152. But as the Company explained, the cost of an ECM fan was included in the calculation. *See* Hearing Tr. 206-08.

requirement was to design an EE&C program with the highest possible TRC, PECO could do so by removing very cost ineffective measures (for example, the SEHP has a TRC of just 0.2). But doing so would prevent the Company from building a diverse portfolio of measures to benefit as many customers as possible.

Finally, the OCA recommends reducing the administrative budget for the EE&C program to $300,000 per year. *See* OCA M.B., pp. 155-56. But, as Mr. Crandall later recognized, the administrative costs for the SEHP are included in that program's total budget. *See* OCA M.B., p. 159 (quoting OCA St. 6-SR, pp. 15-16). When the SEHP is excluded from the overall proposed budget, the Company's and the OCA's proposed administrative budgets are nearly identical. The Company's budget is 30% of the overall residential budget ($1,050,625 / $3,528,125) and the OCA's is 29% of its proposed residential budget ($300,000 / $1,030,500).[51] In short, both the Company and the OCA agree that a 30% budget for the residential EE&C program is reasonable.

In summary, the Company proposed an expanded EE&C program to provide benefits to the greatest number of customers along with a program to benefit low-income customers through both efficiency and safety upgrades. For the reasons above, the Company's request should be granted.

E. Quality Of Service

1. Distribution Integrity Management Program

In his testimony in this proceeding, PECO Vice President for Gas, Ron Bradley described PECO's federally mandated Distribution Integrity Management Program ("DIMP") used to identify and resolve risks to its gas distribution system. The DIMP provides a rigorous

[51] *See* OCA M.B., p. 155.

framework for analyzing, ranking, and mitigating threats, and evaluating the effectiveness of risk mitigation actions as part of PECO's "holistic" approach to distribution system risk management. Mr. Bradley provided examples of the indicators that PECO uses to assess the effectiveness of the DIMP in its other system management activities, including * * * **BEGIN CONFIDENTIAL** * * * * * * **END CONFIDENTIAL** * * *. PECO M.B., p. 90; PECO St. 1-R, p. 7.

I&E is the only party to criticize PECO's DIMP, and I&E witness Bozhko presented several criticisms of the risk categories in PECO's DIMP program in her testimony. * * * **BEGIN CONFIDENTIAL** * * * * * * **END CONFIDENTIAL** * * *.

In its Main Brief, I&E did not present any argument regarding the issues discussed by Mr. Bradley and Ms. Bozhko and simply "refers the reader" to Ms. Bozhko's testimony in support of unspecified recommendations in Ms. Bozhko's testimony. I&E M.B., p. 63. * * * **BEGIN CONFIDENTIAL** * * *

* * * END CONFIDENTIAL * * * In light of Mr. Bradley's testimony and the absence of any argument from I&E in its Main Brief, the Commission should reject Ms. Bozhko's recommendations in their entirety.

2. Leaks and Excavation Damage

As with the testimony and issues in this proceeding relating to PECO's DIMP, I&E again chose not to address any of the testimony of Mr. Bradley and Ms. Bozhko regarding leaks and excavation damage in its Main Brief. *Compare* PECO M.B., pp. 93-94 *with* I&E M.B., p. 64. *** * * BEGIN CONFIDENTIAL * * *** *** * * END CONFIDENTIAL * * *** The Commission should therefore also reject Ms. Bozhko's unsupported recommendations for changes in PECO's monitoring and mapping programs.

X. RATE STRUCTURE

A. Cost Of Service

Differences among the parties' respective approaches to cost of service analysis focus on two principal issues: (1) whether the Average and Excess Demand ("A&E") method or the Peak and Average Demand ("P&A") method should be used to allocate the cost of mains among

customer classes; and (2) whether the costs allocated on the basis of average demand should be proportional to PECO's actual system load factor or to an arbitrarily selected value of 50%.

Four of the five parties that addressed the first issue affirmatively supported the A&E method (PECO and I&E) or accepted the A&E method as appropriate for use in this case (OSBA and PAIEUG). Three of the five parties that addressed the second issue supported weighting "average" demand on the basis of PECO's system load factor as prescribed by the treatise *Gas Rate Fundamentals* (PECO, I&E and PAIEUG), while two parties proposed a 50% weighting of average demand (the OCA and OSBA). Significantly, however, OSBA witness, Robert D. Knecht, opposed allocating any portion of mains costs based on average demand because "mains costs are not causally related to average use". However, he set aside his theoretical opposition to allocating any mains costs based on average demand because he mistakenly believed that a 50% weighting of average demand is required by Commission "precedent". That is not the case, as explained below and in PECO's Main Brief (pp. 100-101).

1. The A&E Method Should Be Used In This Case

The OCA opposes the A&E method and proposes using the P&A method, which its witness, Glenn A. Watkins, employed to prepare an alternative cost of service study ("COSS"). 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). 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 necessarily includes average demand). Consequently, the P&A method introduces a bias against high load-factor customers, who use the distribution system more uniformly (and, therefore, more efficiently) than customers whose peak demands

are much higher than their average usage. Because residential customers have highly temperature-sensitive demand and correspondingly low load factors, the P&A method's double-counting of average demand understates the cost of service for that class while overstating the cost of service of more efficient users of a gas utility's distribution system. This bias against high load factor customers is amplified when an arbitrary 50% weighting is assigned to average demand.

In its Main Brief, the OCA summarizes six reasons its witness offered as purported support for favoring the P&A method over the A&E method. All those reasons lack merit and should be rejected.

The OCA Erroneously Contends That The A&E Method Is "Rarely Applicable Or Used In The Natural Gas Industry" (OCA M.B., pp. 165-66). The OCA's contention is contradicted by authoritative texts, Commission precedent, the practices of other gas utilities and the positions taken by a majority of the parties in this case that addressed the use of the A&E method.

The A&E method is described as a recognized and well-accepted COSS methodology in the widely-accepted treatise *Gas Rate Fundamentals* published by the American Gas Association, as evidenced by the excerpt from that text Mr. Watkins reproduced as Schedule GAW-2 to OCA Statement No. 4. Moreover, the Commission has approved the use of the A&E method in litigated base rate cases for PPL Gas Utilities Corporation ("PPL Gas") and the Philadelphia Gas Works ("PGW"),[52] as I&E, OSBA and PAIEUG acknowledge. And, the A&E method has been used by additional gas utilities in cases where a specific PUC finding was not made because those cases were resolved by settlement. *See* PAIEUG M.B., pp. 12-13 and n.33.

[52] *PPL Gas 2007*; *Pa. P.U.C. v. Phila. Gas Works*, Docket No. R-00061931 (Sept. 28, 2007) ("*PGW 2007*").

Finally, as previously explained, expert witnesses of four other parties testified in favor of using the A&E method in this case as the preferred approach to analyzing class costs of service.

OCA Erroneously Contends That Non-Coincident Class Peak Demands "Have Absolutely Nothing To Do With How Natural Gas Distribution Mains Are Designed [And] Operated" (OCA M.B., p. 167). The OCA's contention, which it failed to support with anything other than its witness's opinion, is directly contradicted by factual evidence presented by PECO witness Jiang Ding, who testified to PECO's actual design criteria – which are driven by peak demand, not "average" usage. PECO St. 6, p. 7. *See also* PAIEUG St. 1-R, p. 4. The causal relationship between class peak demands and the manner in which gas distribution mains are designed, sized, constructed and operated is a fundamental principle that was accepted by the cost-of-service experts who authored *Gas Rate Fundamentals* and set forth the A&E method as an accepted approach to cost-of-service analysis. *See* OCA St. 4, Sch. GAW-2. *See also* OCA St. 1, p. 22 ("[M]ains costs are not causally related to average use").

The OCA Erroneously Contends That There Is "No Double Count" Of Average Demand Under The P&A Method (OCA M.B., p. 172). The OCA claims that the P&A method does not produce a "double count" because "average" demand and "peak demand" are "different concepts." However, the OCA advances a purely rhetorical argument; simply because different names are attached to the concepts of "average" and "peak" demand does not defeat the facts, which demonstrate with mathematical certainty that "peak" demand includes "average" demand and produces a double count. PECO explained this bias inherent in the P&A method in its Main Brief (p. 101), and PAIEUG provided the mathematical proof of the double count in its Main Brief (pp. 15-17).

The OCA Erroneously Contends That The A&E Method Does Not Properly Recognize "Economies Of Scale" (OCA M.B., p. 168). The OCA's contention that the A&E method fails to properly recognize "economies of scale" is based upon a hypothesis that is conceptually flawed and factually unsupported. Specifically, the OCA asserts that the "incremental" cost of increasing the "capacity" of distribution mains to meet peak demands is less than the average cost of distribution mains designed solely to meet "average" demands. However, every COSS analyzes and allocates average plant costs without regard to factors that might have an incremental effect on the cost of serving particular customers or classes (for example, the composition of the plant installed to serve particular areas or differences in excavating and restoring paved versus unpaved surfaces or rural versus urban areas). The OCA is trying to introduce the concept of "incremental" costs only to the limited extent that it believes doing so might serve its purpose (i.e., to allocate more costs based on average demand), while ignoring the fact that COSSs do not employ, nor are they intended to employ, a comprehensive incremental approach in analyzing cost of service. The OCA's contention also lacks factual support. The OCA makes two fundamental assumptions, namely, that excavation, installation and restoration costs do not vary in proportion to the size of pipe being installed and that the cost of pipe itself does not vary linearly with its capacity to meet increasing customer demands. Both assumptions are erroneous. Excavation, installation and restoration costs vary between different locales and types of service for many reasons. The OCA's assumption that "average" excavation, installation and restoration costs vary little, if at all, from the system-wide "average" is unproven and not correct. In short, there is no basis for OCA's assumption that zero correlation exists between the capacity (size) of pipe and the excavation, installation and restoration costs for such pipe. The OCA also errs in asserting – again with no evidentiary

support – that the materials cost for pipe does not correlate with the capacity of that pipe to meet increasing levels of customer peak demand. As Ms. Ding testified, the need to meet increasing demands drives pipe size, and pipe size drives the kind of pipe being installed. Higher demands require larger pipe, and larger pipe is made of more expensive material (e.g., steel versus plastic). PECO St. 6-R, p. 7. Capacity correlates with demand. It also correlates with incrementally higher plant costs. Mr. Watkins' "economies of scale" argument is long on theory and sorely deficient in facts to support that theory. In fact, the evidence in this record refutes Mr. Watkins' theory.

The OCA Erroneously Contends That The Commission's Decision In The Columbia Gas Rate Case Rejected The Validity Of The A&E Method (OCA M.B., p. 169). The OCA claims that the Commission's Order in *Columbia Gas* was an unqualified endorsement of the P&A method that foreclosed any further consideration of the A&E method and rejected the A&E method's results in allocating the cost of mains. That is simply not correct. As explained in detail in PECO's Main Brief (pp. 102-103), the *Columbia Gas* case did not present a head-to-head contest of the A&E method and the P&A method because an A&E-based COSS was not presented by any party in that case. Forced to choose the least-bad alternative among the methods that were presented, the Commission, at the urging of I&E, chose to rely on the results of the P&A method that was available to it. Significantly, in this case, where a sound A&E analysis has been performed and presented by PECO, I&E's witness fully supports its use and accepts the results of the revised COSS presented in PECO's rebuttal case. *See* I&E M.B., pp. 65-66.

The OCA tries to minimize the precedential value of the *PPL Gas 2007* and *PGW 2007* decisions, which validated the use of the A&E method, because Mr. Watkins claimed neither

case presented a head-to-head contest of the A&E and P&A methods. However, Mr. Watkins admitted that he was the OCA's witness in *PPL Gas 2007* and conceded that, despite his strong advocacy of the P&A method in this case, he did not propose a P&A COSS in *PPL Gas 2007* and, in fact, accepted the results of the A&E method presented by the expert for *PPL Gas 2007*. OCA St. 4-R, pp. 5-6; OCA M.B., pp. 173-74. Similarly, Mr. Watkins acknowledged that, in *PGW 2007*, PGW presented a COSS that allocated mains costs based on number of customers and peak demand, which other parties, including I&E, found unacceptable. In that case, where I&E had the opportunity to present an alternative allocation method it deemed to be the best, it selected and used the A&E method for its COSS. *See* OCA M.B., pp. 174-75. And, in its 2010 base rate case, which was resolved by settlement, PGW's expert followed I&E's lead and used the A&E method. Thus, the recent history of PUC decisions lessens the import of the Commission's reliance, in *Columbia Gas*, on the erroneous observation of the Administrative Law Judge in that case that the Commission has "consistently used the Peak & Average methodology". *See Columbia Gas* p., 217, quoted at OCA M.B., p. 169.

The OCA Erroneously Contends That The Commission Should Rely On Decisions From The 1980s And Early 1990s That Pre-Dated The Natural Gas Choice and Competition Act (OCA M.B., p. 175). Although the OCA asks the Commission to afford little or no weight to the decisions in the fully litigated *PPL Gas 2007* and *PGW 2007* cases, it advocates relying on decisions that are much older and, in fact, pre-date the 1999 enactment of the Natural Gas Choice and Competition Act, which fundamentally restructured the gas industry in Pennsylvania by unbundling supply and distribution rates and introducing competition and customer choice for gas supplies. *See* OCA M.B., p. 175, n. 184. The OCA's reliance is

misplaced. The Commission's 2007 precedent should not be subordinated to the much older, pre-restructuring decisions cited by the OCA.

2. Average Demand Should Be Weighted by PECO's System-Wide Load Factor, Not an Arbitrarily Assigned 50% Value

For the reasons set forth above, the A&E method should be used to allocate the cost of mains in this case, as PECO has proposed. The A&E method, as specifically described and applied in the authoritative text *Gas Rates Fundamentals*, is designed to use a gas utility's system-wide load factor to weight the average demand component.[53] The complement of the system load factor (one minus the load factor) is used to weight the "excess" component. For PECO, the weighting factors are 25.3% (average) and 74.7% (excess).

Use of the A&E method normally entails using system load factor to weight average demand. In fact, the National Association of Regulatory Utility Commissioners ("NARUC") *Gas Distribution Rate Design Manual* (1989) also prescribes weighting average demand by a gas utility's system load factor when applying an average and peak allocation methodology such as the P&A method.[54] OSBA, while supporting the A&E method, proposed modifying it from the terms prescribed in *Gas Rates Fundamentals* by employing a 50% weighting of average demand. Mr. Knecht contended that, based on his reading of the *PPL Gas 2007* and *PGW 2007* decisions, the Commission expressed a preference for a 50% weighting of average demand. However, he conceded that a 50% weighting was *not* used or accepted in *PPL Gas 2007*. In *that case*, the

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[53] *Gas Rates Fundamentals*, p. 144 (*see* OCA St. 4, Sch. GAW-2, p. 1), states: "Under the A&E method, also called 'used and unused capacity,' capacity costs are allocated by a two-part formula. It recognizes both the average use of capacity and responsibility for the capacity required to meet the maximum system load. Used capacity costs are calculated by multiplying total capacity costs by the system load factor."

[54] *Gas Distribution Rate Design Manual* (NARUC 1989), p. 27 ("Total demand costs are multiplied by the system's load factor to arrive at the capacity costs attributed to average use and are apportioned to the various customer classes on an annual volumetric basis.") (included in OCA St. 4-SR, Schedule GAW-2SR, pp. 9-10). Consequently, Mr. Watkin's use of an arbitrary 50% weighting of average demand also deviates markedly from the rules for applying the P&A method set forth by NARUC.

Commission explicitly stated that it was accepting the classic formulation of the A&E method that employs system load factor to weight average demand. *See* PECO M.B., p. 100 and n. 53. In *PGW*, I&E prepared an alternative COSS using the A&E method and employed a 50%-50% weighting of average and excess demands. However, because PGW used an entirely different cost allocation approach (i.e., neither the A&E nor the P&A method) it is an open question whether its system load factor was a data point available for use by I&E. Consequently, OSBA's reliance on its perception of PUC precedent is clearly misplaced.

Significantly, OSBA admits that Mr. Knecht's modification of the A&E method to employ a 50% weighting of average demand does not have a significant impact on the present rates of return for the residential (Rate GR) and general service (Rate GC) classes, as shown by the table at page 14 of OSBA's Main Brief. In fact, the class rate of return is the same for Rate GR under the approaches used by PECO, the OCA and the OSBA, while the differences in class rate of return for Rate GC under those three parties' approaches are modest (within a range of 8.1% to 9.1%). The same is not true for other major classes, however. As OSBA conceded, "the primary issue of debate involves the disparate results for the transportation service classes" because the approaches favored by the OCA and OSBA allocate a higher proportion of total costs to Rates TS-F and TS-I. To illustrate, for Rate TS-I, PECO indicates a class rate of return of 8.3%, while the OCA and OSBA indicate class rates of return of 3.1% and 3.0%, respectively.

The results summarized by OSBA are consistent with the outcome to be expected when average demand is arbitrarily weighted at 50% rather than PECO's actual lower system load factor. Allocating a greater proportion of costs based on average demand creates a factually unsupportable bias against high-load factor customers (such as those served on Rates TS-F and TS-I) who use PECO's distribution system more efficiently than customers with high seasonal

variability, higher temperature-sensitive peak demand and correspondingly lower load factors. Employing a system load-factor weighting for average demand – as the A&E method requires – eliminates the bias against customers who use the distribution system more efficiently and treats those customers fairly while, at the same time, having a negligible effect on the class present rates of return for customers served on Rates GR and GC – PECO's two largest rate classes.

3. Other Cost of Service Issues

The OCA addressed two additional cost of service issues in its Main Brief, namely, that Ms. Ding erred in not allocating excess demand to interruptible customers (OCA M.B., p. 167) and used an allegedly incorrect allocation factor for gas storage plant (*Id.*, p. 170). Both points were addressed and fully refuted in PECO's Main Brief at page 103 and pages 104-105, respectively.

For its part, OSBA clings to its argument that PECO's analysis of class-specific design day demands for smaller customers (those served on Rate Schedules GR and GC) was not sufficiently rigorous. OSBA continues to promote the alternative analysis prepared by Mr. Knecht despite his concession that Mr. Knecht's changes "have only modest impacts on allocated costs for the major firm service classes, namely GR, GC and TS-F," as explained in greater detail in PECO's Main Brief at pages 105 and 106.

Despite the fact that Mr. Knecht's exertions amounted to an academic exercise with no noticeable real-world impact, the tenor of OSBA's criticism of PECO's analysis of class-specific design day demands (alleging "statistical ignorance") cannot escape a response. As Ms. Ding explained in her rebuttal testimony – and contrary to OSBA's allegations – PECO did, in fact, conduct a robust analysis of class-specific design day demands for Rate GR and Rate GC customers, which correlated demand with heating degree days during winter months when temperatures were at or below 50 degrees. PECO St. 6-R, p. 18.

Mr. Knecht, on the other hand, appears to have employed a model correlating demand with heating degree days at a base of 65 degrees irrespective of the season. Thus, Mr. Knecht assumes that demand increases linearly with each degree of reduction in temperature below 65 degrees. Stated another way, Mr. Knecht's model gives equal weight to (1) a one-degree decrease in ambient temperature from 64 degrees to 63 degrees on a late-spring afternoon and (2) a one-degree decrease in temperature from 30 degrees to 29 degrees on a windy mid-winter evening. It was precisely for this reason that Ms. Ding testified that the "effect" of Mr. Knecht's modeling was similar to "treating all of the customer load as temperature-sensitive when, in fact, a significant portion of that load is not correlated with temperature." PECO St. 6-R, p. 19. In its Main Brief, OSBA opted for intemperate rhetoric in lieu of addressing the facts or attempting to engage the merits of Ms. Ding's testimony. Ms. Ding's analysis has a sound factual – and statistical – basis that fully withstands, and rebuffs, the unwarranted criticism leveled by OSBA.

For all the foregoing reasons and those set forth in PECO's Main Brief, the revised COSS that PECO presented as part of its rebuttal case should be used as an appropriate guide in determining how the revenue increase in this case is allocated among customer classes.

B. Revenue Allocation

The Company's revised revenue allocation proposal is set forth in PECO Exhibit JAB-1 Revised (Corrected). The revised revenue allocation was necessary after updates were made to the Company's COSS. As noted in the Company's Main Brief, 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 Commission-approved settlement of PECO's 2008 gas base rate case ("2008 Settlement"). *See* PECO M.B., p. 112. *See also* PECO St. 7-R, pp. 2-5; PECO Ex. JAB-1 Revised (Corrected).

1. Opposing Party Revenue Allocation

The OCA, I&E, OSBA and PAIEUG developed alternative revenue allocations. *See* OCA M.B., pp. 177-80; OSBA M.B., pp. 15-17; and PAIEUG M.B., pp. 24-25. Mr. Watkins proposed that Rate GC should remain at its current level, rather than receive a decrease. The OCA's proposed revenue allocation assigns no increase or decrease in base rate revenues to classes currently earning higher than the 7.70% rate of return requested by the Company (i.e., Rates GC, OL, L, MV-I, and TCS). The OCA also recommended that Rates MV-F, IS, and TS-I receive 1.5 times the system average increase. The OCA also allocated equal percentage increases to Rates GR and TS-F. *See* OCA M.B., pp. 177-79.

I&E witness Cline contended that the Company's proposed increase for Rate L violates the concept of gradualism. Mr. Cline also agreed with Mr. Watkins regarding the relative proposed increases and decreases of certain rate classes. I&E M.B., p. 67.

OSBA witness Knecht offered an alternative proposal, but noted that he did not contest the Rate GC revenue allocation. OSBA also stated its disagreement with PAIEUG's proposed revenue allocation. OSBA M.B., pp. 15-17.

PAIEUG witness Billie LaConte proposed an alternative revenue allocation that proposed a below system average increase for Rate TS-F, moved Rate GC and L to the system average rate of return, and capped the increases to all other classes at no more than 1.5 times the system average increase. PAIEUG M.B., pp. 24-27.

The Commission should accept the Company's proposed revenue allocation. The Company's proposal (i) was calculated utilizing the Company's COSS; (ii) moves all rate classes closer to the cost of service indicated by the COSS; (iii) eliminates the remaining difference between the class rates of return for Rates GC and LC and the system average rate of return; and

(iv) properly considers customer impacts, including gradualism. As noted by PECO witness Joseph A. Bisti, "[t]here are many ways to allocate the increase 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. The Company's proposal is substantially within the range of alternative proposals raised by the other parties and no party has provided sufficient reason to reject the Company's proposed revenue allocation. Therefore, the Commission should approve the Company's proposed revenue allocation.

2. Scale Back of Rates

The Company proposed that, in the event that the Company's proposed revenue increase is not granted in full, the Commission should proportionally scale back the Company's proposed rates, but should not scale back any of the Company's proposed customer charges. *See* PECO M.B., p. 115.

The OCA recommended a proportional scale back as well, except for Rates GC, OL, MV-I and TCS, which Mr. Watkins recommended should be excluded from any scale back of proposed rates. *See* OCA M.B., p. 181.

I&E recommended a proportional scale back also, excluding rates that did not receive an increase. I&E also recommended that customer charges be included in any scale back of rates. I&E also noted that the Commission could further modify the revenue allocation if it determines that the proposed rate increase would result in a violation of gradualism. *See* I&E M.B., p. 69.

OSBA 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 M.B., pp. 17-19.

PAIEUG recommended a proportional scale back, applicable to both volumetric and customer charges. PAIEUG M.B., pp. 28-29.

As the Company explained in its Main Brief, 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. PECO M.B., p. 115. Both OCA and CAUSE-PA argued that the Company should allocate universal service costs to all customer classes. OCA M.B., pp. 181-206; CAUSE-PA M.B., pp. 40-49. OSBA and PAIEUG opposed that recommendation in their respective Main Briefs, citing, among other things, the Commission's recent rejection of proposals to reallocate universal service costs to non-residential customers in *Columbia Gas.* OSBA M.B., pp. 19-24; PAIEUG M.B., pp. 29-36.

PECO does not support a change in universal service cost allocation as part of this proceeding but intends to address the allocation of universal service costs in its next electric base rate proceeding. PECO M.B., p. 115. The Company continues to believe that this gas distribution base rate case is not the appropriate place to consider such broad universal service cost allocation proposals, including because PECO's gas-only CAP population is a very small part of its total CAP population. *Id.*

D. Tariff Structure

1. Residential Customer Charge

The Company proposed an increase in its residential customer charge from $11.75 per month to $16 per month. As noted in the Company's Main Brief, the increase in the Company's residential customer charge is, first and foremost, intended to bring the customer charge closer to the residential customer-related costs identified in the Company's COSS (i.e., $30.26 per month). The Company's current residential customer charge is the lowest among all of Pennsylvania's major gas distribution companies, and will still fall within the range of the residential customer charges of the other major gas distribution companies in the Commonwealth at the Company's proposed increased price.[55] *See* PECO M.B., pp. 116-17. *See also* PECO St. 7, pp. 12-14; PECO St. 7-R, p. 6; *see also* PECO Ex. JD-4R, p. 4.

In its Main Brief, the OCA opposed any increase to the Company's customer charge, contending that the proposed increase will disproportionately impact low-income customers. *See* OCA M.B., p. 207. The OCA stated that it believed low-income customers are disproportionately low-use customers who cannot otherwise off-set the Company's proposed increase to the residential customer charge. *Id.* However, in written testimony, Mr. Watkins also conceded that if the Commission does permit the Company to increase its rates, the residential customer charge can be increased, but the increase should be limited to $13.00. *See* OCA St. 4, pp. 30-31; OCA St. 5, pp. 29-32, 55; OCA St. 5-SR, pp. 4-6.

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[55] The Company notes that I&E stated in its Main Brief that it "disagrees with the Company that the customer charges of other natural gas distribution companies should be *the determining factor* for the rates of PECO customers". I&E M.B., p. 70 (emphasis added). To be clear, the determining factor in PECO's proposed residential customer charge is the residential costs identified in the COSS. The fact that the Company's proposed charge will fall within the range of other Commission-approved residential customer charges is one of the factors attesting to the reasonableness of the Company's proposal. I&E did not oppose the Company's proposed increase to its residential customer charge, it only advocated that the customer charge be included in any scale back of rates. The Company's response to that proposal is in Section X.B.3.

CAUSE-PA also recommended that the Commission deny any increase to the residential customer charge. In its Main Brief, CAUSE-PA contended that the Company's proposed increase would limit low-income customers' ability to reduce their bills through conservation and usage reduction, and that the proposed increase would undermine the Company's LIURP since a higher fixed fee would reduce the amount of bill reduction attainable through LIURP measures. *See* CAUSE-PA M.B., pp. 49-52.

The Commission should reject the OCA's and CAUSE-PA's recommendation to deny any increase. As explained in detail in the Company's Main Brief, the Commission recently noted in its decision in *Columbia Gas* 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."[56]

Traditional ratemaking methodology dictates that a utility should be permitted to recover fixed customer class-related charges through fixed customer charges. The Company's proposal is based on traditional ratemaking principles and will more closely align residential customer-related costs with the residential customer charge. Therefore, the Commission should reject the "no increase" position.

Further, while Mr. Watkins maintains that the Company's residential customer charge should be capped at $13.00, an approximately 10% increase, the OCA has not provided any evidentiary support as to why a $13.00 / 10% cap is appropriate. As explained in the Company's Main Brief, the Company's proposed residential customer charge (i) should not constitute "rate shock," as it still falls below the residential class' customer-related costs, and (ii) would be

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

within a reasonable range of the residential customer charges of other major Pennsylvania gas utilities. In addition, the Company's customer charge is not contrary to energy conservation and will not undermine the Company's LIURP, since customers will still have the ability to implement conservation measures. *See* PECO M.B., pp. 117-19.

2. Non-Residential Customer Rate Design

a. Rate GC Customer Charge

As described in further detail in the Company's Main Brief, no parties oppose the Company's proposal to maintain its current Rate GC customer charge at $28.55. *See* PECO M.B., pp. 119-20. The Commission should approve the Company's proposal.

b. Rate GC Declining Block Volumetric Charge Differential

As described in further detail in the Company's Main Brief, the Company adopted OSBA's recommendation regarding its Rate GC declining block volumetric differential. No parties opposed this proposal. *See* PECO M.B., p. 120. The Commission should therefore approve the Company's proposal.

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

The Company adopted an OSBA proposal, advocated by Mr. Knecht, for PECO to reduce its Rate TS-F and Rate TS-I volumetric charge differentials. *See* PECO M.B., pp. 120-21. OSBA recommended that the Commission approve the Company's proposal. *See* OSBA M.B., pp. 26-27.

PAIEUG opposed the Company's proposal. Ms. LaConte contended that (i) the Company did not provide sufficient data in a workable format to support its proposal; and (ii) 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 also alleged Company witnesses Ding and Bisti offered conflicting testimony on this issue.

As noted in the Company's Main Brief (*see* PECO M.B., pp. 110-11; PECO Errata to M.B.), Mr. Knecht contended that Rates TS-F and TS-I have an unacceptably large differential in the volumetric charges for customers with annual gas consumption capability of at least 18 mmcf and annual gas consumption capability of less than 18 mmcf. Mr. Knecht made two recommendations for addressing his concerns. From a customer classification standpoint, he recommended creating separate "large" (at least 18 mmcf annual gas consumption capability) and "small" (less than 18 mmcf annual gas consumption capability) 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 annual gas consumption capability of at least 18 mmcf and less than 18 mmcf, reflected in the existing Rate Schedules TS-F and TS-I.

PECO strongly opposed creating separate rate classification for customers with annual gas consumption capability below 18 mmcf and at least 18 mmcf. However, PECO did accept Mr. Knecht's alternative recommendation to narrow the differential in the volumetric charges for annual gas consumption capability of 18 mmcf and above and below 18 mmcf 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)).

There is no conflict between the testimony and recommendations proffered by Company witnesses Ding and Bisti. Ms. Ding accepted one of the two options presented by Mr. Knecht, and then Mr. Bisti implemented that option in his proposed rate design. As to Ms. LaConte's representation that the Company failed to provide the requested information related to Rate TS-F

in a workable format, the Company provided all parties, in response to Ms. LaConte's request for the Company's workpapers utilized to derive its revised Rate TS-F and TS-I rates: (1) corrected versions of the Company's proof of revenues for Rates 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. This information should have been sufficient for Ms. LaConte to evaluate the Company's proposal, and no other party challenged the "workability" of these materials. Further, the Company's proposal will not result in "rate shock" to 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.

The Company's recommended approach minimizes the differential between small and large Rate TS-F customers and reflects a reasonable balance in rate design that takes into account the needs of all customers. Therefore, the Commission should reject Ms. LaConte's proposal and approve the Company's proposed rate design.

d. Rate L and Standby Sales Service

OSBA proposed eliminating Standby Sales Service under Rate L and requiring PECO to provide stand-alone unbundled gas commodity sales service to back-up Rate TS-F customers' regular gas supplies. *See* OSBA M.B., pp. 28-31. While OSBA posits that its recommendation is the "Sensible Way," the Company finds it far from sensible. As PECO witness Richard A. Schlesinger explained, total Rate L revenues under existing rates are approximately $75,000, and only a portion of those revenues relate to Standby Sales Service. Implementing OSBA's recommendation would require the Company to make wholesale changes in the relationship between Rate L and Rate TS-F, and incur administrative costs and IT changes that would exceed "by many multiples (an order of magnitude or more) the revenues that would be reassigned to

different classes by adopting Mr. Knecht's proposal," in order to have zero material impact on Rate L or Rate TS-F customers or other customer classes. PECO St. 8-R, pp. 5-6. OSBA's position is also perplexing given Mr. Knecht's ultimate conclusion "that the end result under the Company's proposal will be little different from my own". OSBA St. 1-S, p. 25. The Commission should therefore reject OSBA's proposal.

e. Elimination of Rate IS Margin Sharing

As discussed in greater detail in the Company's Main Brief, the Company agreed with recommendations made by the OCA and OSBA to eliminate Rate IS margin sharing, and agreed to do so on or before December 1, 2021 as part of its next annual PGC reconciliation filing. *See* PECO M.B., pp. 122-23. *See also* OCA M.B., pp. 216-19; OSBA M.B., p. 27. No party opposes the elimination of Rate IS Margin Sharing.

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

In OSBA witness Knecht's direct testimony, he recommended that the Company consider eliminating Rates IS, MV-I and TCS. However, he later concluded that the negative aspects of retaining these tariffs were likely to be minimal, and could be addressed in the future. OSBA St. 1-S, p. 26. *See also* OSBA M.B., p. 28. In OSBA's Main Brief, OSBA recommended that, in a future rate case, the Company consider whether to eliminate Rates IS, MV-I and TCS. In the alternative, OSBA stated that the Commission could reasonably determine that these rates should be phased out sooner. OSBA M.B., p. 28.

As noted in the Company's Main Brief, PECO opposes the elimination of Rates IS, MV-I and TC. 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.

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. PECO St. 7-R, pp. 16-19. Moreover, Mr. Knecht conceded that keeping these rates in place would not harm customers and did not need to be addressed in the context of this rate case. The Commission should therefore reject OSBA's recommendation to eliminate Rate IS, Rate MV-I and Rate TCS.

3. Distribution System Improvement Charge Cost Allocation

OSBA witness Knecht contended that PECO should allocate DSIC costs among rate classes based on overall revenues. As OSBA noted in its Main Brief (pp. 31-32), the Company has addressed this recommendation and OSBA's concerns are resolved.

4. Negotiated Gas Service ("NGS")

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 with 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, which is described in further detail in the Company's Main Brief. *See* PECO M.B., p. 125. *See also*

PECO Ex. JAB-2, pp. 76-77. I&E, the OCA, and OSBA contended that PECO did not establish that all of these customers are still eligible to receive service under Rate NGS.

The OCA recommended that the Company reevaluate the terms and rates for three of its NGS customers. The Company agreed with Mr. Watkins' request and stated that it would provide the requested information with its next base rate case filing. PECO St. 7-R, p. 23. *See also* PECO M.B., p. 126.

I&E 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. *See* I&E M.B., pp. 71-72. *See also* I&E St. 3, pp. 33-36; I&E St. 3-SR, pp. 22-25.

The Company believes that the Commission should reject I&E's recommendation for the reasons set forth in its Main Brief. *See* PECO M.B., pp. 126-27. 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 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. 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.

OSBA witness Knecht stated that the Company failed to demonstrate the eligibility and reasonableness of rates, under Rate NGS, for five of its six customers. Mr. Knecht recommended that the Company's proof of revenues should assume regular tariff rates for these customers in this rate case. Mr. Knecht also stated that the Commission should require the Company to demonstrate that its NGS agreements with these customers are reasonable. *See* OSBA M.B., p. 34. *See also* OSBA St. 1, pp. 39-42; OSBA St. 1-R, pp. 13-15; OSBA St. 1-S, pp. 16-17. OSBA also advocated, in its Main Brief, for the Commission to consider broad policy changes with respect to negotiated rate customers.

The Commission should reject Mr. Knecht's recommendations for the reasons set forth in detail in the Company's Main Brief. The Company already agreed to re-analyze the eligibility of three of its NGS customers prior to the Company's next rate case, per Mr. Watkins' recommendation, and Mr. Bisti provided evidence supporting the continued justification of service under Rate NGS for the other two customers impacted by Mr. Knecht's recommendation. It would be unreasonable to require the Company to assume regular tariff rates for customers in this rate case. *See* PECO M.B., pp. 127-28.

In addition, if the Commission does decide to re-evaluate its policies with respect to negotiated rate customers, the Company respectfully requests that the Commission do so in a separate proceeding in which the broader regulated community has an opportunity to participate.

5. Theft/Fraud Investigation Charge

After its initial filing, PECO made some important clarifications regarding proposed Rule 17.7. Specifically, the Company clarified that: (1) proposed Rule 17.7 would only be applied in cases of confirmed active gas theft; (2) the $460 fee associated with the proposed rule was consistent with the average cost to investigate and remediate theft only; and (3) the term "fraud" should be stricken from the proposed rule. PECO M.B., p. 128.

In its Main Brief, the OCA expressed continued opposition to proposed Rule 17.7, arguing that: (1) even after striking "fraud," the proposed rule is overly broad; (2) the Company failed to justify the $460 fee and the $10,000 revenue adjustment for fee-related revenues; and (3) the proposed rule should not be applied to "applicants". OCA M.B., pp. 222-27.

As explained in PECO's Main Brief, the Company has appropriately addressed the OCA's concerns. First, regarding the breadth of the proposed rule, Mr. Schlesinger 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 M.B., p. 128 (citing PECO St. 8-R, p. 3). Second, not only has the Company explained that the proposed $460 fee is based on PECO's average cost to investigate and remediate theft (PECO M.B., p. 128), Mr. Colton acknowledged that the Company supported its $460 by providing actual cost information in response to discovery (OCA St. 5-SR, p. 9, citing the Company's response to CAUSE-PA-II-3). PECO's proposed $10,000 revenue adjustment for "budgeted theft fee revenue" is similarly based on actual costs – namely the $9,740 of actual 2019 gas revenues collected under existing Rule 17.6 related to the investigation and remediation of theft. PECO M.B., p. 129; Hearing Tr. 203.[57] PECO believes that it is appropriate to continue to

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[57] The OCA suggests that PECO's explanation of the revenue adjustment is "incomplete" because $9,740 is not divisible by the existing Rule 17.6 fee of $370. OCA M.B., p. 225, n. 218. PECO did not, however, state that the

collect the costs associated with theft investigations via its proposed theft fee (due to the principles of cost causation) instead of socializing such costs to all customers via base rates. PECO St. 8-R, p. 3.

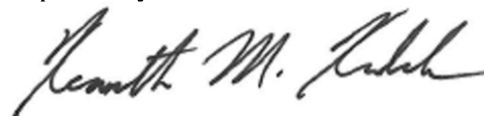
Finally, Mr. Schlesinger provided rejoinder testimony explaining the circumstances under which an "applicant" could appropriately be assessed a fee under proposed Rule 17.7. PECO M.B., p. 129; Hearing Tr. 203. The OCA did not acknowledge that testimony in its Main Brief, nor explain why the circumstances presented by the Company were unreasonable. For all these reasons, the Company has demonstrated that proposed Rule 17.7 is appropriate and should be approved by the Commission.

Company was considering all revenues from Rule 17.6, which include revenues related to reconnection. Instead, Mr. Schlesinger stated the Company looked at actual revenues "related to the investigation of remediation and theft." Hearing Tr. 203.

XI. CONCLUSION

For the reasons set forth above and in the Company's Main Brief, 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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